Taking Stock of Economic Cooperation in South Asia

by

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1. Introduction

As a means of improving the economic prospects of the South Asian region through greater cooperation and integration, the South Asian Association for Regional Cooperation (SAARC) was founded on December 7, 1985 in Dhaka, Bangladesh. The founding members were Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. In 2007, the eighth member included into SAARC was Afghanistan. In 2007, China, Japan, US, South Korea and the European Union (EU) were granted observer status.[1] The official reason for the founding of SAARC is as follows:

> The idea of regional cooperation was first proposed through 'a regional forum' by Bangladesh in 1980, with a view to holding periodic, regional-level consultations among countries in South Asia on matters of mutual interest and possible cooperation in economic, social, cultural and other fields. The rationale was primarily predicated on the premise that regional experiences elsewhere in the globe had been highly successful and that the countries in the South Asian region would benefit enormously from such cooperation as it would strengthen their competitive position, both individually and as a group.[2]

The so-called 'Dhaka Declaration' of 1985 was high on the language, noting that:

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[1] An older -- predominantly South Asia-based -- regional alliance is the Bangkok Agreement established in 1975 as an initiative of the United Nations Economic and Social Commission for Asia and the Pacific (UN-ESCAP). Initial membership involved seven countries, namely Bangladesh, India, Lao PDR, Republic of Korea, Sri Lanka, Philippines and Thailand. The Bangkok Agreement was renamed the Asia Pacific Trade Agreement (APTA) in 2005 and the current member are: Bangladesh, China, India, South Korea, Lao PDR and Sri Lanka. The UN-ESCAP acts as the secretariat for the Agreement. Another sub regional grouping involving South Asia is the BIMSTEC which was formed in 1997 and whose members are Bangladesh, India, Sri Lanka and Thailand. Myanmar joined the organization as a full member in 1997.

[2] See http://www.saarc-sec.org/main.php?id=43&t=3.2

> (I)nherent logic strongly justified regional cooperation, particularly among South Asian countries, because the countries in the region enjoy geographical contiguity, historical, social, cultural and ethnic affinities which would act as centripetal forces and thus, contribute substantively to facilitate coordination and to reducing of transaction costs.[3]

2. Background of SAFTA and SAPTA

The SAARC created an inter-governmental group to establish the Agreement on South Asian Free Trade Area (SAFTA) in 1991. An agreement on the SAARC Preferential Trading Arrangement (SAPTA) and was only signed on April 8, 1993 in Dhaka. The preamble of the SAFTA agreement says that SAARC leaders were "convinced of the need to … promote intraregional trade which presently constitutes a negligible share in the volume of the South Asian trade".[4] The SAPTA agreement came into operation on December of 2005.[5]

The SAPTA was formed to deal with arrangements relating to tariffs, non-tariff measures, and direct trade measures. Since its inception, there have been four rounds of negotiations. Negotiations in the first two rounds were mostly about products. In the first round, 226 items were included in the list on which duties would be cut by 10-90 percent. In the second round, 1,871 items were added to that list. The third round of negotiations started in July of 1997 and ended in November of 1998. Negotiations were restricted to products but were on across-the-board basis. By the end of the third round, there were 4951 items on the list. (Table 1 shows the country by country comparison of the number of products on the list and the depth of tariff concessions after the first 3 rounds of negotiations). The fourth round of negotiations concluded in 2002 and the by the end, there were more than 5500 products in the list. However, this accounted for less than 10 percent of tradable goods.

The agreement on creating SAFTA was signed in January of 2004 in Islamabad, Pakistan. It came into effect in January of 2006 and is supposed to be completed by 2016. According to the agreement, the objectives of SAFTA are:[6] (a) eliminating barriers to trade in, and facilitating the cross-border movement of goods between the territories of the Contracting

[3] The Dhaka Declaration and the Joint press statement is available at http://www.saarc-sec.org/main.php?id=47&t=4

[4] The full SAPTA agreement is available on the SAARC Secretariat's website http://www.saarc-sec.org/old/freepubs/sapta.pdf

[5] A South Asian Economic Union (SAEU) is to be formed on this basis by 2020.

[6] Information on SAFTA can be found at http://www.saarc-sec.org/main.php?t=2.1.6

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.

For purposes of the agreement, member countries were divided into LDCs or Least Developed Countries (Bangladesh, Bhutan, Nepal, and Maldives) and Non-LDC's (India, Pakistan, and Sri Lanka). Afghanistan was not a member at the time of the signing of the agreement but it comes under the category of LDC. Under Article 7 there is to be no tariff reduction on items in the Sensitive List. (Table 2 shows the number of items per country that are on the sensitive list). Non-LDCs are to reduce tariff to 0-5 percent for LDCs by 2009.[7] Tariff reductions by non-LDCs for non-LDCs will be done in 2 phases. In Phase 1 (2006-2008) existing tariff rates above 20 percent are to be reduced to 20 percent within two years and tariffs below 20 percent are to be reduced on margin of preference basis of 10 percent per year. In Phase 2 (2008-2013) tariffs are to be reduced to 0-5 percent within 5 years. Tariff Reduction by LDCs for all SAARC members will be done in 2 phases. In Phase 1 (2006-2008) the existing tariff rates above 30 percent are to be reduced to 30 percent within two years and tariffs below 30 percent to be reduced on margin of preference basis of 5 percent per year. In Phase 2 (2008-2016) tariffs are to be reduced to 0-5 percent within 8 years.

3. Limited *de facto* Integration in South Asia

As of 2006, the extent of actual regional economic cooperation in the SAARC region was very limited. This is apparent from Table 3 which shows the level of intra-group exports as well as the percentage of intra-trade exports as a percentage of total exports among some trade groups while Table 4 shows the same for imports for the years 1980 to 2004. However, when SAARC is compared to groups such as ASEAN, Mercosur, the EU it falls short both in terms of exports as well as imports. In 1980, the intra-trade exports as a percentage of total exports was a paltry 4.8 percent while it was 60.8 percent in the EU15 region and 17.4 in ASEAN. Over the years, that percentage has not increased much at all. In 2004, it was 5.3 percent while it was

[7] The points below are from the Pakistani Ministry of Commerce website. Though the modalities of tariff reduction in Article 7 are given on the SAFTA agreement, the Pakistani ministry website has given the dates while the SAARC agreement gives generic timelines. More information is available at http://www.commerce.gov.pk/SAFTA.asp

22.0 percent in ASEAN and 61.1 percent in EU15. Looking at intra-group imports does not alter the picture and in fact worsens it for SAARC. In 1980, the percentage of intra-group imports as a percentage of total imports was negligible at 2.0 percent compared to 54.0 percent in the EU15, 14.4 percent in ASEAN, and 8.3 percent in Mercosur. Moving to 2004, the percentage for SAARC was 3.9 percent compared to 58.8 percent in the EU15, 22.5 percent in ASEAN, and 18.2 percent in the Mercosur region.[8]

Another measure of regional integration is intra-regional FDI. According to the Asia Regional Integration Center of the Asian Development Bank, FDI between SAARC countries was an extremely low $11.0 million in 2002, $0.4 million in 2001, $9.4 million in 2000 and $8 million in 1999.[9] A recent study on bilateral FDI flows reports that annual intra-South Asian FDI flows averaged $5.2 million between 1997 and 2000 and this number grew to $14.6 million between 2001 and 2005. This compares to an annual average of $1.7 billion for intra ASEAN FDI flows between 1997 and 2000 and this grew to $2.62 billion annual average between 2001 and 2005.[10]

The low level of regional integration is also apparent in terms of the high number of items on the sensitive list, i.e. items that will never come under the purview of SAFTA and can still be subject to high tariffs (See Table 2). Although Bhutan has the smallest number of sensitive list items, at only 3 percent of their tariff lines, it is not that significant as Bhutan has very few resources and its manufacturing facilities are highly dependent on India for inputs. Additionally, there is an India-Bhutan FTA already in existence. The most puzzling case is that of India which has 884 items on the sensitive list representing some 16 percent of its total tariff lines. In comparison, in the India-ASEAN FTA that is being negotiated, the number of items in the sensitive list was some 550 lines in 2006 and this is going to be brought down to around 350 in the near future.

In a 2006 report the World Bank makes a blunt but accurate assessment of intra South Asian integration when they noted:

> South Asia is the least integrated region in the world, where integration is measured by intraregional trade in goods, capital, and ideas. Intraregional trade as a share of total trade is the lowest for South Asia. There is little cross-border

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[8] Of course, some of the trade between the South Asian nations (especially India-Pakistan) either goes unrecorded or is diverted via a third country (e.g. Dubai).

[9] ARIC Regional Indicators Database http://aric.adb.org/indicator.php

[10] See. Hattari, R. and R.S. Rajan (2007). "Intra-Asian FDI Flows: Trends, Patterns and Determinants", forthcoming in R.S. Rajan, R. Kumar and N. Virgill (eds.), *New Dimensions of Economic Globalization: New Surge of Outward FDI from Asia*, World Scientific: Singapore, Chapter 3.

> investment within South Asia. The flow of ideas, crudely measured by the cross-border movement of people, or the number of telephone calls, or the purchase of technology and royalty payments, are all low for South Asia. In South Asia, only 7 percent of international telephone calls are regional, compared to 71 percent for East Asia. Poor connectivity, cross-border conflicts, and concerns about security, have all contributed to South Asia being the least integrated region in the world.[11]

Will SAFTA help rectify this? The above cited World Bank report pours cold water on the supposed benefits of SAFTA and offers reasons as to why an FTA among South Asian countries is not "economically attractive".[12] First, the South Asian economies are relatively small in terms of GDP and trade flows. Because of small per capita incomes, the economic size of the region remains small. The South Asian region accounts for 1.1 percent of world trade but that drops to 0.4 percent when India is excluded. Second, despite the proposed tariff reductions, the level of protection among the SAARC countries remains quite high especially among agricultural commodities. The third reason pertains to the selection of excluded sectors and rules of origin in the sense that when countries get to choose sectors that can be excluded from tariff preferences, domestic lobby groups could influence policymakers to exclude sectors that are less likely to be able to endure competition from the union partners. In addition, the report observes:

> (T)he case for the SAFTA on both economic and political grounds is not especially persuasive. Economically, the region is small in relations to the outside world and remains heavily protected. Prima facie, these features imply that trade preferences to regional partners will likely be trade diverting rather than trade creating….(T)he rules of origin and sectoral exceptions are more likely to restrict the expansion of intraregional trade in precisely those sectors in which the countries have comparative advantage; that is, the sectors in which trade creation is more likely.[13]

The report goes on to note that the movement towards a SAFTA has arisen primarily because of political reasons. As it notes:

> First, with most countries in the world moving forward with more and more (F)TAs, there is a clear sense in the region that it may be falling behind in this race. In the absence of hardnosed economic analysis, the view that "if all others are doing it, it must be good" dominates. Second, the region has definitely suffered from the trade diversion generated by the many (F)TAs in the Americas and the European Union and its neighbors. The leaders in the region may

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[11] The World Bank (2006). "South Asia Growth and Regional Integration" December. Report No. 37858-SAS.

[12] *ibid.*, Chapter 7.

[13] The World Bank (2006), *op. cit.*, pp.136-7.

therefore see a strategic advantage in forging ahead with as many of their own (F)TAs as possible in response. Third, politicians do not seem to distinguish between discriminatory and nondiscriminatory liberalization as sharply as economists do. As a result they see bilateral agreements as one of the instruments of liberalizing trade. Sometimes they even see it as a superior instrument because it leads to reciprocal liberalization in the partner counties. Fourth, SAFTA is also seen as a vehicle of promoting better political ties among neighbors, especially India and Pakistan, which have had a long history of rivalry.[14]

4. Conclusion: SAARC and the Role of India

India dominates the South Asian region in every possible way. India encompasses around 72 percent of South Asia's land area, 78 percent of the GDP and around 75 percent of the population of SAARC as a whole. It is the region's largest exporter and importer of goods and services in the region and the biggest FDI recipient in the region. India is also not overly dependent on the region. India's exports to and imports from the region and exports to SAARC countries accounted for some 5 percent of total exports in 2006 while imports were less 1 percent of total imports in 2005.[15]

While the India of her pre-liberalization days may have warmed up to the idea of a SAFTA, it seems somewhat less interested in the initiative despite having signed on to SAFTA. Part of this has been due to the fact that India has had a bad experience with Pakistan on the issue of Most Favored Nation status (MFN). MFN status broadly means that a country will not be treated worse than anyone else's nation. India granted Pakistan MFN status in 1995 but Pakistan has refused to reciprocate, citing the Kashmir issue. This was despite Pakistan's ratification of SAFTA. This in turn has significantly limited the scope for expansion of intraregional trade.

In view of the above, India has instead found the bilateral route to be a more productive path of liberalization in South Asia. Thus, India signed the Indo-Sri Lanka Free Trade Agreement (ISFTA) on 28th December 1998 and the agreement entered into force from 1 March 2000. India also has separate trade agreements with Afghanistan, Bangladesh, Maldives and Nepal.[16] More generally, as India started liberalizing the economy in mid 1991 it started to earnestly pursue a "Look East" stance which explicitly has as its goal, an increased economic

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[14] The World Bank (2006), *op. cit.*, p.141.

[15] Data based on Centre for Monitoring the Indian Economy (CMIE).

[16] For an inventory of India's current trade agreements, see http://commerce.nic.in/india_rta_main.htm .

relationship with South East Asian and East Asian countries, especially with China.[17] To supplement this growing links, India is negotiating an FTA with ASEAN, has an FTA with Thailand since 2001, a Comprehensive Economic Cooperation Agreement (CECA) with Singapore since 2005, and is looking to sign bilaterals with other Southeast Asian nations. All of this suggests that India is slowly breaking away from its South Asian moorings and moving East.

The success of SAARC going forward in directly dependent on the extent of interest that its largest member decides to take in it which in turn depends on the India-Pakistan rivalry. While India may have been interested in the concept of SAARC in the mid 1980s and well as into the 1990s, its interest has certainly waned in the 2000s. The expansion of SAARC to allow for observer status of the countries like Japan, China and Korea may help to reinvigorate the alliance, though one will have to wait and see.

[17] Also see Kelly, D. and R.S. Rajan (2006). "Introduction to Managing Globalisation: Lessons from China and India", in Kelly, D., R.S. Rajan and G. Goh (eds.), *Managing Globalisation: Lessons from China and India*, World Scientific: Singapore, Chapter 1.

Table 1
Number of Products covered and the Depth of Preferential Tariff Concessions agreed to by SAARC Member States in the first three rounds of trade negotiations under SAPTA

Country	No. of Products
Bangladesh	572
Bhutan	266
India	2402
Maldives	390
Nepal	425
Pakistan	685
Sri Lanka	211
TOTAL	**4951**

Source: SAARC

Table 2
Items in Sensitive List in SAFTA

Countries	No of tariff lines	Percentage of total lines
Bangladesh	1254	24
Bhutan	157	3
India	884	16.9
Maldives	671	12.8
Nepal	1310	25.5
Pakistan	1183	22.6
Sri Lanka	1065	20.3
Total	6524	

Source: SAARC and Ministry of Commerce, Pakistan

Table 3
Intra-Group Exports (1980 – 2004)

			1980	1990	2000	2001	2002	2003	2004
GROUP	PARTNER	UNIT							
EU 25	Intra-trade of group	Percentage	**60.95**	**67.06**	**67.20**	**66.66**	**66.74**	**67.62**	**67.03**
		US$ Millions	483141.17	1022932.49	1618916.24	1623481.21	1732013.22	2101502.80	2440655.08
	Total trade of group	US$ Millions	792712.26	1525304.91	2409034.52	2435510.92	2595201.65	3107931.08	3641258.54
EU 15	Intra-trade of group	Percentage	**60.82**	**65.93**	**62.10**	**61.25**	**61.06**	**61.70**	**61.10**
		US$ Millions	456856.66	981259.50	1420089.62	1408991.03	1491271.79	1796301.01	2080118.35
	Total trade of group	US$ Millions	751159.30	1488360.33	2286914.86	2300350.88	2442277.40	2911168.00	3404526.60
Euro Zone	Intra-trade of group	Percentage	**51.44**	**55.09**	**50.76**	**50.16**	**49.66**	**51.05**	**50.75**
		US$ Millions	306472.86	669970.68	946890.55	954330.82	1006698.50	1244221.73	1465792.18
	Total trade of group	US$ Millions	595827.60	1216163.03	1865487.96	1902661.88	2027114.10	2437389.30	2888330.60
MERCOSUR	Intra-trade of group	Percentage	**11.60**	**8.86**	**20.00**	**17.11**	**11.47**	**11.94**	**12.04**
		US$ Millions	3423.68	4127.11	17828.67	15156.48	10228.46	12731.62	16720.84
	Total trade of group	US$ Millions	29525.54	46559.37	89147.65	88570.19	89155.93	106670.74	138891.50
ASEAN	Intra-trade of group	Percentage	**17.35**	**18.96**	**22.99**	**22.36**	**22.68**	**22.05**	**21.98**
		US$ Millions	12413.45	27364.76	98059.83	86331.38	91764.66	100716.82	125531.24
	Total trade of group	US$ Millions	71538.73	144365.28	426486.69	386129.91	404615.55	456875.17	571090.49
SAARC	Intra-trade of group	Percentage	**4.75**	**3.17**	**4.10**	**4.31**	**4.19**	**5.63**	**5.34**
		US$ Millions	612.67	862.96	2593.37	2826.68	2997.97	4773.32	5919.36
	Total trade of group	US$ Millions	12887.67	27229.44	63294.57	65598.11	71490.36	84767.39	110884.70

Source: UNCTAD Trade Database
Note: ‘Percentage’ in the table means intra-group exports as a percentage of total exports for that particular group.

Table 4
Intra-Group Imports (1980 – 2004)

			1980	**1990**	**2000**	**2001**	**2002**	**2003**	**2004**
GROUP	PARTNER	UNIT							
EU 25	Intra-trade of group	Percentage	**54.16**	**64.27**	**62.09**	**62.34**	**63.51**	**64.52**	**64.41**
		US$ Millions	483642.46	1013045.92	1522718.91	1511109.23	1602054.76	1973396.50	2370618.29
	Total trade of group	US$ Millions	892974.97	1576147.04	2452523.16	2423886.95	2522475.33	3058679.85	3680757.92
EU 15	Intra-trade of group	Percentage	**53.99**	**63.19**	**57.96**	**57.75**	**58.66**	**59.39**	**58.82**
		US$ Millions	455666.59	972452.20	1328018.34	1299639.84	1368237.68	1674189.02	1986487.45
	Total trade of group	US$ Millions	843943.08	1538963.90	2291359.60	2250503.10	2332531.80	2818913.50	3377092.50
Euro Zone	Intra-trade of group	Percentage	**44.51**	**53.33**	**48.06**	**48.82**	**49.60**	**50.44**	**50.40**
		US$ Millions	301513.74	658744.89	883300.46	888360.86	933320.67	1157976.57	1386185.22
	Total trade of group	US$ Millions	677412.78	1235197.90	1837910.30	1819852.00	1881564.80	2295684.80	2750611.70
MERCOSUR	Intra-trade of group	Percentage	**8.27**	**14.21**	**19.75**	**18.62**	**17.19**	**19.11**	**18.22**
		US$ Millions	3327.08	4505.94	18343.34	16193.16	11231.46	13636.88	17909.75
	Total trade of group	US$ Millions	40220.60	31713.76	92876.03	86966.76	65341.26	71376.86	98275.30
ASEAN	Intra-trade of group	Percentage	**14.36**	**15.22**	**22.48**	**21.94**	**22.79**	**22.57**	**22.48**
		US$ Millions	9264.49	24845.63	82929.86	74119.70	80892.37	88144.94	114359.77
	Total trade of group	US$ Millions	64537.45	163243.28	368965.85	337808.39	355017.31	390616.04	508679.29
SAARC	Intra-trade of group	Percentage	**1.99**	**1.97**	**3.48**	**3.62**	**3.52**	**4.42**	**3.87**
		US$ Millions	493.75	755.69	2717.54	3083.22	3274.64	4463.77	5637.56
	Total trade of group	US$ Millions	24810.94	38391.42	78193.06	85158.12	92956.52	101083.91	145618.15

Source: UNCTAD Trade Database
Note: ‘Percentage’ in the table means intra-group exports as a percentage of total exports for that particular group.