

## REGIONAL ECONOMIC INTEGRATION IN SOUTH ASIA: PROGRESS AND PROSPECTS

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### Abstract

“Economic Integration” in South Asia is necessary for enhancing growth rates, trade volumes and improving living standards. While other regional organizations such as the European Union (EU), North American Free Trade Association (NAFTA) and Association of South East Asian Nations (ASEAN) have successfully attained this goal, the South Asian Association of Regional countries (SAARC) despite its inception over a quarter century ago is nowhere near achieving this goal. Political tensions and certain procedural difficulties block the full implementation of the South Asian Preferential Trade Agreement (SAPTA) and the South Asian Free Trade Agreement (SAFTA) which could have advanced economic integration in the region. South Asian countries have a lot of economic potential and possess the will to exploit it through cooperation. This study analyses reasons for sluggish performance of SAPTA and SAFTA and offers recommendations for facilitating economic integration of the SAARC community.

**Key Words:** Economic Integration, Barriers, Monetary, Trade, SAPTA, SAFTA, Cooperation.

### Introduction

Regional economic integration is pursued when countries of a particular region agree on lifting trade barriers among them while retaining such restrictions in relation to trade with the rest of the world. The ultimate goal of this agreement is total removal of trade barriers among countries of the region.<sup>1</sup> The process involves four stages: Establishing a Free Trading Area (FTA) by eliminating tariff and non-tariff

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<sup>1</sup> “Define What is Regional Economic Integration,” *Write Work*, March 2005, <http://www.writework.com/essay/define-regional-economic-integration> (accessed June 11, 2012).

barriers, formation of a Customs Union by adopting a common policy for trade with non-members, making of a common market where free movement of goods, labour and capital is allowed across borders and finally the formation of monetary union by adopting a common currency and monetary policy.<sup>2</sup>

The objective of regional economic integration is to obtain the benefits of mutual trade, investments and joint ventures that regional similarities, short distances, better communications and quick mobility facilitate as costs are reduced and profit margins increase. While regional economic integration increases mutual competition, improves standards of production and makes the goods more competitive for trading with outside world, it also attracts intra regional and extra regional foreign direct investment.

The concept of regional economic integration emerged in the aftermath of World War II and got popular after the end of the Cold War when the process of globalization and liberalization of economies became the norm. The process first started in Europe in the shape of European Union (EU), subsequently spreading to North America as NAFTA and towards the East as ASEAN.<sup>3</sup> South Asian countries could have followed suit from the emergence of SAARC but have been quite slow in realizing economic integration though they have great potential and badly need cooperation to eliminate widespread poverty and improve the living standards. After its inception in 1985, SAARC took solid steps towards economic integration by signing SAPTA and SAFTA but has not been able to properly implement these agreements to the desired level. There is a need that SAARC countries focus on this issue and remove impediments in the way of implementation of these agreements.

### **South Asia's Initiative towards Economic Integration**

#### *Formation of SAARC and Its Efforts towards Economic Cooperation*

South Asia as a whole has great economic potential having rich natural and human resources and a vast consumer market with over 1.5 billion population. To advance socio-economic development of the region and alleviate poverty of its people, countries of the region established the South Asian Association for Regional Cooperation (SAARC) in 1985 comprising seven member states, namely Pakistan, India, Bangladesh, Sri Lanka, Nepal, Maldives and Bhutan. The main goal of the Association is to accelerate the process of economic and social development in member states, through joint action in the agreed areas

<sup>2</sup> Badar Alam Iqbal et al., "A Hurdle-Free SAFTA: Removing Barriers to Trade," *South Asian Journal*, no. 34 (October-December 2011): 109.

<sup>3</sup> "Economic Integration in South Asia," *International Finance Division*, Research Department, Nepal Rastra Bank (2005), 5, [http://red.nrb.org.np/publications/special\\_publication/Special\\_PublicationsEconomic\\_Integration\\_%20in\\_South\\_Asia\\_\(2005\).pdf](http://red.nrb.org.np/publications/special_publication/Special_PublicationsEconomic_Integration_%20in_South_Asia_(2005).pdf) (accessed May 20, 2012).

of cooperation<sup>4</sup> such as transport, communication, resource development, science and technology and poverty alleviation. SAARC has plans to extend the area of cooperation to other areas in the future.<sup>5</sup>

Though South Asia was quite late in embracing the concept of regional economic integration, SAARC has made consistent efforts in this regard. So far it has held 17 summit meetings, almost one in every 18 months, although as per SAARC charter summits are to be held annually.<sup>6</sup> During the first decade of formation its activities remained limited but later they gathered speed. In April 1993 at the Dhaka summit, SAARC took the first concrete step towards enhancing economic cooperation by signing the SAARC Preferential Trading Arrangement (SAPTA). It meant converting South Asia into a trading bloc.<sup>7</sup> The objective of SAPTA was to promote and sustain mutual trade and economic cooperation through the exchange of concessions.<sup>8</sup>

To advance socio-economic development, SAARC has created certain institutional structures such as the Council of Ministers comprising foreign ministers, the Standing Committee consisting of foreign secretaries, a Programme Committee, twelve Technical Committees to prepare programmes and projects of cooperation and some Action Committees to oversee implementation of projects. Apart from these bodies, there are the Committee on Economic Cooperation (CEC), a Group on Custom Cooperation, a Standing Group on Standards, Quality Control and Measurements, and the SAARC Chamber of Commerce and Industry (SCCI). In this context, SAARC leaders have also signed agreements on Mutual Administrative Assistance in Custom Matters, establishment of SAARC Arbitration Council and Avoidance of Double Taxation.<sup>9</sup> In the November 2005 Dhaka Summit, the leaders agreed to expand the organization and included Afghanistan in the SAARC as its 8<sup>th</sup> member state.<sup>10</sup>

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<sup>4</sup> See, "Introduction of South Asian Association for Regional Cooperation," *Actrav Turin*, <http://actrav.itcilo.org/actrav-english/telearn/global/ilo/blokit/saarc.htm> (accessed June 1, 2012).

<sup>5</sup> B. C. Upreti, ed., *Regional Cooperation in South Asia*, (New Delhi: Sumit Enterprises, 2008), 12.

<sup>6</sup> "SAARC Charter," *South Asian Association for Regional Cooperation*, <http://www.saarc-sec.org/SAARC-Charter/5/> (accessed June 3, 2012).

<sup>7</sup> B. C. Upreti, "SAARC from Inception to Dhaka: Constraints and Prospects, Regional Cooperation in South Asia," in *Regional Cooperation in South Asia*, ed. B. C. Upreti (New Delhi: Sumit Enterprises, 2008), 74.

<sup>8</sup> "SAARC Preferential Trading Arrangement (SAPTA)," *South Asia Association for Regional Cooperation*, [http://www.saarc-sec.org/areaofcooperation/detail.php?activity\\_id=4](http://www.saarc-sec.org/areaofcooperation/detail.php?activity_id=4) (accessed June 6, 2012).

<sup>9</sup> B.C.Upreti, *Regional Cooperation in South Asia*, 75.

<sup>10</sup> *Ibid.*, 80.

The SAPTA agreement provided a framework for exchanging concessions by gradual reduction of tariffs on items being traded. For this purpose SAPTA distinguishes between its members according to their level of economic development. Bangladesh, Nepal, Bhutan and the Maldives are defined as the “Least Developed Countries” (LDCs) and are treated differently from the three “non LDC” members, India, Pakistan and Sri Lanka. The agreement provides for Special and Differential Treatment for the LDCs by the non LDCs including deeper and wider preferences.<sup>11</sup> Since signing of SAPTA in 1993 and its coming into force in 1995, SAARC leadership has taken significant decisions to implement it. Four rounds of talks were held and member countries granted tariff concessions to each other on a number of products. But the volume of trade showed no significant increase.<sup>12</sup> In May 1997, during the Ninth SAARC Summit in Male (Maldives), South Asian leaders agreed to further expand tariff concessions and remove non tariff barriers for making South Asia a free trade area.<sup>13</sup>

*Agreement on SAARC Free Trading Area (SAFTA)*

After intense negotiations, the SAARC members signed SAFTA at their twelfth meeting held at Islamabad in January 2004.<sup>14</sup> The objective of SAFTA was to promote and enhance mutual trade and economic cooperation among SAARC countries through exchange of concessions.<sup>15</sup> Comprising 25 elaborate articles, SAFTA is a well structured agreement to facilitate economic integration in South Asia.<sup>16</sup> The Islamabad declaration announced SAARC members’ agreement to launch SAFTA by January 2006.<sup>17</sup> The intervening two years before launching of SAFTA were to be used for making required regulations.<sup>18</sup> To monitor SAFTA, a Ministerial Council (SMC) has been established comprising the Commerce Ministers of the Member States. To

<sup>11</sup> Vijaya Katti et al., “SAFTA: A Boost to Intra-Regional Trade,” in *Regional Cooperation in South Asia*, ed. B.C. Upreti (New Delhi: Summit Enterprises, 2008), 129.

<sup>12</sup> Badar Alam Iqbal, “A Hurdle-Free SAFTA: Removing Barriers to Trade,” 109.

<sup>13</sup> “Ninth SAARC Summit Male,” *South Asian Association for Regional Cooperation*, <http://www.saarc-sec.org/userfiles/Summit%20Declarations/09%20-%20Maldives%20-%209th%20Summit%201997.pdf> (accessed June 11, 2012)

<sup>14</sup> “12<sup>th</sup> SAARCSummitConcludes in Sri Lanka,” *Current Affairs*, Government of Sri Lanka, [http://www.priu.gov.lk/news\\_update/Current\\_Affairs/ca200401/20040106saarc\\_summit\\_12th.htm](http://www.priu.gov.lk/news_update/Current_Affairs/ca200401/20040106saarc_summit_12th.htm) (accessed May 27, 2012).

<sup>15</sup> “Agreement on South Asian Free Trade Area (SAFTA),” *South Asian Associations for Regional Cooperation*, [http://www.saarcsec.org/uploads/document/SAFTA%20AGREEMENT\\_2011081115331.pdf](http://www.saarcsec.org/uploads/document/SAFTA%20AGREEMENT_2011081115331.pdf) (accessed May 30, 2012).

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

<sup>18</sup> Ibid.

assist the SMC, a SAFTA Committee of Experts (SCOE) has also been formed. From 2006 to 2012 the SMC and SCOE have held 6 and 8 meetings respectively<sup>19</sup>.

SAFTA envisaged tariff reductions to 0-5 percent in two installments. While non LDCs were supposed to bring down existing tariff to 20 percent in two years from the date the agreement was to be enforced, the LDCs would bring down their tariff levels to 30 percent in the same time frame. In the second installment, the non LDCs, would take another five years (except Sri Lanka, which has six years) to reduce the tariff structure to 0-5 percent, while the LDCs were given eight years for the same purpose.<sup>20</sup> Based on this procedure the SAFTA was required to become fully operational by 2016 by abolishing all custom duties.<sup>21</sup> The mandatory tariff reduction, however, is not applicable to products under the “sensitive list” which comes under review after every four years.<sup>22</sup> Afghanistan has formally been inducted into SAFTA trade liberalization programme (TLP) since 2007. It was to offer a linear tariff reduction schedule for the consideration of other member states.<sup>23</sup>

### Progress on Economic Integration in South Asia

SAARC deserves credit for setting a path towards attaining the ultimate objective of economic integration by signing SAPTA and SAFTA and creating a robust institutional set up to facilitate their implementation as well as other related agreements. However, analysts believe that in its life of 26 years, SAARC has not been able to achieve much in the area of regional economic cooperation as intra regional trade has remained as low as 3-4 percent of total trade<sup>24</sup> as compared with other regional organizations. For example, after signing free trade agreements (FTAs), trade volumes in the European Community, ASEAN and North American Community have swelled from previous 8 to 10 percent to 65, 39 and 37 percent respectively.<sup>25</sup>

<sup>19</sup> “South Asian Free Trade Area,” *South Asian Association for Regional Cooperation*, [http://www.saarc-sec.org/areaofcooperation/detail.php?activity\\_id=5](http://www.saarc-sec.org/areaofcooperation/detail.php?activity_id=5) (accessed May 21, 2012).

<sup>20</sup> “Agreement on South Asian Free Trade Area (SAFTA).”

<sup>21</sup> Badar Alam Iqbal, “A Hurdle-Free SAFTA: Removing Barriers to Trade,” 110.

<sup>22</sup> N. Manoharan, “SAFTA: A First Step towards South Asian Economic Union?” *Institute of Peace and Conflict Studies*, January 19, 2006, <http://www.ipcs.org/article/south-asia/safta-a-first-step-towards-south-asian-economic-union-1929.html> (accessed June 13, 2012).

<sup>23</sup> “Fifth SAFTA Ministerial Council Meeting, Male, 13th June 2011,” *South Asian Association for Regional Cooperation* (Press Release), June 22, 2011, <http://www.saarc-sec.org/press-releases/Fifth-SAFTA-Ministerial-Council-Meeting--Male-13th-June-2011/11/> (accessed June 1, 2012).

<sup>24</sup> Dattesh D. Parulekar, “Regional Cooperation in South Asia- A Periled Promise?” in *Regional Cooperation in South Asia*, 33.

<sup>25</sup> Ibid.

To assess the degree of SAARC's success the performance of SAPTA enforced in 1995 and SAFTA enforced in 2006 can be considered.

#### *Performance of SAPTA*

According to India's South Asia Centre for Policy Studies, despite the implementation of most of the measures under SAPTA by non LDC countries i.e., India, Pakistan and Sri Lanka, it did not create much impact on regional trade<sup>26</sup> as it did not help in pulling up intra regional trade above 4 percent (\$7 billion) of total regional trade.<sup>27</sup> This weak performance of SAPTA was on account of the ambiguous trade concessions given to non-LDCs, issues of non tariff barriers (NTBs) imposed by India and decisions to be taken regarding rules of origin and loss compensation mechanism for LDCs. Absence of provisions for anti dumping was another reason for sluggish trade despite SAPTA.<sup>28</sup> However, although growth of intra regional trade remained quite low it provided a platform to the regional countries to discuss mutual trade issues.

#### *Progress on SAFTA*

SAFTA was enforced in January 2006 with the ultimate goal to abolish all custom duties by 2016.<sup>29</sup> Its implementation has also faced difficulties due to neglect of some issues and because of various politico-economic reasons. Intra regional trade is still to show comparable results to other economic blocs. While SAFTA's trade expanded only to 5 percent in last five years, after signing FTAs, regional trade of ASEAN, NAFTA and EU has increased from initial 7 to 10 percent to 49, 44 and 67 percent respectively.<sup>30</sup>

Some major reasons for SAFTA's weak performance are delay in finalization of the list of sensitive items, lack of proper rules of origin of goods to be traded and regulations for revenue loss compensation to LDCs and provision of technical assistance to them. Also, as per agreement some mechanism had to be worked out to remove non trade barriers and to harmonize product testing procedures which got delayed. Actions for resolving all these issues in the light of SAFTA were either not started or progress on them remained lukewarm. It would have been better if the agreement had set deadlines for making such arrangements.

<sup>26</sup> Vijaya Katti, "SAFTA: A Boost to Intra-Regional Trade," in *Regional Cooperation in South Asia*, 132.

<sup>27</sup> Badar Alam Iqbal, "A Hurdle-Free SAFTA: Removing Barriers to Trade," 110.

<sup>28</sup> Ibid., 109.

<sup>29</sup> Ibid., 110.

<sup>30</sup> Ibid.

Its implementation has also been delayed due to tensions between India and the smaller South Asian countries since they have disputes with India which are not being resolved because of India's hegemonic attitude.<sup>31</sup> Citing tensions in South Asia, a recent EU report rates political risk in the context of trade investment in South Asia as high.<sup>32</sup> In this regard India-Pakistan disputes including Kashmir were more serious. Pakistan was reluctant to make progress with India on trade front unless India was willing to resolve all disputes<sup>33</sup> particularly Kashmir. In the last 40 years since signing of Simla Agreement (1972),<sup>34</sup> not a single issue has been resolved between India and Pakistan through bilateral negotiations which shows India's hard attitude and resultant mutual tensions. Pakistan's reluctance to accord most favoured nation (MFN) status to India was on this account.

There are other reasons also for South Asia's slow progress on implementation of SAFTA and on achieving regional economic integration. Initially India avoided developing trade and economic relations with smaller South Asian countries since she thought that smaller countries at SAARC forum might gang up against her.<sup>35</sup> India being a big country with aspirations to become a major power also ignored South Asian countries and developed trade relations with outside world. As part of power politics in South Asia, India has also preferred to create some sub-regional trade and economic cooperation organizations like BIMSTEC to the exclusion of Pakistan.<sup>36</sup> Also, official figures of intra SAARC trade remained low because of lot of informal trade taking place on the borders.<sup>37</sup>

### Potential and Prospects of Economic Integration in South Asia

With more than 1.5 billion population having a large percentage of younger people and immense land, water and natural resources, South Asian economies have a lot of potential for attaining higher rates of growth,

<sup>31</sup> Shaheen Rafi Khan, "Regional Integration, Trade and Conflict in South Asia," *Sustainable Development Policy Institute*, Islamabad, Pakistan, [http://www.iisd.org/pdf/2007/tas\\_rta\\_south\\_asia.pdf](http://www.iisd.org/pdf/2007/tas_rta_south_asia.pdf), 16 (accessed March 15, 2012).

<sup>32</sup> Shaheen Rafi Khan et al., "Regional Integration, Trade And Conflict in South Asia," *International Institute for Sustainable Development*, [http://www.iisd.org/pdf/2007/tas\\_rta\\_south\\_asia.pdf](http://www.iisd.org/pdf/2007/tas_rta_south_asia.pdf), 8 (accessed April 12, 2012).

<sup>33</sup> Vijaya Katti et al., "SAFTA: A Boost to Intra-Regional Trade," 121.

<sup>34</sup> "Simla Agreement," *Wikipedia* (online), [http://en.wikipedia.org/wiki/Simla\\_Agreement](http://en.wikipedia.org/wiki/Simla_Agreement) (accessed March 21, 2012).

<sup>35</sup> Shaheen Rafi Khan et al., "Regional Integration, Trade and Conflict in South Asia," 16.

<sup>36</sup> Akhila Mol, "Essay on the BIMSTEC Agreement," *Preserve Articles*, <http://www.preservearticles.com/201103034363/essay-on-the-bimstec-agreement.html> (accessed June 15, 2012).

<sup>37</sup> Vijaya Katti et al., "SAFTA: A Boost to Intra-Regional Trade," 121.

enhancement of intra-regional trade and mutual economic integration through joint investment and development ventures. Since the 1990s Gross National Product (GDP) in South Asian economies has grown at about 6 per cent and almost 7 per cent from 2002 onwards<sup>38</sup>, although due to Pakistan's involvement in the "war on terror," since 2009 its GDP has come down to approximately 3.5 per cent and due to India's slow movement on economic reforms, in 2012 its GDP has also come down from the previous 9 per cent to current 5.3 per cent.<sup>39</sup> It is expected that proper and quick implementation of SAFTA will certainly improve growth rates and help in multiplying intra-regional trade which will encourage mutual investment and joint ventures and will also help in attracting foreign investment.

In this regard improvement in Pakistan- India relations and Pakistan's willingness to grant most favoured nation (MFN) status to India are healthy developments. Above all SAARC countries are now much inclined to promote mutual cooperation than before.

There is another promising development, namely the "New Silk Road Initiative" proposed by the US Secretary of State in November 2011 which, if implemented can connect South Asia with Central Asia. This would make up for energy shortfalls in South Asia. Although the success of this initiative is linked to peace in Afghanistan, the project can be carried forward with speed if China's investment is involved. It appears that China's interest and investment can be easily attracted if it is made a regular member of the SAARC.

### **Recommendations for Speedy Success of South Asia in Economic Integration**

- To achieve economic integration in South Asia in the next 10-15 years, it is necessary to restore confidence between India and other smaller countries by resolving their outstanding disputes. The speedy implementation of SAFTA is also necessary.
- Since India has disputes with all South Asian neighbours and it insists on resolving those under bilateral negotiations, sustainable settlements can only be achieved, particularly of Kashmir dispute, if India displays accommodation.

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<sup>38</sup> I. Rajiv Kumar & Manjeeta Singh, "India's Role in South Asia Trade and Investment Integration," ADB Working Paper Series on Regional Economic Integration, Paper no. 32, July 2009, *Asia Regional Integration Center*, [http://aric.adb.org/pdf/workingpaper/WP32\\_Indias\\_Role\\_in\\_South\\_Asia\\_Trade.pdf](http://aric.adb.org/pdf/workingpaper/WP32_Indias_Role_in_South_Asia_Trade.pdf), 3 (accessed April 7, 2012).

<sup>39</sup> "India's PM Urges Europe to Act on Financial Crises," *News International* (Islamabad), June 17, 2012.

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- The existing anomalies in SAFTA may be addressed by SAARC countries on priority to achieve tangible progress in enhancing intra-regional trade. In the long run SAFTA should include provisions for trade in services and investment also.
  - The required measures should be taken to fix timeline for gradually reducing the number of items in the negative list with the ultimate objective of eliminating it.
  - The major non-tariff barriers (NTBs) such as import policy barriers; standards of testing, labelling and certification requirements; anti dumping and countervailing measures; export subsidies and domestic support; services and investment barriers should be removed within a mutually agreed time frame.
  - There is also a need that SAARC should resolve on priority issues like the pending draft investment agreement; the creation of SAARC Investment Area, formation of a South Asian Development Bank and harmonization of fiscal and monetary policies.
  - It is also an urgent requirement that existing transport infrastructure linking all the SAARC states be put to use through a broad based agreement and plans be prepared to further expand this infrastructure.
  - To meet shortfalls of energy in some member countries, cooperation in energy sector is necessary for which the required measures should be initiated.
  - To enhance mutual trade, issues of existing rigidities of custom procedures, weak networking of private sectors and strict visa regimes should be addressed. The SAARC countries should also try to constrain unofficial trade taking place on borders.
  - SAARC should take measures to make the investment environment of the region conducive so that South Asia and other countries are encouraged to invest in mega projects relating to economic integration in South Asia and with Central Asia.
  - Being a large economy and market in South Asia, India should create favourable conditions for opening up its trade with all regional countries giving easy access to their products. India should also prefer to invest in the SAARC region,
  - To attract China's investment in SAARC region and in New Silk Road Initiative it is necessary that it should be made a full member of SAARC.
  - China's joining the SAARC will also be good for improving the political atmosphere and relations in South Asia. It will also help

in attaining early peace in Afghanistan. If these two developments take place, economic integration of South Asia will move apace.

### **Conclusion**

The process of economic integration will not speed up unless the political atmosphere of South Asia improves through the resolution of mutual disputes, particularly between India and Pakistan. It is also imperative to make SAFTA work, participate in joint economic projects in areas of transportation, infrastructure development, energy production and transmission and building of logistic hubs for oil and gas pipelines across South Asia to connect with Central and West Asia. Mutual cooperation should also include trade in services sector, industrial production, agriculture and construction of water reservoirs. In a nutshell, it can be said that if South Asia can create sustainable peace by envisioning a SAARC mechanism for addressing mutual disputes and moves speedily towards success of SAFTA and further economic integration, the regional countries can achieve higher growth rates which will help in realizing the SAARC goal of removing poverty and furthering the welfare of the people of South Asia. ■