ISSN 1605-2021

লোক-প্রশাসন সাময়িকী
Lok Proshason Samoeeky
সংখ্যা: ৪৩/No. 43
জ্যৈষ্ঠ ১৪১৪/June 2007

Economic Integration within the SAARC Countries
Problems and Prospects

Md. Jahid Hossain Panir*

Abstract: *Since its establishment in 1985, the SAARC has intended to enhance economic solidarity among its member nations. While the organization was framed to boost the socio-economic progress of its members, it is an important question whether it has been able to fruitfully carry on its desired goals. In contrast to other regional trading bodies like the ASEAN and the EU, the SAARC performs poorly in terms of the initiatives to strengthen economic integration. Unlike the EU or the ASEAN, trade among and within the seven SAARC countries remains low, despite the fact that all are located within a close proximity of one another and all are members of the WTO. An accelerated concentration on captivating FDI and endeavoring access to trendy businesses in the SAARC nations demonstrates that economic growth is vital for the South Asia's prosperous tomorrow. Notwithstanding, it is also a key question whether the SAARC will be capable to play a significant role in projecting the region's prospective future, viewing India's predominant power over other member states of this sub-regional organization. Actually, the clashes between South Asian countries end up jeopardizing the creation and effectiveness of regional trade agreements. Admitting that the rising geo-strategic weight of South Asia (particularly India) is now being recognized, the SAARC is still far from voicing opinions on its own issues at the global politico-economic order. Under this backdrop, the study attempts to critically explore the ongoing challenges facing the SAARC under the disruptive pressures of economic globalization. The research also tries to provide some realistic and attainable recommendations about how this organization as an architect could play a more effective and constructive role in advancing economic prosperity for South Asia, one of the world's impoverished regions, rather than as a platform involved simply in pursuing regional dialogues through meetings and conferences.*

1.0 Introductory Perspectives

Since its establishment in 1985, the SAARC has intended to enhance economic solidarity among its member nations. While the SAARC was framed to boost the socio-economic progress of its members, it is an important question whether the organization has been able to fruitfully

* Sr. Asst. Secretary, (OSD, on study leave) Ministry of Establishment.

carry on its desired goals[1]. In contrast to other regional trading bodies like the ASEAN[2] and the EU, the SAARC performs poorly in terms of the initiatives to strengthen economic integration. Unlike the EU[3] or the ASEAN, trade among and within the seven SAARC countries remains low, despite the fact that all are located within a close proximity of one another and all are part of the WTO. An accelerated concentration on captivating FDI and endeavoring access to trendy businesses in the SAARC nations demonstrates that economic uplift is vital for the South Asia's prosperous tomorrow.

Notwithstanding, it is also a key question whether the SAARC will be capable to play a significant role in projecting the region's prospective future, viewing India's predominant power over other member states of this sub-regional organization.[4] Actually, this power imbalance allows conflicts between India and its neighbors to undermine organizational solidarity. The clashes between South Asian countries end up jeopardizing the creation and effectiveness of regional trade agreements. Moreover, it leads respective SAARC nations to foster their economic interests through bilateral agreements, declining the incentive to involve in multilaterally. Whilst South Asia's geo-strategic ties with other regional powers (mainly Japan and China) needs to be nourished more effectively and constructively in an increasingly interconnected, sharply competitive and dynamically changing Asia, there is a deeper understanding that unless India and Pakistan take stern steps to resolve the "Kashmir issue" for promoting enduring peace and facilitating development in South Asia through a string regional cooperation among the countries of the SAARC region, they will not count much in the most challenging era of economic globalization.

Admitting that the rising geo-strategic weight of South Asia (particularly India) is now being recognized, and the South Asian nations are now agreeable to work out some competitive pursuits under the SAARC

---

1 Verinder Grover, Encyclopaedia of SAARC Nations (New Delhi: Saujanya Books, 1997).

2 Ippei Yamazawa and Daisuke Hiratsuka (eds), Toward ASEAN-Japan Comprehensive Economic Partnership (Tokyo: Institute of Developing Economies, 2003).

3 When SAARC is compared with EU, the latter is not simply a regional bloc in the common sense. It is a union of sovereign States with the deepest connections in the political, economical and executive fields. Thus, it is a far more integrated bloc than any other regional bloc or cooperative association of sovereign States in the world.

4 Subrata Mitra, "The Reluctant Hegemon: India's Self-Perception and the South Asia Strategic Environment", Contemporary South Asia, vol. 12, no. 3 (2003), pp. 399-417.

framework, they are still far from voicing opinions on their own issues at the global politico-economic order. They are really dependent on other countries outside the region, and the level of mutual interdependence that is visible in case of the ASEAN is clearly absent in the SAARC. At the sub-regional level, the SAARC also lacks cohesive policy coordination with the ASEAN, while their cooperation has recently developed, especially in the energy sector.

Under this backdrop, the study attempts to analytically explore the ongoing challenges facing the SAARC under the pressures of economic globalization. The research also tries to provide some realistic and attainable recommendations about how this organization as an architect could play a more effective and meaningful role in advancing economic prosperity for South Asia, one of the world's impoverished regions, rather than as a platform involved simply in promoting regional dialogues through meetings and conferences.

2.0 Economic Cooperation among the SAARC Nations

The SAARC integration initiatives have taken place in the context of a significant (non-discriminatory) liberalization process in all member countries of the region.[5] This has involved both trade and investment liberalization, and the adoption of a pro-FDI stance. In the SAARC region, the economic integration process actually gained impetus with the implementation of the South Asian Preferential Trading Agreement (SAPTA) in 1995 under a wider framework of the SAARC.[6] Nonetheless, the SAPTA has come to be seen as an interim platform in the movement toward economic integration in this region. In 1996, the governments of the South Asian nations committed themselves to the creation of a South Asian Free Trade Area (SAFTA). While it was decided at the 9th SAARC Summit to establish the SAFTA by 2001, this has proved far too ambitious. Although the extent of the trade-investment links in the South Asian region are still rather limited, they reveal both potential and manner in which further progress will occur in a more liberal trading and investment climate in this region, and that the common understandings of economic liberalization will spur more effective, beneficial and persistent FDI-trade nexus in diversified arenas.[7]

5 Dilip Dutta (ed.), Economic Liberalisation and Institutional Reforms in South Asia: Recent Experiences and Future Prospects (New Delhi: Atlantic Publishers, 2000).

6 Saman Kelegama, Dushni Weerakoon and S.K.W. Jayasuriya, Foreign Direct Investment and Economic Integration in the SARRC Region (New Delhi: South Asia Network of Economic Research Institutes, 2000).

7 Pradeep Agrawal, Savings, Investment and Growth in South Asia (Bombay: Indira Gandhi Institute of Development Research, 2002).

2.1. The economic liberalization process in South Asia

The South Asian countries that had open economies in the immediate post-independence period in the 1940s became some of the most highly protectionists in the world by the 1970s. Tariff, and even more importantly, non-tariff barriers were extremely high, state interventions in economic activity had become pervasive, attitudes to foreign investments were negative, often hostile, and stringent exchange controls were in place. Nonetheless, this started to change in the late 1970s. In 1977, Sri Lanka initiated a process of policy liberalization, and was in turn followed by other countries of the region in the 1980s. This was however often a rather hesitant liberalization process, and was very uneven across countries. It was from the early 1990s, with the start of a major reform process in India,[8] that the region as a whole really began to liberalize. By the end of the decade, although crucial policy barriers to trade and FDI remained, a notable progress was made in this direction throughout the region. It may however be stated that even by the mid-1990s, in a global comparison of import protection rates, South Asia remained a highly protected region,[9] and this situation prevailed in the early to mid 1990s.

Notwithstanding, policies and attitudes toward FDI regimes in this region have changed sharply, and reforms to the FDI policy regime have accompanied trade liberalization. All SAARC countries now actively encourage and seek FDI, and a range of measures have been implemented to enhance their attractiveness to potential foreign investors. These include provision of various tax, duty and other incentives, removal of restrictions on repatriation of profits, establishing current account convertibility, reduction of number of prohibited or restricted sectors, relaxation of ownership restrictions, non-discrimination in favor of domestic investors, fast tracking of FDI approvals, guarantees against nationalization and expropriation, setting in place of internationally acceptable dispute resolution mechanisms, etc.

Whilst the changes to the trade policy regime in the South Asian region have primarily been driven by across the board, unilateral liberalization by individual countries,[10] there has also been a preferential trade liberalization process, which has been ongoing since the establishment of

[8] Terence Byres, The State, Development Planning and Liberalisation in India (New Delhi: Oxford University Press, 1997).

[9] Will Martin and Alan Winters (eds), The Uruguay Round and the Developing Countries (Cambridge: Cambridge University Press, 1996).

[10] Arvind Panagariya, "Trade Liberalisation in South Asia: Recent Liberalisation and Future Agenda", World Economy, vol. 22, no. 3 (1999), pp. 353-378.

the SAARC in 1985. With the emergence of powerful regional blocs like the Asia Pacific Economic Cooperation (APEC) and the North Atlantic Free Trade Agreement (NAFTA), South Asia also turned its attention to strengthening regional trade cooperation, culminating in the decision to implement a SAPTA in December 1995. However, the SAPTA has come to be regarded as the initial stage of the transition to a more intense form of cooperation under a proposed SAFTA. It should be mentioned here that regional cooperation initiatives providing preferential treatment to members has largely been confined to trade, and have not extended to investment, while India increased the ceiling on investment in the SAARC countries for fast track clearance to US$30 million in May 1999.

The development in economic liberalization by the South Asian countries during recent years is undeniably noteworthy. But, there are a number of inter-country differences in the degree of liberalization, and thus there is room for further improvement in this arena.[11] Conclusively, the evolving patterns of trade and investment in the region reflect the interaction of fundamental economic impulses driving global trade and investment with a process of regional integration, taking place in a group of countries with the distorted and different policy regimes and institutions.

2.2. The trends of FDI flows and its prospective benefits

Most South Asian countries including India[12] have not been regarded yet as the attractive investment destinations by the foreign investors. Also, they did not welcome foreign investment.[13] Consequently, FDI flows were rather minimal until the 1990s. In fact, FDI flows to South Asia started to pick up in the mid-1990s largely as a result of progressive liberalization of FDI policies in most of the countries in the region, and the adoption of generally more outward oriented policies.[14] South Asia

---

11 Arvind Panagariya, "South Asia: Does Preferential Trade Liberalization Make Sense?" World Economy, vol. 26, no. 9 (2003), pp. 1279-1291.

12 Nagesh Kumar, Multinational Enterprises in India: Industrial Distribution, Characteristics, and Performance (London: Routledge, 1990).

13 While it is evident that South Asia has been a region for the operations of multinationals for centuries. The advent of the Dutch East India Company in the sixteenth century exposed this part of the world to foreign capital. Subsequently, the British Raj maintained relative economic openness of this colonial territory as an economic unit in the imperial global order in order to facilitate its economic exploitation.

14 There is indeed a problem with the available FDI figures for the South Asian nations. Often the data available is for approvals, but not for realized investments. Annual data are often cumulated with no adjustments for changes in purchasing power. There are sometimes huge discrepancies between national and international data sources, and among national sources as well. Thus, the data presented here need to be treated with carefulness.

has improved its share in terms of total FDI inflows to the world, developing countries and Asia over the period of 1980-1998. However, the magnitude of inflows attracted by the region remains comparatively meager. According to factual data, South Asia belongs to the "peripheral" circle of countries based on attractiveness as FDI locations in the world.[15] In 1998, it was only US$3.43 billion, a mere 0.5 percent of global flows. In contrast, China received more than 10 percent of all global inflows. Of course, the magnitude of FDI to the SAARC region has come to India.

Although the share of FDI in total fixed investment in the South Asian region has remained comparatively low and stable, the composition and sources of FDI are changing. The foreign investment inflows to the SAARC countries are predominantly from outside the region. The countries of the Organisation for Economic Co-operation and Development (OECD), in general, have the largest share of FDI-led multinationals in South Asia. While the US, Japan and the UK have FDI outflows to all South Asian countries, a number of Asian Newly Industrialized Countries (NICs) including Hong Kong, Singapore, South Korea and Malaysia have a sizeable presence in the South Asia's economies at individual levels. South Korea, for instance, is the largest source of FDI in Sri Lanka, while Singapore and Hong Kong account for a considerable level of FDI in Bangladesh.

As to the sectors of FDI, differences are observed across the countries of the region. The textile & garment sector, with garment being primarily produced for export, has attracted a high proportion of FDI into Bangladesh (28 percent of approvals) and Sri Lanka (16 percent of realization). In case of India, infrastructure (including public utilities) has attracted the bulk (56 percent) of approved FDI, while in Pakistan, the power sector alone accounts for nearly 40 percent of approved investments. In most countries, as in Sri Lanka, the public utilities, such as telecommunications and gas, have received a major share of FDI, driven by the trend towards privatization of public utilities and other state-owned economic enterprises. There are indications that a significant amount of FDI is coming in to exploit the low labor cost advantages of South Asia, and to utilize them as export platforms, while the data are not enough to exactly determine the degree to which non-infrastructure related investments outside the textile & garment sector are export-

15 There are four circles of countries for attracting FDI: "core" (North America, Europe, Japan and the first wave of NICs); "new frontier" (Malaysia, Indonesia, Brazil, etc.); "potential" (Russia, Egypt, etc.) and "peripheral".

oriented or home market-oriented. To the extent that import protection is coming down, the tariff-hopping motive that attracts home market-oriented investments weakens.

Conceding that FDI from outside is far more important than intra-regional investments in most countries, there are signs that intra-regional investments are increasing. The major outward FDI flows are from the Indian firms that have started to expand FDI both within the SAARC countries and outside the region, particularly after the Indian government liberalized its policy administering Indian overseas investments in the early 1990s. There have, of course, been the Indian companies with substantial involvement in joint ventures in the neighboring countries, such as Sri Lanka and Nepal even as far back as the 1970s. Besides, there may have been an unrecorded outward FDI adopted through long established family-linked firms operating in these nations. Furthermore, firms from other SAARC member countries are increasingly undertaking FDI within the region, and investing in a variety of sectors.

More specifically, in spite of India's huge internal market, investments from the SAARC countries have been quite negligible, both in relative and absolute terms, accounting for less than 1 percent of total foreign investment in the country. Bangladesh is the largest investor from the region, followed by Sri Lanka, Nepal and the Maldives. One SAARC country where regional investment dominates in total FDI is Nepal, and India is the single largest investor to Nepal. On the other hand, none of the SAARC member states register as major investors in Pakistan, although data available from Pakistan's Board of Investment (BOI) show that there are some FDI flows from the regional economies, including Sri Lanka. In terms of number of firms, relative contribution to total foreign investment and total investment, India is the largest investor among the SAARC countries in Sri Lanka, followed by Pakistan and the Maldives.

The two major causes of massive poverty and economic backwardness in the South Asian region had already been identified are a lack of investment capital accumulation, and a necessity of regional cooperation. Investment capital can be accumulated through FDI that can be ensured by effective regional cooperation. Unlike East and Southeast Asia where regional cooperation initiatives have contributed significantly to economic growth of the countries within these regions through a rise in inter-regional trade and investment, regional cooperation in South Asia remains weak. An opportunity for accelerated growth and further energizing the economies of the SAARC region does exist by increasing investment through regional cooperation. Therefore, enhancing investment cooperation and facilitating investment among countries in the region will be a stimulus for the development of the economies in the region. Although there are diverse sectors for investment within the region, three sectors including energy, transport & communication, and information technology (IT) have already been identified that can be treated as some of the potential sectors of intra-regional investment. Some more sectors for investment in the region that are yet to be identified include agriculture, tourism, and textile and garment.

2.3. The intra-regional trade and its potentials

The current low level of the SAARC intra-regional trade (i.e., less than 5 percent of total trade) is just partly an outcome of policy.[16] The fact is that the countries share some basic similarities (low income, relatively labor abundant, etc., comparative advantage in similar commodities, such as tea) reduce the potential for comparative advantage driven trade. The low per capita income level also constrains potential for intra-industry trade, generally associated with higher income countries. This does not, however, imply that the current low level of trade is all that can be achieved. On the other hand, the existence of major relative differences among the SAARC nations is also a matter of concern. While India dominates other smaller countries in terms of size,[17] the potential for accelerating intra-SAARC economic ties, in both trade and investment, is not totally absent.[18]

There are several structural changes in intra-regional trade that might be the key indicators of future trends.[19] Textile fibers and machinery & equipment have become increasingly pivotal in intra-regional trade. A large proportion of exports going into the region is now manufactured products, while in the past it was primary products. This shift into manufactured product trade, associated with the level of the region's

16 Manmohan Agarwal, "Regional Trading Arrangements in the Era of Globalization: An Indian Perspective", International Studies, vol. 41, no. 4 (2004), pp. 411-423.

17 T.N. Srinivasan and Suresh Tendulkar, Reintegrating India with the World Economy (Washington, DC: Brookings Institution Press, 2002).

18 Indra Mukherji, "Indo-Sri Lanka Trade and Investment Linkages with Special Reference to SAPTA and Free Trade Agreement", South Asia Economic Journal, vol. 1, no. 1 (2000), pp. 53-77.

19 Isher Ahluwalia and John Williamson (eds), The South Asian Experience with Growth (New Delhi: Oxford University Press, 2003).

industrialization, opens up scopes for scale economies and intra-industry trade to play a vital role. Clearly, the region has expanded its market share of exports of manufactured products, especially in textile & garment during the last decade.

The pattern of change in market shares of the main export products of individual countries indicates that most of them experienced a rather similar pattern of change in export market shares. Measures of trade complementarities reveal that with a few exceptions Pakistan's trade with Bangladesh and Sri Lanka, complementarities are not only rather weak, but have also generally declined over time. Trade intensity indices show a general reduction, proposing that intra-regional trade has become less important. The overall picture that emerges from these analyses is that the region's potential for vitally increased intra-regional trade is at present rather limited. Nevertheless, it is necessary to enumerate that these indices have some salient weaknesses, particularly they are influenced by the determinants of the past policy regime on trade patterns and underestimate the real potentials.

3.0 Directions for the Future

From the regional and global circumstances, in contrast to the volume of intra-trade among the member nations of the EU, the volume of intra-trade within the SAARC countries is very insignificant. In the face of increasing competition in the world economy, while collaborative cooperation among the nations of the South Asian region has become compelling, the globalization process has practically spearheaded the concept of interdependence.[20] Granted that in the South Asian region, there are a number of good possibilities for embellishing a workable economic interaction, which can attain a remarkable uplift of the socio-economic front of the teeming millions here, these potentials are being outshined by huge trade imbalances among the SAARC nations.

Even supposing the SAPTA has been in place for more than a decade, trading within the SAARC accounts for less than five percent of the members' total global trade simply due to differences between India and Pakistan over the disputed region of Kashmir. However, the SAFTA agreement among the nations, effective from the start of 2004, may be seen as having the potential to pave the path to prosperity in this sub-

[20] Achin Vanaik, Globalization and South Asia: Multidimensional Perspectives (New Delhi: Manohar Publications, 2004).

region. While the ASEAN Free Trade Area (AFTA) established in 1992 is viewed as a dynamic model in the Asian trade scenario as well as global economy, the pact by seven SAARC nations which came into effect with the onset of 2006 to set up a Free Trade Area (FTA) looks like a heartening news for the people of this developing region,[21] because it promises to open the markets of all countries to each other by deepening regional trade relations, and thus bring synergy to economic growth. Although this is a good first step, there are a number of challenges toward gaining a FTA in reality.

Notwithstanding, it is shining that the center of gravity of world commerce has recently shifted to the Indian Ocean, South China Seas and the Pacific Ocean, carrying 52 percent of the global output.[22] It is anticipated that the people of Asia and its leaders, by overcoming their shortsighted attitudes, will sincerely unveil their vision of an "integrated, prosperous and poverty-free" Asia in the 21st century. They will work together toward firing the growth engine of the region in order to expand the size of the economic pie, share it equitably, and thus close the disparity gap between the richer nations and the poorer ones. The ASEAN and the SAARC might, in particular, be regarded as the key building blocks for the integration of the entire Asia-Pacific region.

Concerned with FDI, albeit globalization has resulted in vast increase in foreign investment, and the greater inflow of FDI has in turn boosted deeper integration of world economies, the South Asian countries are not still in a position to turn back from FDI due to a number of severe administrative drawbacks and managerial shortcomings. But the region now desperately needs to concentrate on the improvement of its investment environment, and it must develop a comprehensive common investment policy. It is high time that they should at least agree on some fundamental policy frameworks so that there are not much unfair competition among themselves. The other world regions have already realized the implications of regional cooperation, and have taken initiatives accordingly. As a result, they have now started receiving rewards.

The South Asian region needs to learn from their experience. Otherwise, it will lag further behind, and the potential of huge FDI inflows here in South Asia will not be harnessed. Simply providing incentive packages

---

21 SAARC Free Trade Pact Comes into Force", Asian Economic News, 2 January 2006.

22 Gravity of World Commerce Shifted to ASEAN, SAARC", Financial Express, 21 January 2006.

and liberalization measures will not automatically attract FDI, nor has FDI always proved to have a positive impact on economic growth of a country. To ensure that it does, it is necessary that the South Asian governments are retaining the right to choose the types and directions of FDI according to their own necessities. It is redundant to say that in this new epoch of globalization, the investors enjoy enough flexibility, and they may easily transfer their destination when they face any kind of hurdles that adversely affect their businesses. Hence, to attract the foreign investors with an extensive amount of FDI outflows in the near future, the South Asian nations must undertake concerted, aspiring and spirited efforts, by removing all the FDI impediments sooner than later.

4.0 Concluding Observations

It is an undeniable truth that even after considerable liberalization, intra-SAARC trade remains a tiny fraction of cumulative trade of the region, being constrained not only by political and policy factors, but also by underlying similarity of the economies that limits relative advantage driven trade. It may, however, be mentioned that for some of the smaller economies, bilateral trade with a SAARC partner, typically India, constitutes a decisive factor for their overall trade. Also, the relative smallness of intra-SAARC investments in the past is not difficult to grasp, given not only that these are poor, net capital importing countries that had a few firms with the capacity to undertake a plentiful outward FDI, but also that, until recently, quite stringent controls on outward FDI have been in place in most countries, and that they have put forth an inhospitable environment for inward investment.

Both theory and evidence from regional integration arrangements suggest that measures that reduce trade costs among partner countries might offer a stimulus not only to trade but also to FDI. Some specific regional integration efforts could further stimulate the mode of FDI flows among the member countries as well as the outsiders. The SAARC integration initiatives have taken place in the viewpoint of a meaningful liberalization process in all member countries. This has involved both trade and investment liberalization, and the adoption of a pro-FDI stance. Despite many obstacles to trade and investment still remain in most South Asian countries, the regional economies are today far more open than they were until the late 1980s. There is a general acceptance that an expansion of trade and investment confers a large net benefit.

It can fairly be concluded with the following comments that South Asia has frequently been regarded as a "conflict-prone region" or "Kashmir, a nuclear flashpoint". But, there is no denying the fact that the nations of this region, amongst the worst victims, ultimately were able to loosen the two centuries old colonial stronghold after a heroic struggle for independence. The end of the Cold War has indeed brought a number of noteworthy repercussions on South Asia, which might genuinely appeal the attention of Asian powers (particularly China and Japan) to be more responsive to the region's changing needs. It is stimulating that the SAARC nations are now highlighting the importance of access to open markets and increasing FDI in their businesses. They have also come to understand that their earlier restrictive economic strategies will not be in tune with the changing realities of the globalization. In addition, it is noticed in their effective efforts to include future membership for the SAARC.[23] Nonetheless, they need to be more capable to sink some of their deep differences over the political issues to enhance economic cooperation with each other. The seven member states of the SAARC should further understand that the region desperately needs a greater integration to marshal its resources, and help stimulate development that will offer its citizens better lives in the years to come.

---

[23] Afghanistan has been accepted as a new member, but the membership procedures have not yet been completed. China has also been suggested as a possible SAARC member, such membership being encouraged by Pakistan and Bangladesh. However, India is more reluctant about the prospect of Chinese membership, whilst Bhutan does not even have diplomatic relations with China. At the 2005 summit in Dhaka, member states decided to give China and Japan observer status. While the EU has indicated interest in being given observer status, and made a formal request for the same to the SAARC Council of Ministers meeting in July 2006, foreign ministers of the SAARC countries agreed in principle to grant observer status to the US, South Korea and the EU on August 2006.