CHAPTER – 6
SOUTH ASIAN INTEGRATION: EXPERIENCE AND LESSONS

A history is being made in Europe with the introduction of a common currency-Euro. The twelve countries of Europe have brought Euro in use to strengthen the concept of their common market. But the future of South Asian Preferential Trading Arrangement (SAPTA) being followed in South Asia as learning from the European initiative is still uncertain. This chapter focuses on this very theme.

Under SAARC, the initial stages of cooperation have been initiated with the setting up of a Preferential Trading Arrangement (PTA) - under SAPTA- among the member countries. Under the PTA approach, the member countries would have to offer a list of products and services in which they are willing to provide preferential market access in their economies to other members of the group. They will also have to arrive at a consensus for the extent of phased reduction in the tariff and non tariff barriers on a preferential basis for the suppliers of the other member countries, and reflects the perception of the individual countries with regard to the overall balance of benefits and costs of the Preferential Trading Arrangement for their economies in terms of parameters such as income, balance of payments, employment, market share, etc. This product by product approach is indeed a very slow process in evolving a freer trading environment among the member countries. Of course, the pace of liberalisation can be hastened by the agreeing upon an across the board tariff reductions in place of the negotiated product by product approach.
The Preferential Tariff Agreement is however only an interim step towards the final goal of establishing a Free Trade Area—FTA. In fact, the approach of a PTA would be considered as consistent with GATT only when it is explicitly pronounced as an interim agreement towards the final goal of setting up a Free Trade Area and also when a specific time table is clearly set out for this purpose. A fast track approach towards an FTA could be that member countries across-the-board declare reductions in the tariff and non-tariff barriers and also pronounce a specific time table for reaching the stage of zero barriers for trade flows. A free trade area would envisage free flow of goods and services among the member countries, while each member country has the freedom to set its own policies of barriers for trade with the rest of the world outside the group.

A further step in the establishment of a Free Trade Area would be to constitute a Customs Union in which the trade flows within the group are freed from all barriers and the group as a whole adopts a common policy of external barriers in regard to trade with the rest of the world. At this stage of integration, the countries have harmonized their internal and external policies in such a way that they are able to adopt a common stand with regard to trade with the rest of the world.

The next stage in the process of higher order of cooperation is in the form of a Common Market in which the movement of goods and factors of production, namely labour and capital are allowed freely within the group and the regional group as a whole would adopt a common external policy. The European Common Market until 1992 was a good example of functional Common Market. The final stage of integration is the Economic Union under which the fiscal and monetary policies of the
member countries are fully harmonised and they are willing to function under a common central bank with a single currency. The European Union is currently passing through such a critical phase for the evolution of a general consensus on the different elements of forming an Economic Union.

The effects of South Asian economic integration have not been investigated extensively. While there are some qualitative studies on SAARC and SAPTA, quantitative studies on economic integration in South Asia are very limited, with few exceptions. There are a number of possible reasons. Firstly, many trade analysts have not paid much attention to this region until recently since it is not important in terms of global trade, investment and growth. Secondly, data on trade and other variables related to countries in this region are sparse. Thirdly, the volume and value of illegal trade are very high in the region and published data do not reflect the real picture of the trade structure in the region. Finally, non-tariff barriers on trade are very important in this region compared to many other regions in the world, while the recognition and quantification of non-tariff barriers are difficult. Despite these constraints, there are several empirical and analytical studies that have generated a debate over the desirability of SAFTA and South Asian Economic Union.

It is a common phenomenon in international relations that a small neighbour often suffers from a fear complex with regard to its larger neighbour, especially if there are unresolved and complicating factors in their bilateral relations. This is particularly true in the case of South Asia. India finds itself being regarded as a hegemonic 'Big Brother' and bilateral disputes are especially acute with Pakistan, Bangladesh, and Nepal. Indeed, the six other countries see SAARC as a forum for
ganging up to withstand Indian hegemonic pressures.\(^1\) India has a trade surplus with each of these other members and trade liberalisation is bound to widen that surplus and increase resentment towards India. Levels of trade between India and its neighbours are low because their economies do not complement each other in resource availability, the structure and content of production, the supply of services, and cutthroat competitiveness. For example, Bangladesh, India, and Nepal compete with their jute products in the United Kingdom, EC and Japan. India, Sri Lanka, and Bangladesh compete with tea in the UK and EC. Similarly, there is bitter rivalry between India, Pakistan, and Bangladesh over the export of textiles to the US and EC, which has been compounded in recent years by complex rules and regulations regarding textiles in the international trading system. Trade between SAARC countries amounts to a dismal 3.4% of their total global trade. The corresponding figures for ASEAN, European Union (EU), and North Atlantic Free Trade Area (NAFTA) are 27%, 70%, and 19%, respectively. In contrast, all the SAARC members have attempted to diversify their trade relations away from India over the last few years. This trend is far more pronounced in the case of Indo-Nepal and Indo-Pakistan trade.

Given the low level of mutual trust, spillover effects of the ethnic and religious conflicts,\(^2\) and the magnitude of bilateral disputes in South Asia, it is unrealistic to believe that any substantial growth of regional cooperation is possible without easing political tensions. To the extent that political tensions remain unresolved, SAARC is

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likely to experience only a "stop-and-go" pattern of growth, in which limited pragmatic cooperation on specific techno-economic issues is possible over a period of time. In the post-1990 period, there appears to be some realisation among the South Asian leaders that the future of SAARC, like any other regional grouping, lies in concentrating on economic cooperation in specific areas. The SAARC leaders' renewed emphasis on increasing intra-regional trade at three consecutive SAARC summit meetings (Colombo, 1991; Dhaka, 1993; and New Delhi, 1995), the ratification of SAPTA, and the discussion to create SAFTA in future are evidence of their growing willingness to enhance regional economic cooperation in South Asia.

But how soon and to what extent they are going to achieve success remains unclear. Any realistic assessment of the prospects for the growth of economic cooperation and interdependence in South Asia must have to address several of the following issues.

The first issue pertains to the role of the state in promoting regional cooperation in South Asia. Given limited political contacts and mutual security concerns arising out of a typical security complex, in South Asia, a state-directed approach to economic cooperation is better suited to this region. The recent arguments about the limited role of the state in promoting regional cooperation activities in the context of the emerging "post-Westphalian," "post-sovereign," and "neo-medieval" international system appear to be irrelevant in the case of South Asia. The South Asian states may be weak and imperfect, but certainly not irrelevant in initiating or

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3 Government of India, Economic Dimensions of India's Foreign Policy, Foreign Affairs Record, Ministry of External Affairs, New Delhi, 1998
guiding regional cooperation policies and promoting economic interdependence in the region. Given the limited development of transnational market forces in South Asia, any prospect of the growth of regional economic cooperation driven exclusively by the market forces appears bleak. Besides, if regional economic cooperation is left to market forces alone, it would take decades. Therefore, conscious efforts at the political level and demonstration of political will by the South Asian leaders are absolutely necessary for the growth of regional economic cooperation in South Asia.

The second issue concerns the development of a pragmatic economic interdependence in South Asia. Three points merit attention here. (1) Given the extensive heterogeneity in levels of economic development of South Asian countries how can they proceed to achieve economic interdependence? Clearly, the approach should be gradual and based on the economic capability of each state. In this context, the recent approach of operationalising SAPTA appears promising. The Third Round of Trade Negotiations concluded on 23rd November, 1998. A total of 3456 tariff lines were covered under concessional tariffs and India offered more than half the concessions. The cumulative total concessions offered country wise were India: 1917, Bangladesh: 481; Pakistan: 295; Sri Lanka: 82; Nepal: 189; Bhutan: 124; Maldives: 368. The list of items is expected to be expanded in due course as the market space in each country increases and political confidence grows among the South Asian countries. (2) Regional cooperation should not replace, but only complement the existing bilateral trade and economic transactions between the South Asian countries. (3) The growing interest in operationalising SAPTA as a prelude to the creation of a

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South Asian Free Trade Area (SAFTA) should not obscure the importance of the extra-regional and global economic cooperation that most of the South Asian countries are currently engaged in. For instance, it would be detrimental to the economic interest of India, Pakistan, and Sri Lanka if they do not seek access to the markets in Central Asia, Southeast Asia, the Gulf region, and the OECD countries. The key to the development of a pragmatic strategy to increase economic interdependence among the South Asian countries is to promote intraregional trade by lowering tariffs without delinking from extra regional and global economic relations.

Third, setting grandiose goals for intraregional trade is likely to be counterproductive. Instead, over the next ten to fifteen years, SAARC countries should pursue modest trade objectives and seek joint development projects of modest scale. In this context, the SAARC countries should negotiate with the United Nations Development Program (UNDP) and Asian Development Bank (ADB) for the development of joint projects.

Some innovative approaches such as the ADB's vision of growth triangles merit serious attention. Development of joint projects with the assistance of ADB in smaller units can create new opportunities and help establish linkages with other regions. For instance, promising economic opportunities exist, and with respective governments' support extensive economic cooperation is possible in parts of Bangladesh, Northeast India, Myanmar, and Thailand, or South India, Sri Lanka, the Andaman and Nicobar Islands, and Northwest Indonesia.

Fourth, conservation of the natural resource base should constitute an integral part of any economic development strategy. For decades, the South Asian countries
have suffered from the degradation of the natural resource base and environmental pollution because of their overuse and often misuse of the natural resources. Efficient use of the natural resource base and environmental conservation should be given utmost priority by the South Asian countries to meet their growing needs of energy and to alleviate the health risks to their population. Given the integrated environment of South Asia it is essential for the SAARC countries to collectively think of strategies for environmental conservation. This will require policy coordination at the governmental as well as grassroots levels. Passage of environmental legislation and its strict enforcement, dissemination of a wide range of environmental education, and involvement of women in environmental protection programs can go a long way toward the conservation of the environment in South Asia.

Finally, it is necessary to strengthen South Asian Development Fund (SDF) in order to provide financial support to regional projects. The fund should not replicate the role of existing multilateral institutions such as the ADB and the World Bank in South Asia.

Besides undertaking large regional infrastructure and environmental programs, which the purely project-oriented development banks cannot undertake, the SDF can focus on poverty-alleviation programs, provide lending to a comprehensive human resources development program, finance joint ventures, support intra-regional and extra regional trade by arranging finance for export credit and commodity stabilization, and support the existing regional institutions. Resources for the SDF can come from contributions of SAARC countries as well as from external sources. Japan has already shown interest in contributing 20 percent of Japanese ODA to a common
The SAARC countries can also persuade the United States, Germany, OPEC countries, the Nordic group, and other donor countries to contribute some percentage of their ODA to the SDF. Needless to say, a successful SDF will be able to provide the much-needed economic support to regional projects and thereby strengthen interdependence among the South Asian countries.

South Asian countries have traditionally pursued stringent economic management policies including import substitution and exchange controls. High tariff structures and import control arrangements were common and in place mainly to insulate domestic industries from stiff foreign competition. These trade control measures largely served to restrict international trade in the region. Failure of highly managed economic policies to achieve much anticipated economic fortunes and the emergence of economic miracles in the neighbouring South East Asian nations pursuing export oriented open market strategies, forced South Asian countries to rethink over their strategies and finally to adopt more market friendly policies towards their economic management.

Most South Asian countries, for example, India, Pakistan, Sri Lanka, Bangladesh and Nepal, have implemented far reaching economic and trade policy reforms, moving their economies away from protectionism towards greater trade openness and global economic integration. Sri Lanka pioneered economic reforms in the region in late 1970's but other four countries delayed their reforms until late 1980's (World Bank 2003). Trade liberalisation process in India was later reversed in 1997 and but resumed again in 2002 with some tariff cuts. Bangladesh trade

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policy reforms have been slowed and somewhat reversed from mid-1990s. Pakistan embarked upon a comprehensive liberalisation of its trade policies including those on agriculture since 1996. However, India and Bangladesh still maintain high barriers against trade primarily through State Trading Enterprises (STEs), tariff rate quotas (TRQs) and quantitative restrictions (QRs). 8

In line with trade policy reforms, South Asian nations have revised their exchange rate policies. India, Pakistan and Sri Lanka have now moved to a floating exchange rate regime, with Bangladesh, which had a moderately flexible exchange rate system since 1991, floating its currency since May 2003 and Nepal currency being pegged to Indian rupee. 9

In terms of openness to trade measured by the total trade to GDP ratio, Maldives and Sri Lanka top the list with 94% and 65% respectively, and followed by Pakistan 33% and Bangladesh, Nepal and India each having a share of trade around one fourth of their annual GDP in 2002.

Despite various initiatives to liberalise the trade between member countries under the SAARC framework, intra-regional trade has remained very low in South Asia compared to other similar regional trade blocs, with almost 96 percent still accounting for extra regional trade. This indicates that there is a substantial growth potential in intra-regional trade provided right measures and instruments to boost the trade in the region are applied. It is imperative to identify the existing production capabilities of the region and match them with each member nation's

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8 Trade Policies in South Asia: An overview, Poverty Reduction and Economic Management, South Asian Region. World Bank, 2003,

9 Ibid
demand structure to determine the magnitude of future trade potential. Such attempt should typically involve an extensive study to pinpoint existing impediments that have prevented or restricted potential trade in the region.

Efforts on Economic Union and Lessons

The economic prominence of high-income regions such as the North American Free Trade Area (NAFTA), the European Union (EU), and Japan is evident. It appears that these three regions together account for 73 percent of world GDP, 65 percent of exports, and 64 percent of imports. By contrast in a global context, South Asia is a fairly small playing field. Its share of world GDP is only 1.9 percent and exports and imports also represent relatively small shares (less than 1 percent) of world trade. Within South Asia, India is the major trading partner. It accounts for about 76 percent of GDP, 67 percent of imports, and 60 percent of imports in the region. Bangladesh and Sri Lanka are relatively minor players in South Asia. In the light of these figures, any change in trade policy in South Asia is likely to have a negligible impact on the world economy.

South Asia also holds the dubious distinction of lacking the economic incentives for regional cooperation. History shows that regional economic integration can be successful only if the countries concerned establish a commonality of political purpose. France and Germany fought three titanic wars between 1871 and 1945. Thus, the major driving force behind the EEC was a determination to forge closer links between these two historical rivals to prevent the occurrence of yet another world war. The Cold War gave Western European nations another urgent reason to band together economically to gain in strategic strength. Finally, a basic EEC rule was that only
democracies could become members (which meant that Spain, Portugal, and Greece did not qualify until they discarded their dictatorships in the 1970s). This drives home the point that political harmonisation must precede economic harmonisation. The same pattern is evident in the ASEAN, which was formed as a political grouping opposed to the threat of Communist expansion from Vietnam and China. This helped bind together ASEAN members that were otherwise dogged by political disputes.

The volume of legal intra-regional trade in South Asia is quite insignificant, resulting in a limited interdependence among the South Asian countries. In brief, the intra-regional investment and trade among the South Asian countries is quite modest, and has remained stagnant over the years. Consequently, the interdependence among these countries is quite limited. Four factors can be mentioned here to explain the limited intra-regional trade among the South Asian countries. First, most of the South Asian countries, being primary producers, tend to export similar items and thus compete with each other. Second, the South Asian countries, with the exception of Sri Lanka, have a high rate of tariff and non-tariff barriers, which is the most important constraining factor for the expansion of intra-regional trade. Third, lack of adequate transport and information links among the South Asian countries poses serious problems for the expansion of intra-regional trade. Finally, political differences and a lack of willingness to create trade complementarities among the leaders of the South Asian countries contribute to the current low level of intra-regional trade.

The above constraining factors notwithstanding, specific trade complementarities can be created in order to foster greater intra-regional trade in South Asia. One important study sponsored by the Committee on Studies for
Cooperation in Development in South Asia (CSCD) has identified as many as 110 items for intra-regional exports and 113 items for intra-regional imports in South Asia.\textsuperscript{10} Broadly speaking, however, promising prospects for immediate intra-SAARC trade expansion exist in such products as tea and coffee, cotton and textiles, natural rubber, light engineering goods, iron and steel, medical equipment, pharmaceuticals, and agro-chemicals.\textsuperscript{11}

The enormous water resources of the Himalayas offer a great potential for the growth of regional interdependence. Since the Himalayan rivers flow through Bangladesh, Bhutan, India, Nepal and Pakistan, close cooperation is necessary among these countries to harness the Himalayan water resources for flood prevention and management of water flow, development of an inland navigation system, developing ecological watersheds and reforestation programs, and controlling river pollution. It is estimated that the Himalayan rivers flowing through Nepal have a hydropower potential of 83,000 megawatts, while in India, Bangladesh and Pakistan the estimated hydropower potential is about 70,000 megawatts, 1,772 megawatts, and 21,000 megawatts respectively.\textsuperscript{12} It is encouraging to note that in Bhutan, another country of enormous hydropower potential, the Chukha hydroelectric project was recently completed with India's assistance. Besides Bhutan and India, the project has the potential to benefit Bangladesh, Nepal, and Pakistan. Similarly, through cooperation


\textsuperscript{11} Ibid pp-12

between India, Nepal, Pakistan and Bangladesh, it is possible to develop hydropower projects which will provide a great relief to the energy crisis in this region.

There are other compelling economic reasons to suggest that it is in the interest of the South Asian countries to promote intra-regional trade and economic cooperation. Direct trade in such products as steel and aluminum, textile machinery, chemical products, and dry fruits currently being diverted through third countries will benefit both India and Pakistan quite substantially in terms of price, quality, and time. Besides, many goods being imported at high cost from other countries can be made available from India. By importing from India, the SAARC countries will be able to save their hard-earned foreign currencies.

The recent economic reforms in India and Pakistan will doubtless provide these two countries an opportunity to diversify their exports and make manufacturing products more competitive. But the success of their economic liberalisation will essentially depend upon their ability to find new markets both in the developed and developing countries. Two developments in the international environment make the prospects of South Asian exports to new markets less promising. First, the world economy is currently experiencing weak growth and the major industrialized countries are likely to grow more slowly than in the 1980s. Thus, it will be difficult for the South Asian countries to expand exports rapidly. Second, with the formation of regional economic blocs and growing protectionism in both the developed and developing regions, the South Asian countries may find it difficult to gain access to these markets.

Report on the Study on Regional Economic Cooperation among SAARC countries by the Federation of Indian Chambers of Commerce and Industry (FICCI) and the Institute of Economic Growth (New Delhi, 1995).
Recent developments in Eastern Europe and the former Soviet Union are also likely to have adverse impacts on South Asian economies. The immediate impact has been on trade. India's export to these markets has declined. The trend is likely to continue. The longer-term impact is likely to be on the official development assistance (ODA) to South Asia. As some major studies have indicated, the former Soviet Union and Eastern Europe received a major share of ODA from the donor countries in the 1990s. Additional demands for ODA will come from the poorer republics of the former Soviet Union in the near future. Given the slower economic growth in the industrialised countries (compared to past performance) and tighter supplies of such funds from the traditional donors, these additional demands will certainly contribute to a reduction of ODA to South Asia. Besides, the expectation of the South Asian countries for an increase in foreign direct investment may not materialise until they are able to create a stable political climate in the region.

Thus, both the international climate and domestic needs are conducive for expanding regional cooperation in South Asia. It is often argued that if the South Asian countries are able to increase their intra-regional trade from the current level of 3 percent to 6 or 7 percent over a decade, set up some regional joint ventures, and share the available technology in the region, there will be considerable improvement in the region's interdependence and economy. Gradually, the policy makers of the South Asian countries seem to realise this. The ratification of SAPTA by all SAARC members is a beginning in the direction of promoting intra-regional interdependence.
Comparisons between European Union and SAARC

The European Union, which is a successor body of European Community, embodies rich experiences of over 5 decades in the field of regional cooperation. There are now treaty based provisions, inter alia, in regard to common foreign and security policies and development cooperation policy towards all developing countries. SAARC is a fledgling organisation of 2 decades old. It is the most populate regional grouping in the world and potentially a big market for industrial and new technologies. It operates in agreement with the SAARC Charter and has no institutions comparable to those of the European Union. The European Union has succeeded in generating peace and prosperity. On the other hand, the people of South Asia have yet to feel tangible and visible benefits of cooperation. SAARC has hardly progressed beyond signs and symbols. At present more rhetoric than action is evident. SAARC has not yet succeeded in addressing itself successfully to meet the challenges of policy formulation and implementation without which the objectives of SAARC Charter will not be achieved. In their report, the members of the Independent Expert Group on the Integrated Programme of Action (IPA) were not able to carry out an assessment of the benefits of the IPA activities in its entirety because of lack of availability of the precise, methodological tools, well defined criteria, data and information. However, this Group has concluded that the activities of IPA have in general led to, Closer personal contacts between the experts of the region in their individual fields of specialisation. The exchange of data and information contributing to better understanding of the situation obtaining in the Member States in the agreed areas of

14 Ibid
cooperation between the Member States. Seminars and workshops resulting in the sharing of experiences. Study tours, thereby providing first-hand knowledge. Training courses and Expert Group meetings, useful in building up capabilities. Compilation of compendia and directories, which provide a host of information. Completion of the state-of-the art reports valuable in focusing attention on areas of common concern.

In the economic area some progress has been achieved in the framework of South Asian Preferential Trade Agreement (SAPTA) and work is continuously progressing about towards a South Asian Free Trade Area (SAFTA). The Heads of State and Governments of SAARC countries have recognised the importance of achieving the free trade area by 2010.

**Mechanisms**

The novel approach of the EU is based on the development of a unique and unprecedented institutionalism, the rule of law and solidarity. Progress in SAARC can only be achieved on the basis of unanimous inter-governmental decisions taken at the level of the Council of Ministers. SAARC, however, follows the approach of, exchange of information whereby its members learn from each other's experiences; Functional cooperation in major areas, and Trade and economic cooperation where input from the SAARC Chamber of Commerce and Industry is also invited.

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Decision Making

There is a growing acceptance in the European Union of the view that adherence to unanimity would often result in a stalemate. The notion of qualified majority voting has been accepted in case of some institutions. This attempts to reconcile the notion of member states being equal in law whilst being unequal in size by using the references both to a majority of the member states and to a majority of the Unions population. The SAARC Charter has clearly stipulated that all decisions will be taken on the basis of unanimity and that all bilateral and contentious issues will be excluded from discussions. The centrality of location and the size of India practically rules out any amendment to these provisions.

Approaches to Difficulties

The opinion, policy and decision-makers in the European Union subscribe to the dictum, that recognising the difficulties does not mean giving into them. A confident and determined approach marks the work of the European Union. On the other hand, many SAARC leaders have a tendency to highlight the difficulties and constraints particularly those arising from unresolved bilateral problems. There is often ambivalence in approach, prevarication in thinking and tergiversation in action. The virtues of incrementalism in regional cooperation are not always recognised, apathy and inaction are in evidence rather than confidence and determination, are often in evidence Innovation and Change In the European Union there is an ongoing examination of adapting the institutions, i.e. the European Parliament, the Council, the Commission and the Court of Justice. In SAARC there is resistance to the idea of

revising its Charter or even the Terms of Reference of the Charter bodies, i.e. the Standing Committee of the Foreign Secretaries, the Technical Committees, the Committee on Economic Cooperation and the Council of Ministers.17

The example of Economic and Monetary Union shows that organised flexibility can be the route for deepening the Union. The Commission subscribes to the view that the European Union must make it possible to have forms of cooperation or integration between those members wishing to progress faster and further in the attainment of the Treaty’s objectives. This should be envisaged only after exhaustion of all other possible forms of action involving all the Member States.

According to the Commission, the requisite flexibility will have to be guided by the following principles, so as to guarantee the unity of the Union: Compatibility with the objectives of the Union; Consistency with the institutional framework of the Union; Opportunity for other Member States which are willing and able to join at any time; Safeguarding of the single market and the policies accompanying it.

The proposal of some Member States of SAARC to explore possibilities of sub-regional cooperation has raised a furore and some unnecessary controversy.18 It may be recalled that the SAARC Charter stipulates the setting up of Action Committees by three or more Member States on matters of common concern with the approval of the Standing Committee of Foreign Secretaries. At their last Summit Meeting, the leaders have agreed to encourage the development of specific projects relevant to the needs of three or more member states under certain conditions.

18 Ibid
The European Union, which is now at a very advanced stage of integration after the Maastricht Treaty of 1992, has set out four major objectives in the Amsterdam Treaty for the immediate future. These are: to place employment and citizens' rights at the heart of the Union; to remove the last remaining obstacles to freedom of movement; to strengthen security; to give Europe a stronger voice in world affairs; to make the Union's institutional structure more efficient with a view to enlarging the Union, through new member States joining. As far as SAARC is concerned, some scholars and non-governmental bodies have done some very useful work to articulate ideas in towards the visions, goals, and strategies for the future.

**Common Foreign and Security Policy** The European Union has yet to ensure the visibility of the common foreign and security policy. The Commission has proposed the setting up of a Joint Analysis Unit, composed of experts from the Member States and the Commission, and has the incorporation of a Permanent Political Committee into the existing machinery and the Council for preparing decisions in Brussels, so as to facilitate the formulation of common foreign policy. Even though its membership consists of both nuclear and non-nuclear powers, the common ground to cover on security matters is enormous. On several key issues, the Member States of SAARC have diametrically opposite foreign and security policies. Two of the SAARC members India and Pakistan, are nuclear states with perceptions of threats from each other. However, on several issues relating to social development and International Economic Cooperation SAARC countries have common interests and have not hesitated to articulate these, often through joint communiqués of Ministerial Meetings held on subjects such as environment, labour matters, WTO related matters, social
development etc. The representatives of SAARC countries meet at times in New York, Geneva, Brussels to coordinate their positions and to adopt common stands, if possible, on some matters of common interest and concerns.

**Interaction with Civil Society.**

Institutions of the European Union have adopted various measures to bring Europe closer to its citizens by increasing openness in their proceedings. The European Commission holds open and structured dialogues with interest groups. The Commission has published a list of European Non-profit Interest Groups accessible both to officials and to the general public. In any cooperation activities in the European Union, the inclusion of an interest group is purely voluntary and does not imply any form of official recognition by the Commission. The European Parliament has adopted a resolution on the participation of citizen and social players in the institutional system of the European Union. The access to internal documents of the European Commission is governed by an established Code of Conduct. In some cases, a fee is charged to cover the cost of reproduction of a document.

In the case of SAARC, the non-governmental organisations do play a role, which has even been recognised at the highest level.\(^{19}\) There are well-defined criteria, which must be met before any regional NGO can be recognised as a SAARC NGO. Two important bodies, which already enjoy official recognition, are SAARC Chamber of Commerce and Industry (SCCI), and SAARC Law. With some others like the Coalition for Action on South Asian Cooperation (CASAC) the SAARC Secretariat

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has valuable interaction. The SAARC Documentation Centre was established in India with a view to facilitate availability of scientific and technical information to scholars. However, at present there is no Code of Conduct with regards to access to SAARC documents for scholars and NGOs. The SAARC Secretariat has been asked by the Council of Ministers to compile recommendations made by interest groups and NGOs and these are considered by the Standing Committee of Foreign Secretaries. Positive contributions made by the SCCI and SAARC Law have been noted by the SAARC leaders at the Summit Meetings.

Moving South Asia's economies beyond the Indo-Pakistan paradigm

The effectiveness of the South Asian Regional Association for Cooperation (SAARC) hinges upon its dominant Indo-Pakistan axis. A stronger Indo-Pakistan relationship would realise multiple benefits for all the countries of the region, including reduced defence expenditure, enhanced economic growth from increased trade and the sharing of South Asia's water, oil and natural gas resources, and would increase the scope for further integration. However, the failure of India and Pakistan to normalise their political and trade relationship hinders the growth of SAARC, including the possibility of its future as a viable trading bloc. Nonetheless, the relative inaction of the Indo-Pakistan axis in SAARC must not prevent other countries in the region from entering into bilateral, sub-regional and extra-regional agreements to reap the benefits of enhanced co-operation.\(^20\) Although such arrangements would undermine the efficacy of SAARC, it would be a move

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\(^{20}\) Mukherji, I.N., *Charting a free trade area in South Asia: Instruments and modalities*, SANEI, Kathmandu. 2000,
forward from the existing SAARC framework, which Indo-Pakistan intransigence has made virtually obsolete.

The effectiveness of SAARC has been marred by disputes between its two largest member countries, India and Pakistan, both of which remain suspicious of each other's intentions in the region. As a result, regional growth in South Asia is undermined by the lack of commitment on the part of India and Pakistan, and their failure to successfully conclude multilateral agreements under the SAARC framework.

The less than impressive performance of SAARC calls for a closer inspection of the economic characteristics and political dynamics of its member countries, especially the Indo-Pakistan paradigm that inhibits enhanced economic cooperation in the region.

The Indo-Pakistan paradigm in SAARC

Efforts to redress the economic asymmetry of SAARC's member states have suffered from their mutual political distrust stemming from both uncertainties as to the organisation's aims as well as bilateral disputes. This is particularly true in the case of India and Pakistan where the latter argues that full-scale economic co-operation in the region cannot be brought about in an environment of tension and conflict. In an indirect reference to its long-standing dispute with India over Kashmir, Pakistan states that multilateral trade regimes in South Asia cannot function in a political vacuum and the resolution of bilateral issues with India must come first.21 Pakistan officials maintain that 'a durable environment of peace and security' is necessary for trade to

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flourish with India. However, India is opposed to raising bilateral and contentious issues within SAARC, citing the organisation's Charter that does not permit dialogue on politically contentious matters.²²

The preponderance of India in the South Asian polity is unique. This Indo-centricity erects a psychological barrier that aggravates the insecurities of its small neighbours, since marked differences in politico-military weight between states is hardly conducive to building confidence between them. For each member state, SAARC's real utility lies in managing its relationship with large neighbour India, often to the detriment of maximising their economic priorities in the region as a whole.

Inter-regional rivalries also make co-operation difficult in South Asia, particularly in the case of India and Pakistan. Both states viewed the original proposal to create SAARC with scepticism. While India feared that the proposal for regional organisation would provide for an opportunity for its small neighbours to regionalise all bilateral issues, Pakistan assumed it was an Indian strategy to organise the other South Asian states against its and to ensure a regional market for Indian products. The creation of SAARC has done little to lessen the deep distrust between these two countries. While India has thought that Pakistan has stymied the deeper integration of states in SAARC, thereby preventing the fuller realisation of its potential

²² Article X of SAARC Charter states that bilateral and contentious issues shall be excluded from the deliberations. See Charter of the South Asian Association for Regional Cooperation, SAARC Secretariat, (Kathmandu: Nepal), 1990.
organisational benefits, Pakistan has assumed that deeper integration was aimed at strengthening India's dominance in and around the subcontinent. 23

**Indo-Pakistan trade**

For the proposed SAFTA to succeed, India and Pakistan must enjoy free trade. However, Indo-Pakistan trade relations are constrained by political and military disputes. Pakistan's official trade with India is less than 1.5% of its total trade, and their bilateral trade (estimated at US$200 million) is less than 1% of their global trade. 24 Businessmen in both the countries contend that increased trade between the two neighbours would narrow their political differences.

In this regard, Pakistan has been refusing to confer upon India Most Favoured Nation (MFN) access, despite enjoying MFN access to the Indian market since 1995. 25 Although Pakistan has not ruled out the possibility of granting the MFN status to India, it is refusing to give a time-frame for the same, although the World Trade Organisation (WTO) Agreement states that countries extend mutual MFN status to each other. 26

Despite official disapproval, illegal trade between India and Pakistan continues to flourish and is estimated at around US$1.5 billion per year. 27 The nature of this


26 According to Article I (Part I) and III (Part II) of the GATT/WTO regulations, the State that trade concessions granted to one member are extended to all other members; and that members may not use internal measures to discriminate between domestic goods and those imported from members. For more details on GATT/WTO trade regulations,

27 Open border between India & Pakistan for broader trade', *The Economic Times*, 26 October 1998.
two-way trade predominantly concerns the importation of Indian goods by the Pakistani businessmen, causing huge customs revenue losses to the Pakistan national exchequer. At present, only 603 Indian items are allowed for imports into Pakistan.\textsuperscript{28} Other items, not covered under this category, are imported by businessmen though third countries such as the United Arab Emirates, Dubai and Singapore.

The potential for bilateral trade between India and Pakistan is enormous, and co-operation would be beneficial major industries in both countries. This is particularly true in the case of the textile and clothing industries, which account for a considerable manufacturing employment and output in both India and Pakistan. The import of low-cost cotton resources from Pakistan would help cotton-based garment exporters in India. While Pakistan has a competitive advantage in cotton textiles, India has an efficient silk and man-made fibers industry. Co-operation between these industries could not only result in cost-savings for consumers in both countries, but also in strengthening their respective positions on the international market. There have been efforts by business leaders on both sides to intensify commercial co-operation; the India-Pakistan Chamber of Commerce and Industry (IPCCI) was created specifically to explore areas of mutual co-operation. Unfortunately, the IPCCI does not take a unified position on critical issues but, instead, reflects the respective national interests of India and Pakistan. For instance, the Indian delegation to the IPCCI demands the granting of MFN status by Pakistan to

\textsuperscript{28} Ibid
India, which has not been supported by the Pakistani delegation.\textsuperscript{29} As a result there has been no concerted effort to boost bilateral trade between the two countries.

**Alternative bilateral trading arrangements**

There has been widespread disappointment among member states over the lack of visible results achieved under the SAARC framework. While the region's predominant Indo-Pakistan axis remains problematic, the impetus for increased trade between SAARC member states remains limited. The economic stagnation of SAARC has forced its members to look for alternative trade arrangements. In recent years, there has been a move towards bilateral, sub-regional and extra-regional arrangements.

The 'Gujral Doctrine' discussed at the 1997 SAARC summit in Male articulated India's rationale behind the creation of sub-regional co-operation within the organisation. The Doctrine stresses that India's strength and stature cannot be assessed in isolation from its relationship with neighbours, particularly the smaller neighbours of Bangladesh, Bhutan, Maldives, Nepal and Sri Lanka. To emphasise the importance India should accord its smaller neighbours, the Doctrine states that India should accommodate the wishes of its smaller neighbours without demanding reciprocity. India argued that the creation of sub-regional and/or bilateral agreements with other South Asian states would enhance the flexibility and strengthen the functioning of SAARC.\textsuperscript{30} However, the Gujral Doctrine created distrust between India and Pakistan as the latter tended to view it as a ploy to marginalise Pakistan from

\footnotesize{\textsuperscript{29} Khaleeq Kiani, 'Pakistan refuses Most Favoured Nation status to India', *Dawn*, 23 May 2001

\textsuperscript{30} Padmaja Murthy, 'Role of smaller members in the SAARC Forum', *Strategic Analysis*, November 1998, Vol XXII, No.8, pp. 1179-1191.}
regional affairs. Pakistan wanted the creation of sub-regional arrangements to be kept out of the preview of SAARC as they were expected to increase Indian influence in the region.

Having realised that any effort to enhance the intra-regional trade in the region would be checkmated by Pakistan, India has decided to push forward with the idea of sub-regional economic co-operation. While still working for a free trade regime within SAARC, India has gone ahead with lowering tariff barriers on a bilateral basis; India and Bhutan already have zero-tariff barriers, and a similar agreement exists with Nepal. With a successful free trade agreement concluded with Sri Lanka, India is keen to promote free trade regime with Bangladesh.

India and Sri Lanka signed a free trade agreement in December 1998. India is Sri Lanka's single largest source of imports, accounting for around 10% of its overall imports in the late-1990s. Although the signing of the Indo-Sri Lanka Free Trade Agreement (ISLFTA) was aimed at bolstering the levels of Indo-Sri Lanka bilateral trade, its beneficial effects have been contested. It is argued that ISLFTA is largely a political treaty, hastily concluded as India was looking for alternative export markets in the face of American economic sanctions imposed in May 1998 in the wake of India's nuclear tests. However, taking into consideration that India's exports to Sri

31 Khalid Mahmud Arif, 'New Delhi's ceasefire diplomacy', *Dawn*, 23 April 2001
Lanka account for just 1.0% of its total exports,\textsuperscript{35} it could hardly be argued that India saw Sri Lanka as a substitute for its traditional export markets such as the European Union and the United States.

Despite some criticism of ISLFTA, the arrangement is generally mutually beneficial to both India and Sri Lanka. For the latter, the agreement drastically or totally reduces Indian duties on its exports, offers Sri Lanka's tea industry, already one of its largest foreign exchange earners, an opportunity to exploit the huge Indian consumer market, and increases the scope for diversifying its exports, thereby reducing its huge trade deficit with India. For India, ISLFTA opens up the Sri Lankan market to Indian consumer goods as its reduction of import duty gives them cost advantage competitiveness in the face of currency devaluation in South East Asian economies. With goods of Indian origin offered 90% duty concession in 2002 Sri Lankan budget,\textsuperscript{36} Indian companies are well placed to face the competition in the Sri Lankan market. ISLFTA should also help Indian textile industries establish joint ventures with their counterparts in Sri Lanka to enter into lucrative markets such as the United States and the European Union with which Sri Lanka already enjoys preferential trade terms.

The Indo-Nepal Treaty of Peace and Friendship established a framework for strengthening bilateral relations between India and Nepal in 1950. This treaty was renewed in 1961 and 1971 to provide transit facilities for Nepal's third-country trade

\textsuperscript{35} Dushni Weerakoon, op cit, Ref 45.

\textsuperscript{36} Website: http://tradeportalindia.com/
through India. Since 1950, the treaty has significantly contributed to Nepal's economic development by providing duty-free and quota-free access for all Nepalese manufactured products (barring those under a short negative list) to the Indian market on a non-reciprocal basis. India is Nepal's principal trading partner; accounting for 40% of the latter's overall trade. While Nepal's trade with India also accounts for a significant proportion of its overall trade deficit, India is also its largest industrial collaborator and foreign investor. There are almost 200 Indo-Nepal joint ventures in Nepal, and Indian investment amounts to about 36% of total foreign direct investment in the country.40

There have been irritants in Indo-Nepal bilateral trade. One example is the Indian automobile industry, which suffers from what Indian officials have described as a 'discriminatory ban' on exports to Nepal on air pollution grounds. Indian authorities are irked by Nepal's unwillingness to accept Indian automobile manufacturers' testimony as to their pollution control measures, while recognising pollution control certificates provided by the manufacturers of Korean and Japanese vehicles. In a contrasting example, when Nepalese exporters complained of the imposition of 4.0% special additional duty on their exports, New Delhi waived the duty.

An important feature of Indo-Nepal trade is the presence of substantial informal trade. According to an informal report prepared by the Federation of Nepalese Chambers of Commerce and Industry, goods worth about Rs 10 billion are smuggled into the country from India.\(^{41}\) India is worried that the entries of third-country goods that do not meet the requirement of rules of origin principles form a substantial part of this informal trade. India is also uneasy that the growing China-Nepal trade will result in Chinese products, ostensibly marked as Nepalese but without having undergoing any significant structural change in Nepal, ending up on the Indian market.

Significantly, the Indo-Nepal Treaty of Peace and Friendship has helped Nepal promote its industries and narrow its trade deficit with India despite sometimes strained political relations between the two countries; for instance, over the Kalapani border dispute and the Mahakali river accord. Yet, short-term political tensions have not succeeded in sabotaging India-Nepal bilateral trade, as is the case in Indo-Pakistan trade. Indeed, the level of Indo-Nepal bilateral trade continues to increase.\(^{42}\)

Both the economic and political dimensions of Indo-Bangladesh relations have been largely influenced by domestic public opinion in Bangladesh. At times, Indo-Bangladesh relations have been held hostage to the domestic political rivalry between the two main political parties, the Awami League (AL) and the Bangladesh National Party (BNP), especially as the latter's political ideology is infused with anti-

\(^{41}\) Bijaya Ghimire and Gopal Devkota, 'Army to check cross-border smuggling', The Kathmandu Post, 2 March 2001.

India feelings. In the past, efforts to improve Bangladesh's trade relationship with India have been critically viewed by hard-line elements in the smaller neighbour. Even bilateral measures that would bring economic benefits and much-needed foreign exchange to the country was criticised by opposition parties in Bangladesh. For instance, when an AL government was favourably considering India's request for transhipment facilities through its territory for its goods destined for eastern India, the BNP accused it of being an Indian stooge. The BNP also opposed Bangladesh entering into the Ganges Water Treaty with India. Although it was largely believed that the long-standing dispute was settled largely in favour of Bangladesh, the BNP still considered this to be an abject surrender to India.

As with other smaller states in South Asia, Bangladesh's economic relations with India is a highly important—and highly sensitive—issue. Yet, despite hiccups in their bilateral political relations, India and Bangladesh have managed to establish amenable trade relations, with the latter gaining preferential access to Indian market. In contrast, India, aware of domestic political compulsions in Dhaka, does not want to pressurise the Bangladesh government to enter into a free trade arrangement that might negatively impact its domestic industries. Instead, in a gesture aimed at improving neighbourly relations, India has encouraged investment in Bangladesh to help develop its fledgling industrial base. India has also made import concessions to help Bangladesh reduce its bi-lateral trade imbalance, and

43 M.H. Askari, 'Strife and more strife', Millennium special report, Dawn.
positively responded to Bangladesh's long-pending request to grant duty-free entry into the Indian market for twenty-five groups of products.\textsuperscript{45}

While the bilateral trading arrangements described have significantly improved relations India's relations with its smaller neighbours in recent years, the old distrust of the 'big brother' has not wholly disappeared.\textsuperscript{46} India has tried to dispel its recalcitrant image by granting its neighbours preferential access to its domestic market. These arrangements have had a mixed effect on the member countries for, while Sri Lanka, Bangladesh and Nepal have benefited from preferential access to the Indian market, they themselves have only marginally increased their market access for Indian exports. Yet, whatever the controversies surrounding the efficacy of bilateral trading agreements between India and its neighbours, these arrangements have proved that there could indeed be bilateralism in the region outside the ambit of SAARC. For India, the bilateral arrangements are proof of its sincerity in wanting to consolidate its relationship with its smaller neighbours, as well as making sure that its interests in the region are not held hostage to the Indo-Pakistan dispute. For all the signatories, it is a move forward from the existing SAARC framework, where the Indo-Pakistan paradigm is limiting the scope for welfare gains associated in the creation of a regional trade bloc.

The effectiveness of SAARC as a regional trade bloc largely hinges upon Indo-Pakistan relations. A strong and peaceful Indo-Pakistan axis would help fellow member states realise substantial savings from a reduction in defence expenditures and

\textsuperscript{45} Ibid

long-term economic gains from free trade, joint projects and easy access to oil and natural gas resources in the region. However, India and Pakistan show little sign of abating their hostility. The conduct of Pakistan's trade dealings with India confirms that it is willing to compromise its long-term economic interests until and unless contentious political issues—particularly the Kashmir dispute—are resolved. Yet India's Kashmir policy is highly unlikely to change. Given the ongoing political tensions between India and Pakistan, it is highly unlikely that SAARC can realise its potential as trade bloc.

As such, South Asia's states must be prepared to go for bilateral, sub-regional and extra-regional agreements. It is true that such arrangements will undermine the efficacy of SAARC. Nevertheless, it would be a move forward from the existing SAARC framework, which Indo-Pakistan intransigence has made virtually obsolete. SAARC's lethargy must not prevent states in the region from entering into alternative trading arrangements. Indeed, it would only be prudent to visualise alternative trading arrangements outside the existing SAARC framework.