

BRIEFING PAPER

CUTS Centre for International
Trade, Economics & Environment
CUTS-CITEE



No. 2/2005

Economic Cooperation in South Asia *Current State and Prospects*

Events in recent years have brought South Asia into international limelight. However, the wave of regionalism is not new. Regionalism, as described in the lexicon of trade policy terms, is 'actions by governments to liberalise or facilitate trade on a regional basis, sometimes through free-trade areas or customs union'. The global trading system has seen a sharp increase in regional trade agreements over the past two decades. According to the World Trade Report 2003 of the World Trade Organisation (WTO), a total of 259 regional trade agreements (RTAs) had been notified to the WTO by the end of December 2002. Though South Asia is a geographically contiguous region, the economic integration is low, despite a number of initiatives taken by various stakeholders.

This Briefing Paper attempts to explain various issues on the current state and prospects of economic Cooperation among South Asian countries. It also discusses the issues relating to the of South Asian Association for Regional Cooperation (SAARC), South Asian Preferential Trade Arrangement (SAPTA) and the progress towards South Asia Free Trade Agreement (SAFTA), besides strategies for economic cooperation, both within and outside South Asia.

Regional Economic Cooperation: Definition

The terms 'economic cooperation' and 'economic integration' are often used synonymously. But these two concepts are different. Regional economic cooperation is an evolutionary process consisting of several stages. Economic integration represents the most advanced or ultimate stage of economic cooperation.

This paper is primarily concerned with 'regional economic cooperation', which implies collaboration among a group of nations comprising the region on economic matters such that each member nation derives greater benefits than what would be possible in the course of normal economic relationship without cooperation. In a broad sense, the scope of cooperation can cover a wide range of economic issues like trade, tariffs, technology, investment, joint ventures, and fiscal and monetary policies.

An Overview

From a global, or regional, perspective, South Asia provides a disappointing picture in every context – social, economic, and political. After growing at a robust rate averaging 7.1 percent per annum during 1994-95 to 1996-97, the growth rates in the last three years of the 1990s, i.e., 1997 to 2000, have declined to 5.2 percent. The region's economy is expected to turn in the year 2003-04, to achieve a growth rate of 6.9 percent and improve its performance further to 7.2 percent in 2004-05. The recovery in 2003 has been assisted by industrial recovery in India, Pakistan and other countries.

Need for Economic Cooperation

As the South Asian economies got integrated into the world market, their export performance became highly dependent on global changes. Thus, the question is how would South Asia achieve stability and prosperity. Regional economic cooperation, therefore, is pivotal for enhancing economic growth and development of individual countries. Even from the historical perspective, it is through regional arrangements that the countries of Europe, as well as those of South East Asia, secured additional benefits and eliminated the negative fallout of globalisation.

Moreover, with speed breakers encountered by the WTO's efforts to promote global trade on an equitable basis, countries around the world are now giving more emphasis to regional trade blocs and bilateral trade arrangements. SAARC members have also taken note and seem sensitised. But, even after adopting a number of strategies to increase this momentum, it is unfortunate that the intra-regional trade of SAARC has remained below five percent of the total trade, which is small as compared to other regional trade agreements (RTAs). From Table I, it can be observed that the Common Market for Southern Cone (MERCOSUR) and the ASEAN Free Trade Area (AFTA) have performed exceptionally well. By comparison, trade between member nations of the Association of South East Asian Nations (ASEAN) makes up 63 percent of the region's trade.

Interestingly, South Asia has great economic strength in terms of its market potential, rich natural resources and human capital. Considering the huge comparative advantage that these countries have in certain export sectors, the poorly managed

Table 1: Intra-regional trade as Percentage of Total Exports: A Comparison of SAARC with other Southern RTAs

	1995	2000	2002	2003
<i>Latin America</i>				
ANDEAN	12.0	8.5	9.5	7.4
MERCOSUR	20.3	20.0	11.3	11.8
<i>Africa</i>				
COMESA	6.0	4.9	5.4	5.8
SADC	10.6	12.0	9.3	10.0
UEMOA	10.3	13.1	12.1	12.8
<i>Asia</i>				
ASEAN/AFTA	24.6	23.0	22.7	21.2
SAARC	4.4	4.1	4.2	4.5

Source: UNCTAD Handbook of Statistics, 2004.

Notes: COMESA — Common Market for Eastern and Southern Africa
 SADC — Southern African Development Community
 UEMOA — African Western union Economic and Monetary
 ANDEAN — Andean Common Market
 MERCOSUR — Common Market for Southern Cone

customs services effectively reduce the potential for economic growth and employment. Under these circumstances, the need of the hour is to make SAARC a strong economic bloc, leaving aside bilateral disputes. Moreover, the official trade data has often not reflected the true picture, as a significant amount of trade is also taking place through informal/illegal channels. Regional cooperation in South Asia will not only help increase the level of intra-regional trade, but also to integrate smaller economies into the larger regional economic space, thereby expanding the size of the market and facilitating cost reductions through enhanced economies of scale.

The formation of a free trade agreement (FTA) with liberalisation of investment regimes and other facilitating measures can help in the exploitation of the potential of efficiency-seeking restructuring of industries within the region. In the energy sector, particularly, there exists tremendous potential in the subcontinent for fostering cooperation. It would enable countries to optimise the use of scarce energy resources. India, the largest economy of the region, is also energy-starved. However, some of India's neighbours have surplus energy. For example, Pakistan has surplus hydro-electricity, which can gainfully be exported to North-Western India.

Though Pakistan agreed, in principle, to export 300 MW of electricity to India for 10 years in 1998, this cooperation could not materialise due to failure to agree on tariffs. Similarly, India's two other smaller neighbours, Nepal and Bhutan, have suitable conditions for the production of hydro-electricity that cannot be accessed currently. Another possibility is the case of wind energy. India has an installed capacity of 900 MW and it could be shared with other countries. For instance, Sindh, in Pakistan, could make use of this wind power by co-operating with India.

In the case of natural gas, India and Pakistan would require large volumes of imports to meet their domestic demand in the near future. It would be economically more viable for them to construct a common gas pipeline to tap the gas deposits of Persian Gulf and Central Asia than to go for separate ones. Pakistan can earn up to US\$500mn in transit rights. Similar cooperation could also take place with Bangladesh, which has

huge reserves of gas. However, due to unfavourable political environment in the subcontinent, this cooperation has, so far, not materialised. Recently, a large reserve of gas has been found in the Arakan province of Myanmar. To tap this to India, a pipeline has to pass through Bangladesh. None of this is possible without smooth trade in the South Asian region; economic cooperation is a must.

Besides the energy sector, economic cooperation is also required in the tourism sector. Effective coordination of public and private efforts will achieve necessary synergy in the development of this sector. A common marketing strategy, funds and human resource development, through intra-regional investment in hotel and aviation sectors, are a few steps that can be taken in achieving the desired results.

Regional cooperation is needed in the case of primary product exports, which would result in greater value addition. A good example of such cooperation and joint venture was the jute industry, when Bangladesh produced jute and India had processing mills.

At another level, India is a significant dialogue partner of the ASEAN-10. The prospects for a new two-way wave of investment cooperation between the SAARC and the ASEAN would certainly improve in the coming years, with the expansion of ASEAN-6 to ASEAN-9 by the inclusion of Lao PDR, Myanmar, Vietnam and Cambodia. India has historical relationship with countries in the Greater Mekong Sub-region.

This, therefore, requires that SAARC countries achieve a faster rate of economic growth, with greater orientation towards external trade and foreign direct investment (FDI). Hence, the prerequisite for developing successful inter-regional economic linkages between the SAARC and other regions would be predicted on the success of regional economic cooperation within the SAARC itself.

Regionalism in South Asia

The South Asian region has witnessed wide-ranging regional economic integration efforts. SAARC, as an institutional framework, was formed with the signing of its Charter by the Heads of Governments/States at Dhaka, in December 1985. It was set up with the objective of accelerating the process of economic, social and cultural development and promoting and strengthening collective self-reliance through joint action in certain agreed areas of cooperation.

Complementing the regional, bilateral and unilateral initiatives in the South-Asian Region are two other important sub-regional initiatives, viz., Bangladesh-Bhutan-India-Nepal Quadrilateral Growth Initiative (BBIN) and Bangladesh-India-Myanmar-Sri Lanka-Thailand Economic Cooperation (BIMST-EC). While the former is being pursued under the SAARC framework, the latter is outside the SAARC process and it includes two countries of the ASEAN.

The growing popularity of RTAs has ignited South Asian countries to create SAPTA, in 1993, as the first step towards higher levels of trade and economic cooperation in the region. SAPTA contains provisions which grants 'Special and Favourable or Preferential Treatment' to the least developed countries (LDCs) in the SAARC region. Although the actual exchange of preferences has remained extremely limited, since 1993, three rounds of negotiations have helped reducing tariff barriers across the region.

SAFTA: Where Do We Stand & the Road Ahead?

SAPTA paved the way for the creation of SAFTA. The signing of SAFTA in 2004 has changed the environment in South Asia. Now, every nation, big or small, is planning to increase its trade with other nations in its own way. For example, Nepal is planning a direct bus service from Kathmandu to Dhaka. The development of this land route can increase trade between Nepal, Bhutan and Bangladesh, which is, again, not feasible in a hostile environment.

It is expected that SAFTA would not only expand intra-regional trade, by legalising the substantial unofficial trade in the region and thereby boost revenue collection in the sub-continent, but also generate substantial new trade.

SAFTA would be a vehicle through which all participants can gain by exploring their competitive advantages. Integration of economies in South Asia would lead to the emergence of a big market for investors. Industries can be located anywhere in the region, according to suitability. Increased trading activity will have a cascading effect on other segments of the economy, viz., the hotel industry, the aviation sector.

Though SAFTA has managed to get all the South Asian nations on board, everybody is not equally optimistic. Relatively developed economies like India, Pakistan and Sri Lanka are upbeat and hope to reap the benefits of SAFTA. But some of the LDCs are sceptical and fear the risk of the erosion of revenue and collapse of their weak industrial base, due to decrease in tariff. Contrary to this generally held belief, it has been experienced that lowering of import tariffs among SAARC member nations is likely to benefit them, as has been the case of FTA between India and Sri Lanka and the open border policy pursued by India with Nepal. There is no reason why the same experience cannot be replicated with other smaller economies of the region. If these countries fail to co-operate once again, the cost to commerce, industry and consumers would be immense.

SAFTA is an achievement, though the following shortcomings need to be rectified and should be taken into consideration during the process negotiations:

- The SAFTA treaty must reduce the value-addition requirements under the rules of origin (RoO). Considering the economic realities of the region, more flexible RoO is required, so that trade diversion is minimised.
- It should include a section on trade in services that would be more helpful to LDCs, as they have minimal comparative advantage in exports, as compared to India and Pakistan. Simultaneously, visa restrictions must be made as minimal as possible for free movement of people within the region.
- The treaty has hardly any provisions relating to anti-dumping, subsidies and countervailing measures, technical barriers to trade, and sanitary and phyto-sanitary measures. These issues are pertinent when a region moves into a free trade arrangement.

Pre-conditions for Enhancing Trade

The progress towards achieving complete economic integration depends on willingness of national authorities of member countries to confer real powers on supranational authorities of the region. In the final stage of regional economic cooperation, a regional authority is established, which decides on all regional policy issues and also implements them.

The lack of 'region-ness' in South Asia can be understood by applying Kolodziej's theory. International relations involve the global pursuit of order, welfare and legitimacy, popularly known as OWL. In other words, it implies that the nation states and the people of the world are engaged in a ceaseless struggle to define authoritatively what systems of order and welfare should prevail for their respective societies.

In order to understand the preconditions for free trade in South Asia, it is necessary to analyse the factors impeding intra-regional trade expansion. For this purpose, reference can be made to bilateral trade agreements (BTAs) between India and Bangladesh, India and Nepal, India and Pakistan, and India and Sri Lanka.

Taking account of the India and Bangladesh relationship, both possess a natural advantage in trading because of geographical contiguity. However, facts and figures show that this natural advantage is not fully utilised by either. According to a World Bank report, unofficial trade between India and Bangladesh and the volume and direction of unrecorded cross-border trade 'mirrored the pattern of official trade'. Hence, it is high time that the two countries first solve the illegal border trade problem.

The India-Pakistan relationship is one of the most crucial issues for economic cooperation in South Asia. Fluctuations in two-way trade between India and Pakistan can be attributed mainly to trade policies adopted by them. At present, Pakistan allows only 596 items that can be exported to Pakistan. The official trade between India and Pakistan stood at barely US\$262mn in 2002-03, whereas unofficial trade is estimated at not less than US\$1.5-2bn. A number of Indian products exported to Pakistan have been subject to not only customs duties but also para-tariff measures that must be reduced to enhance trade in this region.

Although both countries are carrying out reforms of their economic policies, it would serve very little purpose in boosting bilateral trade, as long as restrictive trade policies are pursued. Both India and Pakistan are members of the WTO. While India has accorded Most Favoured Nation (MFN) status to Pakistan, the latter has not reciprocated. This goes against the WTO norms [(Article I of the General Agreement on Tariffs and Trade (GATT) 1994]. Adhering to the principle of bilateralism, India has not brought this up for discussions at

Box 1: Policy Consideration for Countries of South Asia

- Border controls must be extended well beyond assessing and levying duties on the import of goods to issues concerning the flow of people and security.
- Paradoxically, the checking measures at the customs posts constraining legitimate trade failed to prevent the movement of people and huge lucrative market for illegal goods.
- Many business interests take advantage of the lax, dilatory or corrupt customs procedures to further their interests, or to keep competitors out of the market.
- Much of the unofficial trade is localised to the marketing of village produce along the border, occasionally ratified through bilateral agreements, and meeting the social and other needs of border communities.
- Countries of the South Asian region should press for greater disclosure relating to financial transactions that are currently protected by commercial confidentiality laws.

Source: Julius Sen, "Trade Facilitation and South Asia: The need for some serious scenario planning," CUTS-CITEE Research Report, No. 0425, 2004.

the WTO. Thus, the objective of SAFTA would fail, if these two relatively developed trading partners fail to increase their mutual trade.

In the north, Nepal's trade policy has been to diversify trade away from India. The share of India in Nepal's imports as well as India's share in Nepal's exports has declined. In the midst of Nepal's policy of trade deflection, India's own supply constraints compelled it to apply quota restrictions on the export of certain materials.

Sri Lanka has been having a persistent adverse balance of trade with India. Simultaneously, there has been a slow utilisation of the line of credit offered by India to Sri Lanka, due to various factors such as inadequacy of export incentives in India for exports under the line of credit. Special measures on both sides are required to facilitate fuller and faster utilisation of the lines of credit in future programmes of cooperation between India and Sri Lanka.

As in the case of other neighbouring countries, the Indo-Sri Lankan trade through legal channels is also affected by a substantial volume of unauthorised trade. The total volume of unofficial trade between Sri Lanka and India is Rs 9121.2mn, in 2000-01. These facts prove that free trade between the two countries would benefit both the countries.

Hence, all these problems need to be resolved for enhancing economic cooperation as a precondition. Peace is essential for national as well as regional prosperity.

In addition to these, the other preconditions for economic cooperation are as follows:

- Non-tariff barriers must be dismantled.
- A common currency for the region should be introduced as it promotes inter-country trade and investment by reducing transaction costs arising from currency conversion and by eliminating exchange risk and uncertainty.
- There is a need to strengthen transport infrastructure. Appropriate agreements on roads, rail, shipping and air would at least double the current level of trade.
- There is an acute need of adequate financial infrastructure, viz., banking, insurance, clearance mechanism and capital market for facilitating trade and investment.

Conclusions

Being the two big powers of South Asia, India and Pakistan need to provide leadership and become major stakeholders in South Asian economic cooperation. Otherwise, it will be

difficult for SAFTA to realise its potential. Pakistan should take regional cooperation seriously and not mix it with bilateral disputes. India has to show greater accommodation for smaller countries. In ASEAN, for instance, President Suharto of Indonesia offered its huge market to many other countries, without insisting on reciprocal action by them. India too has to develop a similar vision to accommodate the needs of the smaller countries of the region for common economic upliftment.

In order to achieve a better economic relationship in the region, tariff barriers should be dismantled. Joint ventures (JVs) between these countries are required in the field of infrastructure, development, banking, etc. And, the rules, regulations and procedures that are relevant to bilateral JVs must be simplified and standardised. For this purpose, substantial fiscal and institutional measures must be adopted.

In today's era of transnationalism and interdependence, dysfunctional OWL imperatives of one state can frustrate the order and bring economic deprivation in others too. No wonder, then, that South Asia has been described as a 'loveless hothouse where member states feed on each other's fears'.

Among the SAARC countries, India happens to dominate the economic scenario and India's hegemony is a lurking fear in the minds of other SAARC members. Hence, they are generally hesitant to commit themselves to cooperation in hard-core economic areas. Experts suggest that India can assist most of the other SAARC members in their developmental efforts by virtue of its diversified industrial base and relatively skilled manpower. For example, Nepal and Bangladesh could benefit in textiles and plastic products, while Bangladesh and Pakistan could substantially improve iron and steel production with cooperation from India. Sri Lanka and India can co-operate in exporting tea to the rest of the world, through a properly evolved set of guidelines. But, it appears that attempts to use SAARC as a platform to launch joint industrial or manufacturing ventures threatens the smaller states.

Governments apart, the civil society, the intelligentsia, the business community, the NGOs, etc., must all emphatically promote awareness about the need and the advantage of regional cooperation. There ought to be a much greater interaction between the civil society and the political class across different countries of South Asia. Regrettably, such interaction is minimal. It would contribute significantly towards a quicker settlement of differences and a greater South Asian solidarity, which is essential for the progress and prosperity of all our people.

An earlier version of this paper was presented at a seminar on Economic Cooperation in South Asia, which was held in Colombo (Sri Lanka) in May 2005 and organised by CUTS-CITEE, India and India Office of Friedrich Ebert Stiftung, Germany.

© CUTS-CITEE 2005. This Briefing Paper is produced by CUTS-CITEE to inform, educate and provoke debate on issues of regional economic cooperation in South Asia. Readers are encouraged to quote or reproduce material from this paper for their own use, but as the copyright holder, CUTS-CITEE requests due acknowledgement and a copy of the publication.

This Briefing Paper is researched and written by Nilay Chandra of and for CUTS Centre for International Trade, Economics & Environment (CUTS-CITEE), D-217, Bhaskar Marg, Bani Park, Jaipur 302 016, India. Ph: 91.141.228 2821, Fx: 91.141.228 2485, E-mail: citee@cuts-international.org, Web Site: www.CUTS-CITEE.org. Printed by Jaipur Printers Pvt. Ltd., M. I. Road, Jaipur 302 001, India.

