Towards Greater Economic Connectivity in South Asia

To strengthen economic connectivity in south Asia, members of the South Asian Association for Regional Cooperation should not depend solely on the SAARC framework, and the agreement on the South Asia Free Trade Area. The natural market integration process that started in south Asia with the high growth in India in particular, can give an impetus to strengthening economic connectivity. The private sector in south Asia, through the SAARC Chamber of Commerce and Industry, has to play a key role as a pressure group to remove impediments for economic integration. Steps also need to be taken to not overload the SAARC agenda with soft issues so that economic connectivity issues receive due attention.

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The key theme of the 14th South Asian Association for Regional Cooperation (SAARC) summit concluded in New Delhi in April 2007 was having better connectivity within south Asia. This article presents a critical examination of economic connectivity in the region and a possible way forward to strengthen it.

Although economic connectivity appears attractive to any region, achieving a meaningful connectivity in the SAARC region is not going to be an easy exercise Europe took nearly 50 years to achieve its current level of economic connectivity as demonstrated by the European Union (EU). The EU not only has free trade but also common external tariffs, free movement of labour and capital among member countries, and a common currency with one central bank. The EU moved from a free trade area to a customs union, then to a common market and subsequently to an economic union. Each stage of economic integration was used to do the required groundwork to move towards a more advanced stage. This work was done with a political commitment to achieve a vision articulated by Jean Monet in the 1950s that is one Europe. A study by Chechni et al (1988) on the cost of non-Europe basically provided the political commitment by European leaders to achieve the formation of the EU.

South Asia would ideally like to see the same level of economic integration as seen in Europe and this is precisely what the group of eminent persons (GEP) report of the SAARC argues for, i e, to achieve a SAARC customs union by 2015 and a SAARC economic union by 2020 [GEP 1998]. In other words, by 2020, south Asia will have a high level of economic connectivity with free movement of labour and capital among member nations of SAARC and a common currency for all financial transactions. It will be argued in this article that given the current ground level reality in the SAARC process, it will be difficult for SAARC to achieve the goals of the GEP report. However, economic connectivity in the region will strengthen over the years via market integration. It is also argued that more than the official SAARC process, the natural market integration process in the region taking place via various unilateral liberalisation measures of individual SAARC countries and cross-border trade and investment induced by high growth in the region will play a more prominent role in strengthening connectivity in coming years.

Background

When SAARC was formed in 1985, economic issues were deliberately left out of the SAARC agenda. It was felt that economic issues were too complex to be incorporated into the SAARC agenda when the task was to engage in confidence-building to iron out the deep- seated inter-state mistrust in the region. Cooperation on non-economic issues was considered to be non-controversial and therefore, desirable. Most non-economic issues were soft and easy to agree upon: sports, culture, education, etc. Perhaps the only economic issue that entered the SAARC agenda during the early days of the association was the need to combat poverty in the region and setting up of an independent commission to look into the matter in 1991. Poverty, too, was non-controversial and there was unanimity on the issue. Other than poverty, during the first decade of SAARC's operation, there were hardly any measures taken to promote economic cooperation in the region.

It was during the start of the second decade of SAARC that economic cooperation came into its agenda. With the birth of the SAARC Preferential Trade Arrangement (SAPTA) in December 1995, a key component of economic connectivity, i e, "trade" made an entry into the SAARC agenda. Intra-regional trade in goods was to be granted trade preferences by the SAPTA. Before the birth of the SAPTA, the private sector chambers of south Asia took note of the existing open economies of the region, especially after India's reforms in 1991 and formed the SAARC Chamber of Commerce and Industry (SCCI) in 1992 to promote trade and investment flows in the region.

The SAPTA was based on a "positive list" approach and thus, the negotiations were based on a product-by-product approach, which is a time-consuming process. Moreover, most actively traded goods were left out of preferential tariffs and non-tariff barriers were not simultaneously addressed when granting tariff preferences. The SAPTA also became vulnerable to regional politics with a number of negotiation rounds being postponed until the political situation became more conducive for negotiations. Consequently, the SAPTA was not effective in stimulating intra-regional trade in the region, which averaged about 4 per cent.

In 1997, at the ninth SAARC summit, a GEP was formed to set goals and a vision for SAARC so that economic cooperation could be made more meaningful. The GEP suggested the following with regard to economic cooperation: (a) regional economic integration, including negotiating a treaty on South Asia Free Trade Area (SAFTA); and (b) reforming SAARC institutions. It envisaged a SAARC customs union, with the harmonisation of external tariffs by 2015, and a SAARC economic union, with the harmonisation of monetary and fiscal policies by 2020. It also recommended a South Asia Development Fund (SADF) to finance development activities in the least developed member countries.

At the 10th SAARC summit (1998), SAARC leaders accepted negotiations of a treaty for SAFTA and it was suggested that the SAFTA should be achieved by 2001. However, progress with regard to the SAPTA was slow and from 1998 onwards, a number of bilateral treaties for free trade emerged in south Asia. Prominent among them were the India-Sri Lanka bilateral FTA (2000) and the Pakistan-Sri Lanka bilateral FTA (2005). The India-Nepal trade treaty was formalised in 1996 and negotiations were under way for a possible Bangladesh-India bilateral FTA. Obviously, these bilateral deals diverted attention from the SAPTA. These bilateral FTAs mostly used a "negative list" and fast track tariff liberalisation, which never featured in the SAPTA.

SAFTA Treaty

The SAFTA treaty was ratified at the 12th SAARC summit in early 2004 and SAFTA came into operation in July 2006. SAFTA unlike the SAPTA is based on a negative list and has an eight-year tariff phasing out period. Prima facie, SAFTA looks an attractive framework with a negative list, a clearly defined tariff phasing out programme, transparent rules of origin, etc, compared to the SAPTA in strengthening economic connectivity in the region. However, SAFTA has a negative list that can go up to 20 per cent of tariff lines and a detailed analysis has shown that as a result of large negative lists in member nations, 53 per cent of regional imports are excluded from SAFTA tariff preferences [Weerakoon and Thennakoon 2006]. In other words, as in the SAPTA, the actively traded goods seem to have been left out of the SAFTA framework. The SAFTA framework also does not articulate how the SADF will be used to enhance the supply capacity of the SAARC less developed countries (LDCs) [Kelegama 2004].

Besides the problems in SAFTA, a major problem that has slowed down economic integration in the region is the issue of special and differential treatment for LDCs. This problem has exacerbated consequent to the expansion of SAARC before consolidating the regional grouping with the entry of Afghanistan. With Afghanistan as a new member, the total number of LDCs in SAARC has increased to five and consequently, the SAARC agenda is going to be dominated by issues relevant to LDCs such as revenue compensation, anti-dumping and safeguard measures, negative lists, etc. It is a well known fact that the SAFTA, ratified in January 2004, took nearly one and a half years to become a formal treaty due to issues of concern to LDCs such as revenue compensation. These issues are bound to delay the SAARC connectivity process in the coming years.

Normally, trade in services follows trade in goods. This is how economic integration takes place under a regional trade arrangement. Thus, it must be noted that until trade in goods is deepened, bringing in services liberalisation to the SAFTA framework will be premature. But in the 13th SAARC summit, it was mentioned that trade in services will be brought under SAFTA and for this purpose the SAARC secretariat was requested to initiate a study on trade in services in the region. Liberalisation of trade in services is a complex exercise and this move once again shows that SAARC is trying to be more ambitious when the basic trade promoting framework is still not in place to create an FTA.

Trade in services already takes place among SAARC countries with the unilateral liberalisation in this area that has already taken place in individual SAARC countries. One way of stimulating trade in services in the region without having a formal General Agreement on Trade in Services (GATS)-plus framework (under article V in GATS) in the SAFTA treaty is by promoting regional services projects such as regional health centres, universities, etc. Already, a south Asian university has been mooted and India is taking steps to establish one. Such a centre will promote the movement of people in the region and improve economic connectivity. Increasingly, such movement of people will trigger more liberalisation of trade in services such as more air travel, visa liberalisation, etc.

Needless to say that the SAARC secretariat has made a concerted effort to promote people-to-people contact by granting SAARC visa exemption to selected professionals (operational since 1992) and recognising some professional bodies under two schemes [SAARC 2002]: SAARC regional apex bodies (SCCI, SAARCLAW, South Asia Federation of Accountants) and SAARC recognised bodies (SAARC Architects, SAARC Association of Town Planners, etc). These bodies have certainly facilitated professional interactions but have not contributed much towards improving economic connectivity. It is perhaps by realising this that the Indian prime minister announced the unilateral liberalisation of Indian visas for students, teachers, journalists and patients from SAARC countries at the 14th SAARC summit [SAARC 2007]. In all SAARC countries, mode 4 is linked to mode 3. Thus, professional movement is governed by intra-SAARC investment, which is currently at a low level.

It must be mentioned that the transport links between India and Sri Lanka via air services have improved significantly after the bilateral free trade agreement came into operation in 2000. This happened consequent to unilateral liberalisation measures, with regard to open skies, being implemented by both countries. Sri Lanka also unilaterally implemented a visa at arrival policy from early 2002 to a selected group of countries that included India. Consequently, the tourist flow between the two countries has significantly improved with India being the top tourist supplier to Sri Lanka [Kelegama and Mukherji 2006].

The need for more air connectivity was mooted in the 13th SAARC summit in 2006. The Indian prime minister stated that India will pursue an "open skies" policy for other SAARC member countries. However, without other SAARC members reciprocating to such a unilateral gesture, it is difficult to take full advantage of the Indian unilateral offer. What needs emphasis here is that if deeper economic integration via trade takes place, some services liberalisation will be triggered off automatically as in the India-Sri Lanka bilateral FTA. Trying to formalise trade in services before dynamic trade flows in goods occurs may sometimes prove to be counter productive and will be resisted by those with vested interests.

Role of Private Sector

It is said that both the SAARC region private sector and academia are ahead of SAARC governments in terms of ideas that will economically deepen integration in the region. But ideas being generated from the private sector and academia are slow in making an impact on the official SAARC process. Why is this the case? Here, it is imperative to examine various tracks that are functioning under the SAARC process. Basically, if we consider the ministry of foreign affairs driven SAARC official process as track one, then private sector initiatives such as SCCI led proposals and academic initiatives such as Coalition for Action for South Asian Cooperation (CASAC), South Asia Centre for Policy Studies (SACEPS), Indian Council for South Asian Cooperation (ICSAC), etc, could be considered as track two. There are two other tracks, viz, the civil society led track three – South Asia People's Forum and various south Asian NGOs – and track 1.5. Examples of the latter are the earlier mentioned professional bodies under SAARC recognition, Independent South Asian Commission for Poverty Alleviation (ISACPA), SAARC Research Network, SAARCFINANCE, etc, where there is a considerable degree of autonomy from the SAARC official process but the SAARC secretariat gets involved in feeding the final output to the SAARC official process. Unlike track 1.5, both tracks two and three have limited influence on the SAARC official process. It may be useful to analyse the reasons behind this.

The second track documents are usually handed over to government officials as is the case with any other report. However, since they are not initiated by the official SAARC process, they are treated as an outside opinion, which has little relevance for contemporary discussions of the official SAARC process. There is reluctance on the part of the foreign ministries to overload the SAARC agenda with another set of policy proposals from the second track, when the agenda for the SAARC ministerial is already overloaded.

SAARC is too comprehensive in its scope and there is very little progress in the issues that really matter, like the SAPTA. At the summits and at other levels, the agenda has been overloaded with housekeeping matters and soft issues and so focusing on hard issues has become difficult. Many soft projects have not brought tangible benefits for the people of the SAARC region. If an assessment is made on the existing five regional centres in SAARC, viz, the SAARC Agriculture Information Centre, SAARC Tuberculosis Centre, SAARC Document Centre, SAARC Meteorological Centre and SAARC Human Resource Development Centre, it can be found that their contribution to stimulating trade and investment and improving the living standards of the people is insignificant.

A number of suggestions from the private sector have emerged to support economic connectivity in the region. Since, of late, the SCCI has been organising annual business conclaves and various seminars to sensitise people about new opportunities available in the region for trade and investment. Various trade fairs that the SCCI has organised over the years have played a role in bringing buyers and sellers together and promoting intra-SAARC investment. These trade fairs have also facilitated the promotion of tourism in the region. The SAARC Tourism Council under the SCCI has actively promoted tourism. The SCCI has been instrumental in getting some SAARC member country governments creating a SAARC national channel for SAARC citizens in their respective airports. While these could be considered as some achievements of the private sector in enhancing economic connectivity, many other suggestions of the private sector unfortunately are noted by the SAARC official process due to reasons explained earlier.

Natural Market Integration

SAARC is in a unique situation compared to other regional groupings with regard to creating a free trade area because before creating an FTA in the region it has bilateral FTAs within the group (India-Sri Lanka FTA, India-Nepal FTA, Pakistan-Sri Lanka FTA, etc) as well as RTAs that include some SAARC countries with non-SAARC countries (Bangkok Agreement and BIMSTEC). ASEAN, for instance, did not have bilateral FTAs among ASEAN countries before moving to AFTA, and neither did Mercosur. Thus, SAFTA is coming into operation when a "spaghetti bowl" (a la Bhagwati) already prevailing in the region. The challenge for SAFTA is to either supercede them or integrate them. Given SAFTA's timetable, this may prove to be difficult. Thus, the bilateral FTAs will move rapidly, move trade in the region and have a life of their own. This will make the SAFTA framework less useful in moving trade in the region.

In any case, SAFTA suffers an obstacle in tariff liberalisation when Pakistan refused to offer most favoured nation (MFN) status to India for about 700 products. This problem emerged in the finalisation of the negative list of SAFTA before it came into operation. These problems related to SAFTA can be solved if the regional grouping gets strong political leadership to move forward. But with no country offering the required leadership SAFTA will move forward slowly. SAARC enjoyed leadership from India for a brief period during 1997-99 when I K Gujral was India's foreign minister and later, prime minister. India then pursued the "Gujral doctrine" where taking into account the asymmetry in the region, India did not demand reciprocity for its moves with regard to certain trade liberalisation measures. However, this leadership disappeared into thin air after Gujral was no longer in office. Today, SAARC remains leaderless and confined to an organisation that makes high sounding statements at the time of summits and thereafter, remains dormant till the next summit begins for another round of high sounding statements.

It may also be noted that the SAARC economic agenda is highly vulnerable to regional politics. The postponement of SAARC summits due to political reasons has substantially slowed down the economic agenda in the past. When the economic agenda cannot have a smooth existence under the SAARC umbrella, one cannot have much hope for the SAARC official process to bring about rapid economic connectivity [Weerakoon and Wijayasiri 2001].

One key factor that contributed to stimulating economic cooperation among ASEAN countries was the external investment from Japan. When the cost of production increased in Japan, most firms shifted various components of their operations to ASEAN. SAARC is not in a position to attract similar investment from outside the region and thus, needs to look at new avenues. As RIS (2004) argues, the region should adopt a SAARC Agreement on Promotion and Protection of Investment and move towards harmonised investment policies across the region to facilitate intra-regional investment. These steps will assist efficiency-seeking restructuring of industries in the region, enabling them to exploit economies of scale and specialisation. India is a country with exportable capital surplus and could play a major role in other SAARC countries if the enabling environment exists. More than 50 per cent of Indian investment in the SAARC region is in Sri Lanka and the India-Sri Lanka bilateral FTA has played a major role in attracting such investment [Kelegama and Mukherji 2006].

In this situation, more economic connectivity will come through the bilateral track and natural market integration than through the SAFTA framework. The natural market integration will strengthen through economic growth and development in the region, in particular, with the lead taken by India. The recent growth in services in south Asia and particularly in India could be the pillar that could improve economic connectivity in the region. As wages in the services export industry in India rise, some of the activities will relocate to other south Asian countries. Common culture, similar institutions, short distances, etc, reduce costs and risks for a first mover to a new country, and her success provides comfort and encourages other investors. This is basically the spillover effect of rapid development. Moreover, growth in intra-industry trade enhances the neighbourhood advantage. Thus, a flying geese pattern of growth can emerge in south Asia, based on service exports with India as the leader. Perhaps there may be possibilities of promoting south Asia as a premier service export hub in the global economy.

Concluding Remarks

India's high growth is good for the entire south Asian region for there will be spillovers from India's growth to the region. However, to capture the spillovers, the other south Asian countries should work on their infrastructure, and create a stable macroeconomic environment with good governance. Meanwhile, some politically feasible measures should be taken to strengthen the existing SAFTA framework. This would be possible if the SAARC agenda is not overloaded with soft issues as it has been in the past.

First, in order to overcome the problem of the LDC agenda dominating the SAFTA programme, it could be suggested that the SAFTA uses the 3 + X formula (8 > X > or = 0), where if there are three or more countries willing to go ahead with a particular proposal, they can go ahead while the others could join when they are ready. Second, better transport connectivity alone could facilitate exploitation of the open trade environment in south Asia, including trade preferences offered by SAFTA. For instance, direct air connectivity is crucial for businessmen to play an active role in intra-regional trade and investment. Cooperation in this area is not new for SAARC; as early as 1995 a study showed the high cost of non-cooperation in transport [Waqif 1995]. A number of studies have been undertaken in the subject areas by independent research networks/institutions such as SACEPS (2002), CASAC, etc, over the years. According to some commentators, funding for regional transport projects are available from international donor organisations but the political will to go ahead seems to be lacking in the region. This political will needs to be invigorated.

With regard to the role of the private sector, the SCCI economic conclaves should be converted into south Asia economic summits along the lines of the India Economic Summit that is organised annually by the Confederation of Indian Industry in India, where government officials are invited to interact with the private sector. In the Indian Economic Summit, the government officials get a good overall picture of the type of problems the private sector is confronted with and what remedial action is required to solve these problems. The SCCI conclave needs to go beyond the current narrow focus to a mega event with broader participation.

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In terms of output, India is ranked 11th in the world and Pakistan 42nd. In terms of population, south Asia has a 1.5 billion market out of which about 300-400 million people could be considered middle class. If the existing impediments for trade and investment are removed, with the current economic growth in south Asia, many trade and investment activities can take place across the borders. The entire region can grow with more intra-regional trade and this can automatically trigger measures for deepening integration to move towards higher stages of regional economic cooperation. However, for this to happen there has to be a political will to see south Asia as a deeply integrated region. It is only then that economic connectivity in south Asia will achieve the status of contemporary Europe in the near future. EPW

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