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Abstract

Although South Asia was relatively slow to take up the issue of regional economic cooperation, it was quick to set itself an ambitious agenda. In 1993, the proposal to set up a South Asian Preferential Trade Agreement (SAPTA) was accepted by all seven member states of the South Asia Association for Regional Cooperation (SAARC) and SAPTA came into formal operation in December 1995. A year later, SAARC countries agreed to the formation of a South Asian Free Trade Agreement (SAFTA) by 2000, but not later than 2005. Subsequently, the date for establishing SAFTA was brought forward to 2001, but reflecting concerns of some member states, a more practical target of 2008 has since been proposed.

So far, three rounds of tariff negotiations under SAPTA have been completed and concessions of nearly 4700 tariff lines out of a total of 6000 under the HS code system have been exchanged. But the impact of SAPTA on generating trade in the region has been negligible. Intra-regional trade remains disappointingly low, accounting for about 4 percent of trade in South Asia. In the case of Sri Lanka, SAPTA has had no discernible impact on Sri Lanka's trade with the rest of South Asia. This has largely been due to the limited number of concessions, the irrelevance of much of the concessions that have been offered, limited depth of tariff cuts, failure to deal with non-tariff issues and restrictive rules of origin. Political tensions in the region, particularly between India and Pakistan have only served to undermine regional economic cooperation.

Given the limited achievements of the SAPTA process, bilateral trade agreements are now being pursued more vigorously among the SAARC member countries, offering far more liberal and substantial concessions than anything under the regional framework. The Indo-Lanka Free Trade Agreement (ILFTA), signed in December 1998 came into operation in March 2000. More such agreements are in the pipeline, posing a threat to further fragmentation of a common South Asian goal towards regional integration.

The question then remains whether economic cooperation within the framework of a regional arrangement in South Asia has any future. The first step that has to be taken is to acknowledge the limitations of past performance. Although the present quite low level of intra-regional trade is only partly a result of policy, SAARC has to rethink its approach to the trade negotiating process adopted so far. A realistic option to hasten liberalization in the transition to a free trade area appears to be a combination of both a product-by-product and chapter wise negotiations. It will require a more substantive commitment than shown in the past to open markets to each other and a willingness to set aside political differences. Only by insulating the economic agenda as far as possible from regional politics will South Asia begin to achieve any tangible results from closer economic cooperation.

1. Introduction

The global economy witnessed an explosion of regional trade agreements (RTAs) from the latter half of the 1980s to the early 1990s, prompted by the apparent faltering of negotiations under the multilateral framework of the Uruguay Round. South Asia – although slow to take up the issue of regional economic cooperation – also began to take cognizance of developments in the global economy and hastened to implement its own regional trade agenda. The emergence of new RTAs in North America and Latin America and the expansion of existing ones in Europe and East Asia saw the increasing marginalization of South Asia as a region in the global economy. For South Asian countries, in the absence of an entry point into one or more of these more dynamic regional bodies, the next best option appeared to be to cooperate amongst themselves in the hope that it would generate economic benefits in the medium to longer term.

Although South Asia was fairly late in embracing the concept of regional cooperation in trade, it was quick to set itself an ambitious agenda. The proposal to set up a South Asian Preferential Trade Agreement (SAPTA) was accepted by all seven member states of the South Asia Association for Regional Cooperation (SAARC) in 1993 and SAPTA came into formal operation in December 1995 with the ratification of the first round of tariff concessions. In 1996, SAARC member countries agreed in principle to go a step further and attempt to enact a South Asian Free Trade Agreement (SAFTA) by 2000, but not later than 2005. In subsequent developments, the date for establishing SAFTA was inexplicably brought forward to 2001. However, reflecting concerns of some of the smaller economies in the region, the Group of Eminent Persons (GEP) Report recommended a more gradual phase-in of SAFTA with a target date of 2008.[1] In the meantime, South Asia has forged ahead in expanding concessions under SAPTA; the second round of negotiations were completed in 1997 and a third round in 1998. In total,

[1] The GEP envisages establishing a South Asian Economic Union (SAEU) in successive stages, with the first step being the setting up of SAFTA. The implementation is to be initiated in the beginning of year 2000 and completed over nine years – that is, by year 2008. In the case of LDC members, the date of completion was extended to 2010. All NTBs are to be identified in the first year and gradually phased out by 2008 for non-LCD members and by 2010 for LDC members. In the second stage, a South Asian Customs Union (SACU) is to be created by the year 2015. In the third stage, a South Asian Economic Union is to be established by the year 2020.

SAPTA concessions have covered nearly 4700 tariff lines out of a total of 6000 under the HS code system.

Despite the apparent progress made in pushing ahead with SAPTA negotiations, the actual trade impact on the region's economies remains nebulous; the trade coverage of SAPTA concessions have been limited while other non-tariff barriers and bureaucratic hindrances have constrained countries from benefiting from the agreement. Political tensions in the region, particularly between that of its major partners – India and Pakistan – have only served to undermine the agenda in economic cooperation. The political impediments that SAARC faces are quite different to those faced by other regional groups such as the EU and ASEAN which had to face a common external threat such as Soviet and Chinese communism rather a problem within the group. Although cooperation amongst the SAARC members are based on areas of mutual cooperation where 'bilateral and contentious issues' are specifically excluded from its deliberations, these very problems continue to plague and divide South Asia as a region.

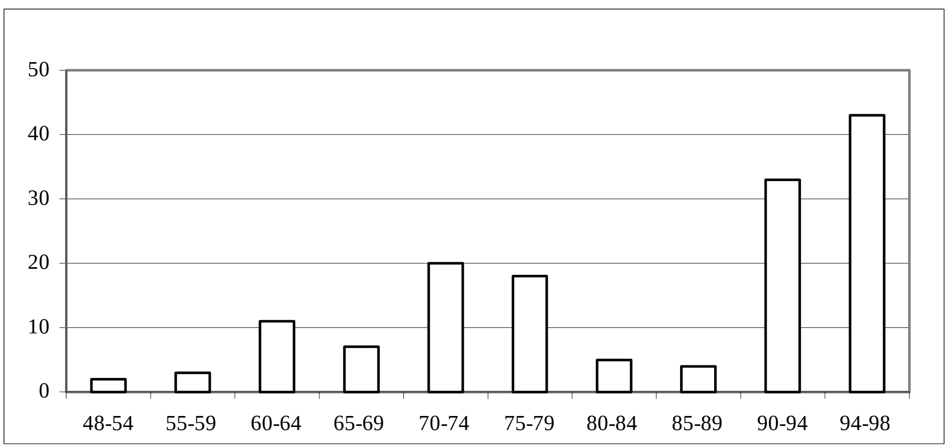
The indefinite postponement of the SAARC Heads of State summit on the heels of renewed tensions between the two countries has focused attention not only on the future of SAARC but also on the feasibility of achieving any sort of tangible results in the arena of trade cooperation. This paper attempts to evaluate the likely costs and benefits to Sri Lanka of membership in South Asian regional initiatives aimed at strengthening economic links. Section 2 of the paper attempts to clarify the perceived costs and benefits underpinning regional trade cooperation. Section 3 details the achievements of SAPTA to date. Section 4 assesses the impact of SAPTA on Sri Lanka's export and import trade and the future prospects for regional cooperation in South Asia in the face of a shift towards bilateralism in the region, paying particular attention to the Indo-Lanka Free Trade Agreement (ILFTA). Section 5 assesses the future prospects for economic cooperation in South Asia while Section 6 concludes.

2. Regional Trade Arrangements: Costs and Benefits

The 1990s witnessed an unprecedented resurgence in establishing Regional Trade Agreements (RTAs) on a global scale. Between 1948 and 1998, 153 regional trade agreements have been notified to the GATT or the WTO, of which most are still in force (Figure 1). While the 1970s also saw a proliferation of agreements, it was on a less dramatic scale than that experienced in the 1990s. Almost a half of the agreements notified to GATT/WTO – albeit revisions of previous agreements in some instances – have been set up since the 1990s.

Many reasons have been put forward for the resurgence in RTAs in the 1990s. The most convincing explanation appears to be that the protracted nature of negotiations under the Uruguay Round encouraged countries to look to regional partners as an alternative means of pushing ahead with a reform agenda. The United States in particular – long opposed to regionalism – initiated discussions on a North American Free Trade Agreement (NAFTA) in the face of seeming intransigence on the part of the European Community (EU) to arrive at an agreement on agriculture under the UR. However, even with the successful conclusion of the UR in 1993, interest in regionalism did not wane. In fact, the enthusiasm for expanding and deepening levels of integration has grown in most regional groupings.

Figure 1
Number of RTAs Notified to GATT/WTO



Source: The Economist, 'A Survey of World Trade', October 1998.

The enthusiasm for RTAs seems disproportionate to the possible gains or losses to member countries. A favoured argument against regionalism is that it will impede multilateral trade reform efforts; that is, that they are "stumbling blocks" more than "building blocks" in efforts at global trade liberalization (Bhagwati, 1993). At the heart of this argument lies the concern that preferential tariffs will cause trade to flow in inefficient ways, a process known as "trade diversion" (Viner, 1950). It occurs if, as a result of a trading arrangement, sourcing of a good is switched from an efficient producer in the rest of the world to an inefficient producer from within the trading bloc. Similarly, "trade creation" would take place when countries in a trading block producing the same good divert production to the more efficient economy as a result of a trading arrangement. Trade diversion is more likely to occur where there are complementary production structures, whereas overlapping product mixes are likely to result in trade creation.

In addition to the problem of trade diversion, it is argued that a free trade area – which by definition allows each country to choose a common external tariff – can also lead to a situation of 'trade deflection'. If each member has different external tariffs, it can encourage imports from a non-member to enter the countries with the lowest external tariff and be transshipped to other members. In order to prevent just such an occurrence, RTAs are typically tied into complex rules of origin (ROO) requirements. However, as ever more complex systems of RTAs emerge, regional trade rules may complicate the creation of new global rules. Some detractors of regional arrangements see the creation of a "spaghetti bowl" of overlapping rules of origin under preferential trade, distorting investment decisions as well (Krueger, 1995).[2] Another frequently cited concern is that as the number of regional groups multiply, they might raise barriers against each other, creating protectionist blocs within the global trading system.[3]

By and large, however, the World Trade Organization (WTO) and its precursor, the General Agreement on Tariffs and Trade (GATT) appears to see a complementarity between regional and multilateral integration.[4] To some extent, this perception is based on more recent developments that have broadened and deepened the international trading system. The UR agreement was innovative in covering new ground, crafting rules to

[2] Such a scenario has prompted some economists to argue that given the political economy problems associated with rules of origin, a Customs Union (which by definition has a common external tariff) is preferable to a FTA (see Krueger, 1995).

[3] For example, in the wake of the financial crises in East Asia, Mercosur raised its common external tariffs to avert an expected flood of imports from Asia.

[4] According to Article XXIV of GATT, groups of countries are allowed to form free trade areas provided they do not increase barriers on imports from outside the group.

govern trade in services and to protect intellectual property for the first time in the history of multilateral trade relations. The WTO is increasingly turning its attention to even more complex and higher levels of integration involving the environment, labour and health issues. RTAs have taken the initiative in many of these areas as opposed to the multilateral framework and therefore, are seen as laying the foundation for future progress under multilateral negotiations (Fernandez, 1997; Srinivasan, 1998).

An explanation for continuing support of RTAs remains elusive. The debate on their costs and benefits – whether theoretically or empirically – remains largely unresolved. However, there are many who argue that RTAs may confer benefits other than those related purely to trade expansion (Fernandez, 1997). It might allow a country pursuing economic liberalization to sell its reform agenda more easily if it is being perceived as a regional initiative. At a more advanced level of integration, perhaps even involving coordination of macroeconomic policies, a RTA might also be a buffer against the problem of time inconsistency. For example, a country tempted to provide protection to some sectors could well be in danger of inviting retaliatory measures from other members of the RTA. Thus, the cost of either exiting from the agreement or bearing an agreed upon punishment could be a deterrent to ad hoc policy changes.

At a more fundamental level, RTAs could provide increased competition and increasing returns. Access to an increased market can lead to greater productive efficiency for any industry with economies of scale. Moreover, spillover effects of attracting greater foreign investment can be another driving feature. A RTA can stimulate and increase foreign investment not only from within the regional grouping, but also from outside the RTA (Balasubramanyam and Greenaway, 1993).

In the case of South Asia, while a number of empirical studies have looked at the prospects for regional integration, the results are mixed. A 1993 World Bank study concluded that most of the pre-conditions required for a successful trading arrangement were not present in South Asia (De Melo et al., 1993). These pre-conditions included: high pre-arrangement tariffs; a high level of trade in the region before the arrangement; the existence of complementary rather than competitive trade; and differences in economic structures in countries concerned. The study found that only the first condition was met in the case of South Asia and it concluded that the region would be better off liberalizing trade unilaterally and by joining an already established group.

Empirical research by Srinivasan and Canonero (1993) and Srinivasan (1994) suggest that although potential gains from preferential liberalization are less than those from unilateral liberalization, they are substantial; and that smaller countries are likely to gain more than larger countries from regional integration. A simulation using a gravity model shows that the effect of removing all tariffs would be to increase total trade between 3 per cent of GDP for India and 59 per cent of GDP for Nepal and in between for other countries. A 50 per cent reduction in tariffs would increase trade between 1 per cent of GDP for India and 9 per cent of GDP for Nepal.[5] On the other hand, Rajapakse and Arunatilake (1997) who also use a version of gravity model find that the expansion of trade is larger, the larger the economy. For example, Sri Lanka's bilateral trade with India is estimated to increase by 22 per cent of Sri Lanka's current total trade, while the corresponding figure for Nepal is 0.4 per cent. South Asia is also deemed to be better off dealing with other regional arrangements as a group rather than individually (Srinivasan, 1994). The potential gains for South Asia is estimated to be highest with the EU, though a strategic tie-up with East Asia may also be beneficial.[6]

While the gravity model has a number of advantages in analyzing intra-regional trade, particularly for preferential trade agreements, it also has many limitations. It does not take into consideration the possible impact of the terms of trade associated with trade creation. Hence, the simulated results based on a gravity model are generally biased upwards. The estimates also give the results in a static framework and the extent of intra-regional trade will possibly increase further if the estimation is carried out in a dynamic framework, incorporating the effects of factors like terms of trade, scale economies, technology spill-overs, investment flows, etc. It is very difficult to estimate the parameters related to some of these factors. However, a number of existing studies have shown that the short-term impact is higher than the dynamic impact. In addition, most of

[5] See also Mehta and Bhattacharya (1999) who suggest that complete free trade (elimination of tariffs) will increase intra-regional trade by 1.6 times the existing level.

[6] DeRosa and Govindan (1997) suggest that while SAPTA could provide substantial benefits for the region, South Asian countries may achieve much larger gains in trade and economic welfare by intensifying efforts to integrate their economies with the world or with faster growing economies of the Asia Pacific region. They argue that focusing on regional trade preferences could jeopardize progress of general trade liberalization in the region.

the studies based on the gravity model do not take into consideration inhibiting factors in the form of NTBs.

Besides looking purely at the trade impact, other studies have attempted an assessment of the welfare consequences of preferential and unilateral liberalization. The World Bank (1997) has used the Global Trade Policy Analysis Project (GTAP) model, which takes into account the production structure of each region of the world, bilateral trade between regions, and major global trade distortions (Pigato et al., 1997). The results from the study suggest that regional liberalization will generate significant welfare gains both for India and the rest of South Asia. However, India's gains are estimated to be much higher under unilateral liberalization than under preferential liberalization. On the other hand, the benefits to the rest of South Asia from preferential liberalization are larger than that from unilateral liberalization. Besides the welfare gains suggested by the simulations, the case for encouraging an intensification of regional cooperation rests on broader considerations. First, the study suggests that it could complement efforts to open up to world competition and make the region a more attractive location for multinational companies and foreign capital. Second, and most important, it is considered a step towards better political relations and peace. It is argued that additional economic benefits from reduced military spending following a settlement of regional disputes could well be substantial.

Jayaraman (1978) has extended the analysis beyond a free trade area to look at the static effect of a hypothetical customs union in South Asia (comprising Bangladesh, India, Pakistan and Sri Lanka). The study suggests that a customs union becomes beneficial only when the post-union common external tariff (CET) structure consists of the lower pre-union tariff rate. However, the gains are of a small magnitude. Under all other alternative post-union external tariff structures, the net effects produce a welfare loss, with the minimum being when the post-union external tariff is fixed at the highest pre-union rate. As far as individual countries are concerned, Nepal and Sri Lanka appear to be the countries that will gain the least, and lose the most from the formation of a customs union. Such a result is not surprising given that typically both Nepal and Sri Lanka would be expected to have low tariff structures before the union compared to other South Asian countries. Another study on the static welfare effects of a South Asian customs union that computed the CET by taking the weighted average rates of all country averages showed that the expected welfare gain for the region as a whole is likely to be quite modest, not exceeding 0.07 per cent of the region's total national product (Rahman et al., 1981). It is significant to note that both Nepal and Sri Lanka would have to sustain a loss of welfare under this scenario. The reason for this is that their post-customs union rate is assumed to be higher than the pre-customs union tariff rate and hence the trade diversion effects would exceed the trade creation effects.

Thus, the empirical results, appear to be mixed and offer different interpretations of the costs and benefits (of both trade and welfare) that South Asia may experience at deeper levels of economic integration. While some studies appear to suggest that the smaller countries will benefit (in trade and welfare terms), this is found not to be the case in other studies. While most of the studies do appear to suggest that there are gains to be had for South Asia from pursuing a path of regional economic cooperation, most appear to suggest that unilateral liberalization initiatives are likely to prove more beneficial.

3. The Experience of Economic Integration in South Asia

Although acceleration of economic growth through regional cooperation was incorporated as an objective of the South Asian Association for Regional Cooperation (SAARC) Charter in 1985, it was not until the late 1980s that South Asian governments made an explicit commitment towards promoting an economic agenda. A Committee for Economic Cooperation (CEC) was set up in 1991 to examine a proposal for a South Asian Preferential Trade Agreement (SAPTA), the framework of which was finalized in 1993. Simultaneously, most South Asian economies (with the exception of Sri Lanka) were also engaged in accelerating the liberalization of their economies unilaterally. Thus, the impetus for regional economic cooperation came not only from events shaping the global economy, but also from within the region. The rest of this section examines the trade liberalization experience in South Asia and regional economic cooperation under the aegis of SAARC.

3.1 Trade Liberalization in South Asia

South Asian countries, that had very open economies in the immediate post-independence period in the 1940s, had become some of the most highly protectionist in the world by the 1970s. Tariff and, even more importantly, non-tariff barriers (NTBs) 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. But 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 in the 1980s. However, this was 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, that the region as a whole really started to liberalize. By the end of the decade, though important policy barriers to trade and foreign investment remained throughout the region, enormous progress had been made in the direction of trade liberalization. But it should be noted that even by the mid-1990s, in a global comparison of import protection rates, South Asia remained a highly protected region (Blackhurst et al, 1996). The situation that prevailed in the early to mid 1990s is shown in Table 1.

Table 1

Status of Trade Liberalization Measures in South Asia

Criteria	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Exchange Rate	Unitary	Unitary	Unitary	Unitary	Unitary
Exchange Rate Determination	Managed Float	Managed Float	Pegged[1]	Managed Float	Free Float
Payment Restrictions					
Current Account	No	No	No	No	No
Capital Account	Yes	Yes	Yes	Yes	Yes
State Monopolies in External Trade	Yes	Yes	Yes	Yes	Yes
Import Licences	Yes	Yes	Yes[2]	Yes	Yes[2]
Simplification of Tariffs	Yes	Yes	Yes	Yes	Yes
Average Tariff –1995 (unweighted) %	42	48	17	51	24
Maximum Tariff Rate - 1997	45	40	110[3]	45	35
Existence of High Level of NTBs	No	Yes	No	No	No

Note: 1-Pegged to Indian Rupee; 2-Coverage is very limited; 3-But most items have tariffs between 20-30 per cent, hence low average.

Source: Samaratunga (1999); Weerakoon (1998).

Notwithstanding tariff reductions, most of the countries continue to maintain significant quantitative restrictions (QRs). In the case of Sri Lanka, practically all import licences have been removed (with the exception of around 12 items on grounds of national security, public health and environment). At present, only four items remain under export licence. On the other hand, India, for instance, restricted the import of consumer goods on balance of payments considerations until April 2001 when they were removed under a WTO directive. Some 210 agricultural, mineral and metal items still remain under export restrictions. Bangladesh maintains QRs on 40 imported items while a large number of 'essential' items such as livestock, fruits, vegetables, sugar and edible oils are highly protected. Pakistan has minimum import controls on the grounds of health, safety and procedural reasons. Thus, despite the policy reform process, South Asia as a region still lags significantly behind in terms of its 'openness' to trade with the rest of the world (Table 2).

Table 2
Openness in South Asia and Southeast Asia Trade Share of GDP (%)

	1980	1990	1999
SAARC			
Bangladesh	24	23.3	29.6
India	17	16.4	19.2
Nepal	30	24.4	43.8
Pakistan	37	36.5	32.7
Sri Lanka	87	64.5	76.9
ASEAN			
Indonesia	54	44.2	62.4
Malaysia	113	138.3	202.0
Philippines	52	49.6	99.2
Singapore	440	327.4	295.5
Thailand	54.5	70.0	107.4

Source: World Bank, World Development Report, various years.

3.2 South Asian Trade Cooperation

Historically, the SAARC member countries have not been trading among themselves to any significant extent. The low complementarity of products of the region's economies as well as the trade policy regimes followed by South Asian countries have acted as inhibiting factors. As indicated by Table 3, intra-SAARC trade accounted for less than 4 per cent of trade in South Asia for much of the 1980s but has gradually increased to 4.4 per cent by 1999. Intra-SAARC exports accounted for 4.6 per cent of SAARC's exports to the world and the corresponding share of intra-SAARC imports was even lower at 4.1 per cent in 1999. The share of imports from South Asia for the two largest economies in the region – India and Pakistan – remain disappointingly low at approximately 0.8 and 1.9 per cent of their total imports respectively (Table 4). Bilateral trade imbalances in the region are, therefore a contentious issue. With the exception of Pakistan, all other South Asian economies are running significant trade deficits with India. The low volume of intra-SAARC trade is a reflection of the fact that much of the trade of South Asian economies is with developed countries. The industrial economies of the EU, USA and Japan together accounted for the following percentage shares of trade in 1998: Bangladesh (86.5 per cent); India (56.5 per cent); Maldives (68.2 per cent); Nepal (61.2 per cent); Pakistan (60.1 per cent); and Sri Lanka (76 per cent).

Table 3
Intra-SAARC Trade

	Intra-SAARC Trade (US $ mn)	World Trade of SAARC Countries (US $ mn)	Share of Intra-SAARC Trade in World Trade of SAARC Countries (%)
1980	1210	37885	3.2
1985	1054	44041	2.4
1990	1584	65041	2.4
1995	4228	104159	4.1
1996	4914	111479	4.4
1997	4390	115961	3.8
1998	6073	121331	5.0
1999	5640	129738	4.4

Source: IMF, Direction of Trade Statistics, Yearbook 1999.

The low intra-regional trade of SAARC as a percentage of its total trade with the rest of the world is probably one of the lowest among regional groupings in the world. In 1999, for example, intra-SAARC trade was 4.4 per cent, which compared poorly with 63 per cent for intra-European trade, 37 per cent for North America and 38 per cent for East Asia (IDCJ, 1996). Given that the share of intra-ASEAN trade with the rest of the world was 7 per cent at the time of its establishment in the 1960s, the low level of trade amongst the South Asian countries is a cause for concern in attempts to successfully push ahead an agenda for regional economic integration.

Table 4
Percentage Share of Intra-Regional Trade in SAARC: 1999

	Share of Intra-SAARC Exports in Total Exports	Share of Intra-SAARC Imports in Total Imports	Share of Intra-SAARC Trade in Total Trade
Bangladesh	1.9	13.6	9.5
India	5.0	0.8	2.8
Maldives	5.2	2.5	3.3
Nepal	28.5	31.7	30.8
Pakistan	3.6	1.9	2.7
Sri Lanka	2.8	12.3	8.6
SAARC	4.6	4.1	4.4

Source: IMF, Direction of Trade Statistics, Yearbook 1999

Despite the low complementarity of trade in South Asia, the potential economic benefits of cooperation were considered attractive enough to prompt the establishment of SAPTA. The first round of concessions came into effect in December 1995 where tariff concessions were exchanged on a total of 226 products under the HS Code system on a product-by-product basis.[7] The second round also adopted the same negotiating method and was completed in November 1996 with the exchange of concessions on an additional 1900 products. The third round of negotiations was completed in November 1998, combining both a product-by-product and chapter wise approach to include further concessions on nearly 2500 tariff lines at 6-digit level of aggregation. With the conclusion of the third round, over 4600 tariff lines out of a total of 6000 have been covered by preferential access (Table 3).[8] India has offered the largest number of concessions followed by Bangladesh, Pakistan and Nepal. The LDC member states within SAARC have also been offered a larger share of such concessions vis-à-vis the non-LDC states.[9] It has to be noted that the total concessions offered to all member countries still remains very limited at only 1900 of a total of 6000 tariff lines available for concessions.

[7] This entails an exchange of 'offer' and 'request' lists of goods on a bilateral basis where the results are later multilateralised.

[8] It must be noted that the total number of tariff lines covered at the end of the third round of negotiations is subject to variation. For our purposes concessions have been aggregated to 6-digit level of the HS code. Other studies suggest a wide variation. For example, Udegedera (2001) has found the total number of tariff lines covered at the end of the third round to be 5553, while Mukherji (2000) estimates the total to be 3257.

[9] Bangladesh, Bhutan, the Maldives and Nepal are considered LDC member states within SAARC.

Table 5
SAPTA Preferences: SAPTA 1-3[a]

	LDC		All		Total	
Bangladesh	144	(44)	407	(558)	521	(602)
Bhutan	124	(122)	109	(68)	233	(193)
India	2082	(2412)	472	(484)	2554	(2896)
Maldives	6	(369)	172	(19)	178	(388)
Nepal	163	(177)	328	(252)	491	(429)
Pakistan	229	(242)	262	(284)	491	(517)
Sri Lanka	44	(52)	155	(144)	199	(196)
SAARC	2762	(3418)	1095	(1770)	4667	(5218)

Notes: a. the figures in parentheses indicate concessions offered at 8-digit level HS code.
Source: Compiled from the Consolidated National Schedule of Concessions of Member States.

While a product-by-product approach allows a certain amount of flexibility – each member country can decide its own line of commodities and tariff rates for preferential treatment to other members – it can also be a time consuming method of attempting to liberalize trade. And there are also more inherent problems of using preferential trade concessions as a means of increasing trade volume within any given regional framework.

Table 6
MFN Tariff Rates and Tariff Range Negotiated under SAPTA

Country	MFN Tariff Rate		Tariff Range[a] SAPTA-1	SAPTA-2	SAPTA-3
Bangladesh	0-40	Non-LDCs	10	10	10
		LDCs	10	10	10-15
Bhutan	20-50	Non-LDCs	15	10-15	10
		LDCs	10-15	10-15	10-20
India	5-45	Non-LDCs	10-90	10-50	10-25
		LDCs	50-100	50-100	50
Maldives	0-40	Non-LDCs	7.5	7.5-10	10
		LDCs	7.5	7.5-10	..
Nepal	5-25	Non-LDCs	7.5-10	7.5-10	5-10
		LDCs	10	15	10-15
Pakistan	0-45	Non-LDCs	10	10-15	10-20
		LDCs	15	15	30
Sri Lanka	0-30	Non-LDCs	10-20	10-20	10
		LDCs	15-25	60	10-75
SAARC		Non-LDCs	7.5-90	7.5-50	5-25
		LDCs	7.5-100	7.5-100	10-75

Notes: a. as a per cent of MFN tariff rate.
Source: Compiled from the Consolidated National Schedule of Concessions of Member States.

One of its more limiting factors is that the depth of tariff cuts offered under a preferential agreement can again be a limiting factor. As evidenced by the data in Table 6, tariff concessions offered under SAPTA have not been very substantial. India has offered the highest margins but given that its MFN rates are typically higher than those of its partners, this is to be expected. By and large, the LDC members of SAPTA have been offered higher tariff preferences than the non-LDC members.

Table 7

Distribution of Products Offered Concessions under SAPTA

	HS Code Chapters	BD	IN	BH	MD	NP	PK	SL	SAARC
01-05	Live animals, animal products	142	88	1	0	6	10	73	320
06-14	Vegetable products	35	38	6	1	66	35	10	191
15	Animal/vegetable fats and oils	3	46	0	24	0	4	1	78
16-24	Prepared foodstuffs	49	41	54	5	69	58	1	277
25-27	Mineral products	59	10	0	1	3	12	1	86
28-38	Chemical products	48	496	52	7	30	144	18	795
39-40	Plastics and articles	5	153	7	3	18	25	3	214
41-43	Leather products	18	23	15	25	19	17	14	131
44-46	Wood products	29	64	0	45	74	11	0	223
47-49	Paper products	8	58	0	0	1	11	0	78
50-63	Textile articles	40	595	15	4	80	27	11	772
64-67	Footwear	0	38	4	35	19	0	3	99
68-70	Stone, plaster cement	1	35	29	0	6	15	0	86
71	Pearls	3	0	9	0	3	1	0	16
72-83	Base metals	39	160	2	0	18	49	42	310
84-85	Machinery and mechanical appliances	13	403	0	0	26	7	6	455
86-89	Transport equipment	15	2	0	0	8	0	16	41
90-92	Optical, photographic, equipment	6	215	14	0	9	55	0	299
93	Arms and ammunition	0	0	0	0	0	0	0	0
94-96	Misc. manufactured articles	1	89	25	26	36	9	0	186
97-99	Works of art	7	0	0	2	0	1	0	10
	Total	521	2554	233	178	491	491	199	4667

Notes: BD=Bangladesh, BH=Bhutan, IN=India, MD=Maldives, NP=Nepal, PK=Pakistan, SL=Sri Lanka concessions offered at HS code 6-digit level of disaggregation.

Source: Compiled from the Consolidated National Schedule of Concessions of Member States.

In addition to the problem of the depth of tariff cuts, a preferential trading agreement that is negotiated on a product-by-product basis can also appear very generous simply on the basis of the number of concessions given. What is more relevant, however, is the actual trade coverage of those preferences. Of the nearly 4700 items negotiated for tariff concession up to the third round, most of the concessions offered have been in chemicals (795 items), textiles and clothing (772) and machinery and mechanical appliances (455), as shown in Table 7. India has offered most of its concessions on these same items. Both Bangladesh and Sri Lanka have offered the majority of their concessions in the category of live animal and animal products. The largest number of concessions offered by Pakistan is in chemical products.

4. The Relevance of SAPTA in Generating Trade in South Asia: The Case of Sri Lanka

As previously noted, it is not the number of concessions, but the actual trade coverage of those concessions that are vital in any attempt to raise the volume of trade within any given preferential trade agreement. In this section, an attempt is made to assess the relevance of SAPTA concessions for Sri Lanka vis-à-vis its trade with the rest of South Asia and to assess whether SAPTA has had any positive impact on Sri Lanka's export and import trade with SAARC countries.

As evident from the data in Table 8, Sri Lanka's exports to South Asia in 1999 consisted mainly of vegetable products (42.1 per cent of total exports to SAARC countries), textile articles (19.6 per cent), plastics and rubber articles (8.9 per cent), and base metals (5.1 per cent). But most of the preferential tariff concessions offered to Sri Lanka are irrelevant to Sri Lanka's export interests and thus do not generate much benefit. Of the 1750 concessions offered to Sri Lanka, only a fraction of the total (126) is of export interest to Sri Lanka. The bulk of concessions (539 out of a total of 1750 concessions) has been given to the chemicals sector, which account for 2 per cent of Sri Lanka's exports to the region; while vegetable products, which is the largest export sector to the region received a mere 143 concessions. But even of the 143 concessions extended, only 11 items are being exported by Sri Lanka. While 138 concessions on textile articles have been offered, only 2 items are of actual trade interest to Sri Lanka. Only in the category of plastics and rubber is there some evidence of trade relevance to the country.

Table 8
SAPTA Concessions and their Actual Trade Relevance for Sri Lanka's Exports to SAARC

HS Code	Chapters	Number of Concessions Granted under SAPTA to SL	Concessions on Goods Actively Exported to SAARC 1999	Composition of SL's Exports to SAARC
01-05	Live animals, animal products	56	0	2.6
06-14	Vegetable products	143	11	42.1
15	Animal or vegetable fats and oils	30	10	4.7
16-24	Prepared foodstuffs	123	11	1.3
25-27	Mineral products	73	3	0.4
28-38	Chemical products	539	7	2.0
39-40	Plastics & rubber	79	10	8.9
41-43	Leather products	79	13	0.1
44-46	Wood products	86	26	0.2
47-49	Paper products	15	2	3.6
50-63	Textile articles	138	2	19.6
64-67	Footwear	43	10	0.2
68-70	Stone, plaster, cement	34	0	1.4
71	Pearls	14	0	1.5
72-83	Base metals	96	2	5.1
84-85	Machinery & mechanical goods	51	0	2.0
86-89	Transport equipment	25	1	3.9
90-92	Optical, photographic equip.	40	0	0.1
93	Arms & ammunition	0	0	0.0
94-96	Misc. manufactured articles	77	18	0.4
97-99	Works of art	9	0	0.0
	Total	1750	126	100.0

Source: Compiled from the Consolidated National Schedule of Concessions of Member States and data available from the Department of Customs, Sri Lanka.

As indicated by the data in Table 9, Sri Lanka's major imports are vegetable products (23.8 per cent of total imports from SAARC), textile articles (19.6 per cent), transport equipment (11.3 per cent), machinery and mechanical appliances (9.9 per cent), base metals (8.7 per cent), and chemical products (8.5 per cent). While Sri Lanka has granted a total of 199 concessions, only 68 are actually being imported from the rest of South Asia. The largest number of concessions granted has been in the category of live animals and animal products (73 concessions), but this accounts for less than 4 per cent of Sri Lanka's total imports from South Asia. However, Sri Lanka's concessions on base metals, chemicals and textile articles are likely to prove beneficial to its partners in South Asia. A significant number of products in those categories are in fact being imported into the country from the region.

Table 9
SAPTA Concessions by SL and their Actual Trade Relevance for Sri Lanka's Imports from SAARC

HS Code	Chapters	Number of Concessions Granted under SAPTA by SL	Concessions on Goods Actively Imported from SAARC	Composition of SL's Imports from SAARC
01-05	Live animals, animal products	73	14	3.6
06-14	Vegetable products	10	3	23.8
15	Animal or vegetable fats and oils	1	0	0.1
16-24	Prepared foodstuffs	1	0	3.3
25-27	Mineral products	1	0	0.9
28-38	Chemical products	18	7	8.5
39-40	Plastics & rubber	3	1	2.6
41-43	Leather products	14	2	0.2
44-46	Wood products	0	0	0.3
47-49	Paper products	0	0	3.1
50-63	Textile articles	11	7	19.6
64-67	Footwear	3	0	0.8
68-70	Stone, plaster, cement	0	0	1.5
71	Pearls	0	0	0.4
72-83	Base metals	42	25	8.7
84-85	Machinery & mechanical goods	6	6	9.9
86-89	Transport equipment	16	3	11.3
90-92	Optical, photographic equip.	0	0	0.6
93	Arms & ammunition	0	0	0.0
94-96	Misc. manufactured articles	0	0	0.7
97-99	Works of art	0	0	0.0
	Total	199	68	100.0

Source: Compiled from the Consolidated National Schedule of Concessions of Member States and data available from the Department of Customs, Sri Lanka.

Table 10
Impact of SAPTA on Sri Lanka's Exports to SAARC

HS Code	Chapters	Exports from SL under SAPTA as a % of of Total Exports to SAARC 1997	1998	1999	SL Exports to SAARC as a % Total Exports of Each Sector 1997	1998	1999
01-05	Live animals, animal products		2.4		4.5	3.0	4.4
06-14	Vegetable products	49.7	58.6	55.1	4.4	4.2	6.5
15	Animal or vegetable fats and oils	82.1			85.4	87.0	92.6
16-24	Prepared foodstuffs	36.4	19.1	14.3	2.5	2.8	2.9
25-27	Mineral products	80.1	65.2	65.9	1.4	2.7	2.0
28-38	Chemical products	14.6	0.3		13.0	13.0	9.1
39-40	Plastics & rubber	89.2	3.1	4.1	5.3	3.6	5.0
41-43	Leather products				0.2	0.2	0.1
44-46	Wood products	3.2	13.2	14.2	1.2	2.4	2.4
47-49	Paper products				11.9	12.0	22.3
50-63	Textile articles	1.3	0.6	0.4	0.8	1.1	1.1
64-67	Footwear				0.2	0.2	0.2
68-70	Stone, plaster, cement	47.3	0.9	17.4	2.8	2.6	3.6
71	Pearls				0.4	0.4	1.4
72-83	Base metal	2.0	1.3	2.8	42.7	37.1	32.7
84-85	Machinery & mechanical goods				5.0	1.7	1.5
86-89	Transport equipment				14.0	0.9	25.4
90-92	Optical, photographic equip.	7.2			1.5	0.3	3.7
93	Arms & ammunition				56.6	0.0	0.0
94-96	Misc. manufactured articles	17.1	42.6	30.3	0.3	0.1	0.8
97-99	Works of art				0.0	0.0	0.0
	Total	34.3	24.2	24.6	2.5	2.2	2.8

Source: Estimated from data available from the Department of Customs and Department of Commerce, Sri Lanka.

Given the limited number of concessions and the irrelevance of much of the concessions that have been offered so far under SAPTA and more importantly the limited depth of tariff cuts, it is not surprising to find that it has had no discernible impact on Sri Lanka's trade with the rest of South Asia. As indicated by the data in Table 10, the share of Sri Lanka's exports falling within SAPTA preferences as a percentage of its total exports to South Asia has seen a gradual decline from 34 per cent in 1997 to less than 25 per cent in 1999.[10] At a more disaggregated level, there is some evidence that certain sectors that have received SAPTA concessions have increased the share of exports to South Asia. In

[10] It has to be noted, however, that this is bound to be an overestimate of the actual trade that is taking place under SAPTA preferences. While such exports fall within HS Codes granted preferential reductions under SAPTA, it does not necessarily imply that exporters are in fact filing the necessary rules of origin and other documents to take advantage of the tariff reductions on offer.

the category of vegetable products, exports under SAPTA rose from 49 per cent in 1997 to 55 per cent in 1999 and concurrently the share of exports to SAARC has increased from 4.4 to 6.5 per cent during the same period. The same is true for wood products and miscellaneous manufactured articles which have received the largest number of concessions –on items that are actively traded – relative to other sectors. On the other hand, while Sri Lanka has been successful in increasing the share of exports of paper products to South Asia from 12 per cent in 1997 to over 22 per cent in 1999, the sector has not recorded any trade under the SAPTA agreement. The same can be said about the export performance of transport equipment. In sum, SAPTA has been ineffective in raising the share of Sri Lanka's exports to SAARC. This is evident from the fact that total exports have increased only marginally from 2.5 per cent in 1997 to 2.8 per cent in 1999.

Table 11
Impact of SAPTA on Sri Lanka's Imports from SAARC

HS Code	Chapters	Imports to SL under SAPTA as a % of of total imports from SAARC			SL Imports from SAARC as a % Total Imports of Each Sector		
		1997	1998	1999	1997	1998	1999
01-05	Live animals, animal products	95.38	43.71	0.42	18.9	14.3	15.1
06-14	Vegetable products	21.03	23.81	21.74	39.8	39.2	42.6
15	Animal or vegetable fats and oils				1.4	0.7	1.3
16-24	Prepared foodstuffs				10.1	9.0	8.1
25-27	Mineral products				4.3	6.1	1.4
28-38	Chemical products	11.19	31.23	51.29	15.6	17.0	15.8
39-40	Plastics & rubber	19.07	18.23	6.24	10.2	7.9	6.8
41-43	Leather products	2.32	1.90	4.07	11.2	7.0	5.6
44-46	Wood products				13.9	10.4	7.8
47-49	Paper products				11.5	9.5	11.5
50-63	Textile articles	0.87	1.05	2.63	8.5	9.0	8.8
64-67	Footwear				12.1	13.5	27.3
68-70	Stone, plaster, cement				18.5	17.4	19.9
71	Pearls				0.3	1.0	1.1
72-83	Base metal	3.34	2.69	2.24	25.2	17.3	20.3
84-85	Machinery & mechanical goods	7.63	6.03	4.64	5.7	5.9	7.5
86-89	Transport equipment	7.81	6.94	7.54	18.2	19.2	17.1
90-92	Optical, photographic equip.				5.3	5.2	5.9
93	Arms & ammunition				0.0	1.3	1.9
94-96	Misc. manufactured articles				3.4	4.6	4.4
97-99	Works of art				0.1	0.0	0.2
	Total	12.39	11.78	11.75	11.8	11.6	11.7

Source: Estimated from data available from the Department of Customs and Department of Commerce, Sri Lanka.

Looking at the impact of SAPTA on Sri Lanka's imports, the data in Table 11 suggest that the items on which concessions on actual traded goods were granted have not led to a significant diversion of trade. For example, while there has been a significant increase in chemical products imports under SAPTA, it has not led to a concurrent increase in the share of such imports from South Asia. This is true of imports of textile articles as well. On the other hand, the import share of both vegetable products and footwear from South Asian countries has indicated an increase; but these products were not subject to any significant concessions under SAPTA (in fact, footwear products have not received any concessions at all). What becomes apparent at the aggregate level is that SAPTA has not had any impact in diversifying Sri Lanka's trade towards the South Asian region. The percentage of imports falling within SAPTA concessions in total imports from South Asia has, in fact, declined marginally from 12.4 per cent in 1997 to 11.8 per cent in 1999. The end result has been that Sri Lanka's share of imports from SAARC has remained fairly constant, registering 11.7 per cent of total imports in 1999.

Table 12
Revenue Loss Incurred on Account of Concessions Offered to Imports from Other SAARC Countries (US$ '000)

Importing Country	BD	BH	IN	MD	NP	PK	SL	SAARC
Bangladesh		84.8	215.5	0	0	3.0	82.3	385.6
Bhutan	6.2		0	0	14.2	0	0	20.3
India	2453.5	0		6.6	0	1639.0	650.1	4749.2
Maldives	0	0	3.5		0	3.3	11.3	18.1
Nepal	2.8	11.0		0		5.3	27.2	46.3
Pakistan	1654.4	0	844.6	0.8	0		494.2	2994.0
Sri Lanka	8.2	0	714.9	69.4	0	168.3		960.7
Total	4125.0	95.8	1778.5	76.7	14.2	1818.8	1265.1	9174.2

Source: Mukherji, 2000.

An equally important issue in trade negotiations is the substantial loss in revenue that countries would suffer as a result of trade liberalization, which would need to be addressed adequately. As indicated by Table 12, the estimated total revenue loss from trade liberalization under the three rounds of SAPTA negotiations amount to US$ 9.2 million. The largest revenue loss is sustained by India (US$ 4.8 million), equivalent to nearly half of the total revenue loss sustained by the whole region. This was to be expected given that India's existing MFN rates were higher in comparison with other countries in the region, and India offered the largest number of concessions and highest tariff preferences under SAPTA. Next to India, Pakistan sustained a loss of nearly US$3 million – about one-third of the total revenue loss of the region. Sri Lanka's revenue loss amounted to roughly US$ 1 million. The remaining countries – Bangladesh, Bhutan, Nepal and Maldives – sustained modest revenue losses. While revenue losses to date have been marginal (given limited concessions under SAPTA), it has to be kept in mind in the event of more substantial liberalization. However, it is also important to note here the possibility that as a result of tariff reductions, preferential imports could increase, offsetting the revenue loss.

The inevitable conclusion that can be drawn from a simple assessment of current trade flows is that SAPTA to date has had no significant impact in changing the existing trade patterns of Sri Lanka vis-à-vis its South Asian partners. The limited progress so far has been due to various reasons, including inherent limitations of the SAPTA agreement and the negotiations conducted so far. Negotiations have been mainly on a product-by-product basis, although in the third round negotiations were conducted by some countries on a sectoral basis. But this has been confined in its extent. Only India and Bangladesh have offered concessions across sectors and even then only a limited number of items have been offered preferential tariff concessions. Moreover, many of the products offered concessions are not widely traded in the region. Preferential margins have also been very small, except for those granted in favour of the LDC members.

In addition, SAPTA has so far been confined solely to the issue of tariff cuts. Although there are provisions in the agreement to negotiate on para-tariff and non-tariff measures, it does not specify a definite and binding timeframe for their elimination. Whilst all the SAARC countries have in the recent years unilaterally liberalized their trade regimes, considerable trade barriers – especially in the form of quantitative restrictions – remain.[11] While the issue of NTBs has been raised in the negotiations, a commonly acceptable

[11] While some progress in eliminating NTBs has been achieved – for example, India removed NTBs on nearly 2000 products for all SAARC countries in August 1998 – non-tariff and para-tariff barriers continue to pose an obstacle to the free flow of goods within South Asia.

resolution to the problem has not been found. Tariff concessions alone will, therefore, not generate significant gains.

Like many other preferential trade agreements, SAPTA also has rules of origin requirements built in to the agreement.[12] The system of ROO is a useful mechanism to facilitate value addition and augment the volume of intra-regional trade. It is also a mechanism that is commonly used to prevent trade deflection in regional trade arrangements and allow contracting parties to be the beneficiaries of preferential tariff arrangements. On the other hand, it is often argued that ROO might favour high cost and inefficient production and even inhibit intra-regional trade.

In order to qualify for concessions under the SAPTA Agreement, non-LDC countries were compelled initially to have a domestic content of 50 per cent (and 40 per cent for LDC members). This was deemed too high a domestic content requirement, particularly for a small country like Sri Lanka with a limited resource base. In 1999, the ROO requirements were subsequently revised downwards to 40 per cent for non-LDCs (and 30 per cent for LDC members). Despite the downward revision, ROO requirements are still more restrictive than those under other trade agreements in the region.[13] It is estimated that at ROO of 40 per cent, only a third of Sri Lanka's total exports qualify for preferential treatment (Pitigala, 1998). For processed agricultural exports, the share of imported raw materials in total output could be as high as 51 per cent (Table 13). For the industrial export sector as a whole, import content in FOB value appears to lie in the range of 40-70 per cent.

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[12] Whether or not a product has originated from a particular country is determined on the basis of the product having undergone substantial transformation. That is, the final product should be distinct from its constituents. Three common methods of determining originating status of products are as follows: (i) a change in tariff heading test whereby the tariff heading of the final product is different from the tariff headings of its components; (ii) a percentage test according to which a minimum percentage of total value addition should be achieved on the basis of domestic inputs and; (iii) specified process tests that require a product to undergo certain stipulated processes.

[13] Under the Indo-Lanka Free Trade Agreement, for example, products having a domestic value addition of 35 per cent will qualify for preferential market access. In addition, those Sri Lankan exports having a minimum 10 per cent content of inputs originating from India will qualify for preferential market access under a reduced total domestic value addition of 25 per cent.

Table 13
Import Content in Sri Lanka's Exports

HS Code	Chapters	% Share of SL Exports to South Asia	% of Imported Inputs in Total Output A	Import Content as a % of FOB Value B	Import Content as a % of FOB Value C
01-05	Live animals, animal products	2.6			
06-14	Vegetable products	42.1			0-5
15	Animal/vegetable fats and oils	4.7	6-10		0-5
16-24	Prepared foodstuff	1.3	38	51	
25-27	Mineral products	0.4			
28-38	Chemicals, pharmaceuticals	2.0	36-58	65-70	30-40
39-40	Plastics & rubber	8.9	23-44	40-55	5-35
41-43	Leather products	0.1	50		
44-46	Wood products	0.2	0-13	40-55	
47-49	Paper products	3.6	35-41	40	55
50-63	Textile articles	19.6	44-47	60-70	0-55
64-67	Footwear	0.2	33		
68-70	Stone, plaster, glass, cement	1.4	15-28	79	24
71	Pearls	1.5			
72-83	Base metal	5.1	42-63	60	60
84-85	Machinery & mechanical gds	2.0	39-63	75-85	60
86-89	Transport equipment	3.9	25	85	
90-92	Optical, photographic equip.	0.1	18		
93	Arms & ammunition	0.0			
94-96	Misc. manufactured articles	0.4	64	40-60	
97-99	Works of art	0.0			
		100.0			

Notes: A: Estimated from data available from the Dept. of Census and Statistics, Annual Survey of Industries 1998. It has, however, to be noted that the import content as a per cent of total value of production is a likely underestimate of import content as a per cent of FOB value.
B: Data made available from the Dept of Commerce.
C: Data collated from a preliminary survey.

Source: Dept. of Census and Statistics, Annual Survey of Industries 1998 and Department of Commerce.

4.1 The Drift Towards Bilateralism in South Asia: Is it a Threat to SAARC?

The major impediment to economic cooperation amongst the SAARC countries has long been recognized as being political rather than economic per se. In South Asia, political divisions, lack of confidence and conflicts have hampered the process of regional cooperation. Tensions between India and Pakistan, and to a lesser degree the natural preponderance of India among the other South Asian countries, have hampered regional cooperation. The political constraints to economic cooperation is most clearly evident from the recent experience where the SAARC agenda has come to a virtual standstill since the outbreak of tensions following nuclear test explosions in South Asia in early 1998. A resultant development of that stand-off has been the shift in focus to bilateral trade agreements between SAARC member countries. The rest of the section examines in some detail the impact of bilateral agreements – with special reference to the Indo-Lanka Free Trade Agreement (ILFTA) – in the context of the prevailing political backdrop to the SAARC process.

The concept of strengthening bilateral trade cooperation between India and Sri Lanka has been pursued since the early 1990s.[14] However, the decision to accelerate trade cooperation through a wider regional framework under SAPTA served to push the bilateral agenda more or less to the background. Given the limited achievements of the SAPTA process, it was increasingly felt that countries willing to embark on ‘fast-track’ liberalization should proceed at a quicker pace and allow other members of SAARC to join the process at a slower pace. However, with the decision to implement the ILFTA, the process was in reality taken out of the regional ambit altogether, giving fresh momentum to more such bilateral agreements in the future.

Under the ILFTA, India agreed to remove tariffs on 1351 products, immediately upon the coming into force of the treaty.[15] However, both countries agreed to maintain negative lists that will safeguard ‘sensitive’ domestic industries whereby the FTA would not apply to items placed under such a list. India submitted a negative list of 429 items and agreed to phase out prevailing tariffs on the balance items over a span of three years: 50 per cent reduction of Indian customs duties in the first year; 75 per cent in the second year; and 100 per cent in the third year.[16] Sri Lanka therefore, will be able to have duty free access to the Indian market (excluding those items coming under the negative list) three years after the FTA becomes operative.

[14] See Panchamukhi, V.R., et al., 1993; Jayawardena, L., et al., 1993.

[15] The products were to be named within 60 days of the signing of the agreement. However, the exchange of lists was delayed until March 2000 due to various reasons, including some opposition by both Indian and Sri Lankan interest groups.

[16] With the exception of concessions on textile items in Chapters 51-56, 58-60 and 63 where the margin of preference will be restricted to 25 per cent.

In return, Sri Lanka submitted a negative list consisting of 1180 items and undertook to grant immediate duty free access to India on 319 items. In addition, a 50 per cent margin of preference was offered on a further 889 items, with the preferential reduction raised to 70, 90 and 100 per cent over a three year period. The duty on the balance items (excluding those that do not fall within Sri Lanka's negative list) are expected to be phased out over an eight year period – 35 per cent of the existing duty level by the end of the first three of the eight years; 70 per cent of the existing duty level by the end of the sixth year; and 100 per cent removal of duties by the end of the eighth year. Thus, India will have duty free access to the Sri Lankan market for her exports (excluding those items in the negative list) after eight years of the signing of the FTA.

Table 14
Applicability of FTA to Indo-Sri Lanka Traded Commodities

	Sri Lanka's Concessions		India's Concessions	
	No.	%	No.	%
Negative	623	21.4	50	13.1
0 %	3	0.1	68	17.9
50%	598	20.6	218	57.4
25%	-	-	44	11.6
Other	1683	57.9	-	-
Total	2907	100.0	380	100.0

Source: Compiled from Sri Lanka Customs Database.

The ILFTA also has more relaxed rules of origin requirement vis-à-vis SAPTA, allowing products having a domestic value addition of 35 per cent to qualify for preferential market access. In addition, those Sri Lankan exports having a minimum 10 per cent content of inputs originating from India will qualify for preferential market access under a reduced total domestic value addition of 25 per cent.

Looking at the trade relevance of concessions exchanged, it can be seen that of Sri Lanka's negative list of 1180 items, nearly 623 products were subject to imports from India (Table 14). By contrast, of the Indian negative list of 429 products, Sri Lankan exports consist of only 50 items. Where both countries have zero tariff reduction, India's export interests are again marginal. Of 319 items on which Sri Lanka has reduced its tariffs to zero, the actual number of Indian exports that will benefit stand at only 3 items. By contrast, of the 1351 Indian list subject to zero tariffs, Sri Lankan exporters can expect to gain from 68 products.

Looking at the overall distribution of concessions under the FTA, of the 2907 products being exported to Sri Lanka by India, 21.4 per cent are subject to the negative list, only 0.1 per cent would benefit from zero tariffs and 20.6 per cent have received preferential tariff reduction. Conversely, of the 380 products exported to India by Sri Lanka, 13.1 per cent are subject to the negative list, 17.9 per cent to zero tariffs, 57.4 per cent will enjoy preferential tariff reduction of 50 per cent and a further 11.6 per cent of exports will be subject to preferential duty reduction of 25 per cent.

At first glance it appears therefore that the concessions on the part of India have been more generous than that proffered by Sri Lanka. However, it has to be borne in mind that Sri Lanka's external trade regime is far more liberal than that of its neighbour with nearly 70 per cent of products items subject to a nominal import tariff of only 10 per cent. In attempting to redress the imbalance, the bulk of tariff reduction on the part of Sri Lanka with regard to the FTA will take place over the next 8 years where a significant proportion of the traded items (57.9 per cent) will be subject to further liberalization.

Table 15 sets out the distribution of India's concessions on a chapter wise basis vis-à-vis Sri Lanka's exports to India. Only two traded items under vegetable products have been granted zero tariffs while the majority of it is subject to 50 per cent tariff preference. Similarly, all traded goods under the category of base metals are also subject to the same tariff preference. However, in the cases of both plastics and rubber products and textiles articles, a significant number of export items of interest are subject to India's negative list. Table 13 also looks at the percentage distribution of Sri Lanka's exports subject to concessions under the FTA. The data indicate that nearly 99 per cent of Sri Lanka's exports of vegetable products and all base metal products have gained access to the Indian market at a preferential tariff reduction of 50 per cent. However, more than 91 per cent of exports of plastics and rubber products and 22 per cent of textile articles to India will not gain any benefit from the FTA as these are subject to India's negative list. The bulk of Sri Lanka's traded exports enjoying zero tariffs are to be found in the category of machinery and mechanical goods and paper products. Concessions in the former, however, will have only a limited benefit for Sri Lanka given that it comprises only a very small proportion of exports to India. By contrast, exporters of paper products do stand to gain. Over 90 per cent of total exports of paper products to India can enter the market at zero duty.

Table 15
Concessions Granted by India to Sri Lankan Exports

HS Code Chapters		No. of Concessions Granted by India				% of Exports Subject to Concessions			
		-ve	0%	50%	25%	-ve	0%	50%	25%
01-05	Live animals, animal products			2				100.0	
06-14	Vegetable products		2	18			0.2	99.8	
15	Animal or vegetable fats and oils			3				100.0	
16-24	Prepared foodstuffs			28				100.0	
25-27	Mineral products		2	1			92.0	8.0	
28-38	Chemical products		2	34			0.3	99.7	
39-40	Plastics & rubber	21		10		91.4		8.6	
41-43	Leather products			4				100.0	
44-46	Wood products		6	1			98.1	1.9	
47-49	Paper products	2	18	3		9.3	90.4	0.3	
50-63	Textile articles	27			44	21.5			78.5
64-67	Footwear			4				100.0	
68-70	Stone, plaster, cement			11				100.0	
71	Pearls			4				100.0	
72-83	Base metal			37				100.0	
84-85	Machinery & mechanical goods		36	22			50.5	49.5	
86-89	Transport equipment			9				100.0	
90-92	Optical, photographic equip.		2	8			6.5	93.5	
93	Arms & ammunition								
94-96	Misc. manufactured articles			19				100.0	
97-99	Works of art								
Total	Total	50	68	218	44	13.6	9.9	68.0	8.5

Source: Compiled from Sri Lanka Customs Database.

Table 16 sets out the distribution of Sri Lanka's concessions on a chapter wise basis vis-à-vis Sri Lanka's imports from India. Most of categories of export interest to India are subject to Sri Lanka's negative list. For example, of the 623 traded items on the negative list, 86 items are applicable to the category of vegetable products, 99 items in base metals, 61 in machinery and mechanical goods and 23 in transport equipment. As a result, almost all imports of vegetable products from India will not benefit from the FTA as they are subject to Sri Lanka's negative list. Similarly in transport equipment, nearly 77 per cent of all imports from India fall within Sri Lanka's negative list. In other categories, however the benefits are more evenly distributed. In the category of

Table 16

Concessions Granted by Sri Lanka vis-à-vis Indian Exports

HS Code	Chapters	No. of concessions granted by Sri Lanka				% of imports subject to concessions			
		-ve	0%	50%	Other	-ve	0%	50%	Other
01-05	Live animals, animal products	25			6	17.5			82.5
06-14	Vegetable products	86			8	99.2			0.8
15	Animal or vegetable fats and oils	11			3	84.9			15.1
16-24	Prepared foodstuffs	58			5	35.4			64.6
25-27	Mineral products	8			44	74.4			25.6
28-38	Chemical products	19		124	325	5.9		14.5	79.7
39-40	Plastics & rubber	62			78	52.6			47.4
41-43	Leather products	6			23	61.5			38.5
44-46	Wood products	5			30	35.3			64.7
47-49	Paper products	42			49	74.3			25.7
50-63	Textile articles	16			474	1.9			98.1
64-67	Footwear	22			10	93.5			6.5
68-70	Stone, plaster, cement	33			73	75.0			25.0
71	Pearls	1			14				100.0
72-83	Base metal	99		162	116	25.4		56.5	18.1
84-85	Machinery & mechanical goods	61	3	312	203	18.0	0.5	50.2	31.4
86-89	Transport equipment	23			40	76.8			23.2
90-92	Optical, photographic equip.	6			131	4.8			95.2
93	Arms & ammunition								0.0
94-96	Misc. manufactured articles	40			49	56.0			44.0
97-99	Works of art				2				100.0
Total	Total	623	3	598	1683	44.1	0.1	12.8	43.0

Source: Compiled from Sri Lanka Customs Database.

machinery and mechanical goods for example, while 18 per cent of Indian exports will not benefit from the FTA, a further 50 per cent will be able to enjoy a 50 per cent preferential duty reduction to the Sri Lankan market. Similarly, in the case of base metal goods, 25 per cent of such exports to Sri Lanka will be subject to the negative list, but a further 57 per cent will enjoy preferential duty reduction of 50 per cent.

The data indicate that at least in the short term, there is very little trade that is actually free of import duties under the ILFTA. Of the 319 items on which Sri Lanka offered zero tariffs, only 3 items were of trade interest to India, accounting for a mere 0.1 per cent of its total exports to Sri Lanka. While India removed all tariffs on 1351 items, only 68 of such products were of export interest to Sri Lanka, comprising approximately 10 per cent of total exports to India. By contrast, items placed on the negative list by Sri Lanka accounted for over 44 per cent of India's total exports to Sri Lanka and the Indian negative list accounted for nearly 14 per cent of Sri Lanka's total exports to India.

However, in the medium to longer term, the ILFTA will confer freer access for Sri Lankan exports to the Indian market. Sixty-eight per cent of Sri Lanka's current total exports to India will enter the market at a preferential duty reduction of 50 per cent in the first year. At the end of 3 years, India has committed to allow all such items to enter its market at zero duty. Sri Lanka will permit free access to only 13 per cent of total Indian exports in the medium term.[17] In the longer term however, Sri Lanka will significantly deepen tariff liberalization, reducing tariffs on the bulk of the remaining traded goods presently accounting for 43 per cent of India's total exports to the country. In effect, this means that at the end of 8 years, nearly 55 per cent of all Indian exports to Sri Lanka will be traded at zero import tariffs.

Thus, it is clear that the ILFTA has been far more generous in reducing tariff barriers bilaterally than that offered by the SAPTA negotiations to date (see also Weerakoon, 2001). While there are 2 other bilateral free trade agreements in operation in South Asia – between India and Nepal and India and Bhutan – all indications are that more such agreements are likely to be forthcoming in the not too distant future. Already, Sri Lanka and Pakistan are engaged in negotiating a free trade agreement, while both India and Sri Lanka are considering the possibility of extending similar agreements to Bangladesh.

[17] That is, those items currently entering Sri Lanka at a concessionary duty reduction of 50 per cent will have complete free access to the Sri Lanka market at the end of 3 years.

The drift towards bilateral trade agreements in the context of efforts to promote economic cooperation at a regional level raises complex policy issues for SAARC. In fact, there is little evidence of similar trends in other regional groups. The vast majority of regional blocs have started from an agreed base on the intensity or degree of cooperation and have progressed from there, taking collective decisions with regard to either the speed of integration or admission of new entrants to the bloc. In those situations, the members of the regional grouping set specific guidelines and time frames within which potential members have to meet targets in order to qualify for membership. This is clearly the path that has been followed by the more successful regional groupings such as the EU and ASEAN member countries. South Asia, on the other hand, is currently faced with the spectre of countries within an existing regional trade arrangement moving outside of it to form bilateral agreements that are far more liberal and substantial than anything under the regional framework.

First and foremost, bilateral arrangements can undermine broad support for the formation of SAFTA. In the case of Sri Lanka for example, its support for SAFTA was prompted largely by the desire to gain access to the Indian market. Having already achieved that under the ILFTA – with the prospect of signing a similar agreement with Pakistan, Sri Lanka's other major trading partner in South Asia – there is a real danger that SAFTA will become marginal to its trade interests. And this is not only true of Sri Lanka, it is likely to be the case for other South Asian economies as more such bilateral agreements are entered into. Secondly, it raises the issue of how bilateral agreements are to be treated vis-à-vis SAFTA negotiations. Will they be incorporated into the SAFTA process or will they stand as separate bilateral trade agreements? If they are to be incorporated, then they will have to be used as the starting base from which to begin negotiations. If not, they will then exist as parallel trade agreements. The Indo-Nepal FTA however, offers far more liberal terms to Nepal than does the Indo-Lanka FTA. It effectively has no negative list safeguards and this is unlikely to be acceptable to a majority of the SAARC countries. Alternatively, if bilateral agreements are to continue alongside the SAFTA process, this will mean that countries will have to contend with a multitude of bilateral and regional agreements – what some economists have referred to as a 'spaghetti bowl' of overlapping trade agreements.[18] Whether South Asian interests will be best served by such arrangements is again questionable; it will mean a greater administrative burden, as well as less cohesion in marketing South Asia as a region to foreign investors.

There are also important lessons to be learnt from the bilateral negotiating process. There was little discussion prior to the signing of the Indo-Lanka FTA. This has been defended on the grounds that were it to have been made public, then interest group pressure may have led to lengthy negotiations or that opposition could have ultimately killed off the agreement altogether. Even with this backdrop, it took more than a year after the agreement was signed for India and Sri Lanka to agree on a negative list that was at least partially acceptable to both countries. The compromise solution arrived at compelled Sri Lanka to accept some form of quantitative restrictions on its exports of tea and garments into India under the ILFTA. In multiplying this process to include all seven countries of SAARC, the task of agreeing to a formula with regard to negative lists will require intense negotiations. Are negative lists to be worked out after signing the bare skeletons of the agreement such as under the ILFTA or will they be worked out before the agreement is signed? Whatever the procedure adopted, it will mean that SAARC countries have to show a greater commitment to open their markets to other member countries than has been the case under the SAPTA process. Whether such a commitment will be forthcoming given the political backdrop to the SAARC process is debatable.

Any potential benefits of bilateral agreements have to be weighed against the political fallout in a wider South Asian context. Not only is there the real danger that bilateral agreements may undermine commitment to SAFTA, but there is a far greater danger of alienating key players even further. For the moment at least, it appears that both India and Pakistan are intent on signing agreements with their smaller South Asian partners. To some extent this is driven by the political imperatives that drive the SAARC process. But

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[18] Even in the case of SAPTA and the ILFTA there are instances where Sri Lankan exporters are eligible for tariff concessions under SAPTA but where those same items fall within the Indian negative list under the ILFTA.

such a strategy will serve to only widen rather than bridge existing differences between these two key players.

5. The Future Prospects for Economic Cooperation in South Asia

The present quite low level of intra-regional trade is, of course, only partly a result of policy. The fact that the countries share some basic similarities (low income, relatively labour abundant comparative advantage in similar commodities, such as tea, etc.) reduce the potential for comparative advantage driven trade. The economies are mostly agricultural based with a small industrial sector, manufacturing only a narrow range of goods (with the exception of India). While trade complementarities in other regions have grown on the basis of manufactured goods, this has not taken place in South Asia due to the small size of the manufacturing sector and the limited range of goods produced. The low volume of intra-regional trade that is taking place is based largely on agricultural products, which are produced in some countries and not in others. Therefore, although SAARC countries have diversified their exports, they are still geared to markets outside the region, where they compete with one another's products. For example, garments form the largest single export of Bangladesh, Sri Lanka and Nepal, and it is a major export category of India, Pakistan and the Maldives. Similarly, fresh fish and crustaceans are the leading exports of the Maldives and a major export category of Bangladesh, Pakistan and Sri Lanka. Low growth and demand in the region itself, abetted by historical trade links with the developed countries have resulted in extra-regional trade patterns. The low per capita income level also constrains potential for intra-industry trade, generally associated with higher income countries.[19]

Preferential treatment of imports therefore, may not necessarily result in mutual trade expansion. This is because lower import price per se is not the only decisive factor for trade expansion. The ability to supply, and supply a quality product, is also equally important. In addition, some goods produced in certain SAARC countries do not appear to meet the demands of the importing SAARC country. For example, Pakistan is a major tea consuming country that offers a large market for tea exports of Sri Lanka, India and Bangladesh. But Pakistan's tea requirements are met by tea imports from East African countries that produce the variety (CTC tea) required by Pakistan. Sri Lanka, India and Bangladesh do not produce adequate quantities of CTC tea to meet Pakistan's demand

[19] Of course this does not imply that the current low level of trade is all that can be achieved.

(Kelegama, 1999). Thus, it is unlikely that trade preferences for certain goods would result in an expansion of such goods. Even if trade preferences increase the demand for these goods, it is unlikely to be significant as the sub-regional market is limited and the demand for agricultural products is typically inelastic (as in the case of Bangladesh's jute exports).

On the other hand, the existence of significant relative differences among the SAARC countries should not be forgotten. India dominates other countries in terms of size. In comparison, most others are much smaller. Sri Lanka has a relatively more educated workforce than others, and also has relatively higher per capita income and wage levels. The potential for expanding intra-SAARC economic links, in both trade and investment, is not entirely absent.[20] There are important structural changes in intra-regional trade that may be important indicators of future trends. Textile, and machinery and equipment have become increasingly more important in intra-regional trade and a larger proportion of exports going into the region is now manufactured products, while in the past, it was primary products (Jayasuriya et al., 2000). This shift into manufactured product trade, associated with the higher level of industrialisation of the region, opens up opportunities for scale economies and intra-industry trade to play an increasing role.

If South Asia is to take advantage of such opportunities, it has to rethink its approach to the trade negotiating process adopted so far. This means recognising that the product-by-product approach adopted so far has not been successful and that a fast track liberalization approach is necessary if regional economic cooperation is to be kept on the SAARC agenda. Even the opportunities for fast-track liberalization offered under a product-by-product method – liberalizing either the top 50 or 100 products exported/imported by each country – have not been pursued under the negotiations concluded so far.

[20] See Mukherji (1998) for a study of trade and investment links between India and Nepal, and Mukherji (2000) for a study of trade and investment linkages between India and Sri Lanka. See also Jayasuriya et. al, 2000 for a more detailed assessment of potential trade-investment nexus in South Asia.

Table 17
Major Import Chapters of SAARC Countries

Imports From	BD	BH	IN	MD	NP	PK	SL
Bangladesh		8, 25, 20 (98.1)	10, 25, 52, 84 (61.8)	73, 84 (100.0)	7, 10 (93.4)	52, 10 (78.9)	15, 40, 69 (82.6)
India	53, 28, 3, 52 (93.3)			5, 72 (99.4)		8, 17 (80.3)	72, 9, 47 (67.0)
Maldives		52 (7.8)				7, 8, 10 (74.7)	4, 7, 52 (46.3)
Nepal	11, 31 (94.1)	27 (100.0)		19 (95.0)		12, 52, 84 (85.9)	8, 45, 87, 29 (100.0)
Pakistan	2 (92.4)	7 (90.7)	2, 5, 6 (92.7)	5, 6, 7 (99.6)	2, 4, 8 (99.7)		2 (94.2)
Sri Lanka	53, 63, 56,82 (89.3)		3, 7, 9 (98.5)	3, 23, 61, 62 (92.7)	7 (98.0)	3, 7, 10 (78.9)	

Note: Figures in brackets are imports of products covered under the chapters cited above as a percentage of total bilateral imports.

Index: Ch.3 Fish & crustaceans; Ch.4 Dairy products; Ch.5 Products of animal origin, Ch.7 Edible vegetables; Ch.8 Edible fruits and nuts; Ch.9 Coffee, tea, malt; Ch.10 Cereals; Ch.11 Product of milling; Ch.12 Oilseeds; Ch.15 Animal, veg. Fats; Ch.17 Sugar and confectionery; Ch.19 Prep. Of cereals; Ch.20 Prep. Of veg. fruits, nuts; Ch.23 Residues and waste; Ch.25 Salt, sulfur; Ch.27 Mineral fuels; Ch.28 Inorganic chemicals; Ch.29 Organic chemicals; Ch.30 Pharmaceutical products; Ch.31 Fertilizer; Ch.40 Rubber and articles of rubber; Ch.45 Cork and articles; Ch.47 Pulp of wood; Ch.52 Cotton; Ch.53 Other veg. textile fibres; Ch.54 Manmade filaments; Ch.55 Manmade staple fibres; Ch.56 Wadding felt non-woven; Ch.61 Articles of apparel knitted; Ch.62 Articles of apparel, non-knitted; Ch.63 Other made up textile articles; Ch.69 Ceramic products; Ch.72 Iron and steel; Ch.73 Articles of iron and steel; Ch.82 Tools; Ch.83 Misc. articles of base metal; Ch.84 Nuclear reactors, boilers; Ch.87 Vehicles; Ch.94 Furniture, etc.

Source: Mukherji, 2000

In the case of Sri Lanka, for example, the top 50 exports to the region in 1999 accounted for about 85 per cent of its total exports to South Asia[21] (see Appendix A). Of the top 50 products, 24 have already received concessions under SAPTA. However, of these 24 products, only 11 are of actual trade relevance to Sri Lanka in terms of its bilateral trade composition. In the case of the large majority of items in the top 50 list, such as in the case of pepper products, the concessions offered have been from countries that are not Sri Lanka's major markets in South Asia. India is the largest South Asian importer of pepper

[21] The top 100 accounted for 92 per cent of total exports to the region.

from Sri Lanka (96 per cent of all pepper exports to South Asia), but concessions to Sri Lanka have been offered by Pakistan, Bangladesh and Nepal. Therefore, any future negotiations should insist on bilateral concessions on major items of trade interest between all SAARC countries to be multilateralized thereafter. Even the fact that 11 of Sri Lanka's top 50 exports to South Asia have gained some preferential treatment does not amount to much. The extent of tariff cuts for these products is rather limited and trade in some of these products has not always been free of other barriers. For example, exports of dried tamarind fruit (the ninth largest export commodity from Sri Lanka to South Asia) offered concessions from India is nevertheless subject to Indian import licensing requirements.

With respect to imports, the top 50 imports in 1999 accounted for much less than the share of exports – around 61 per cent of Sri Lanka's total imports from the region (the top 100 imports accounted for 71 per cent of total imports). Of the top 50 products, only 8 have been granted concessions by Sri Lanka. Though the top 50 (or 100) products traded amongst the other members of the SAARC are not available to examine how much they account for trade within the region, if these products were used as the base from which to begin serious negotiations, then the movement to a free trade area would be a more realistic option.

There is also the possibility of across-the-board or sectoral liberalization, which would be more effective in hastening liberalization. Some of the SAARC countries – particularly India and Bangladesh – used this in a limited way during the third round of negotiations under SAPTA. In the case of Sri Lanka, for example, all chapters that account for at least 1 per cent of exports to and imports from the region are identified in Appendix B. In total, such products add up to more than 80 per cent of Sri Lanka's total exports to and imports from South Asia. Table 17 offers a matrix for future negotiations on a chapter-wise basis for the region as a whole. While an across-the-board approach offers even a more broader framework towards liberalization, it may prove contentious in practice. In the case of Sri Lanka, for example, agricultural imports alone account for over 30 per cent of total imports from South Asia. But Sri Lanka's agricultural sector remains highly vulnerable to competition from its neighbours, particularly from India, and across-the-board liberalization of agriculture will prove politically unfeasible in the face of adverse employment implications. On the other hand, leaving agriculture out of all negotiations (effectively placing agriculture in the negative list) and concentrating attention on non-agriculture may narrow the application of a free trade agreement. Thus, the most realistic option to hasten liberalization in the transition to a free trade area appears to be a combination of both a product-by-product and chapter wise negotiations. Besides looking simply at existing trade patterns in the region, attention should also focus on tariff preferences for goods with high potential for future trade, particularly in the manufacturing sector. While it will involve a certain amount of trade diversion, it will also assist in building intra-industry linkages that are vital if a regional trade bloc is to achieve any measure of dynamism in the longer-term.

While the potential for raising the current volume of trade between South Asian countries certainly exists, is it likely to come about through the mechanism of a regional trade agenda? It could well be concluded that the political obstacles to South Asian economic cooperation are too deeply ingrained to justify the costs of negotiating, administering and implementing a regional trade arrangement. It is not surprising that some political economists have drawn what seems to be an inevitable conclusion that the most likely scenario for South Asia is that it will remain locked in an unstable situation. Their argument is that in light of the Indo-centric nature of the region, any change will require India becoming more accommodating.[22] However, India may regard accommodation as unnecessary given that it considers itself powerful enough to cope with any tension in the subcontinent (Maass, 1999). Such reluctance will then serve to strengthen anti-Indian hawks in Pakistan and as a consequence, South Asia may never benefit from a true spirit of regionalism. Moreover, one of the impediments to the progress of regional cooperation in South Asia may be the economic predominance of India in the region. Even a substantial increase in trade within SAARC will not fulfill a fraction of the needs of the Indian economy. In the case of Pakistan, an integration of economies of SAARC that has India as the dominant member can threaten to blur Pakistan’s political and strategic identity and therefore, may never be fully acceptable.

The political dimensions that have crept into economic relations between India and Pakistan have persisted despite the rhetoric on regional trade cooperation. While India

[22] India accounts for 74 per cent of the region’s total population, 76 per cent of its GNP and 64 per cent of its export trade.

extended MFN status to Pakistan in 1989/90, it has not been fully reciprocated by Pakistan. Rather, Pakistan allowed a mere 270 products to be imported from India (increased thereafter to 700 products). A South Asian Free Trade Area cannot become a realistic proposition until and unless such bilateral economic issues are addressed. The non-extension of MFN status to India means that Pakistan is in effect constrained from granting tariff concessions to other member countries of SAARC due to the fact that those same concessions have to be offered to India as well. And this has wider repercussions for regionalism in South Asia. Pakistan for example, was reluctant to grant concessions on tea to Sri Lanka under SAPTA negotiations since the same concessions would have to be extended to India. As a result, Sri Lanka and Pakistan are in the process of negotiating their own bilateral free trade agreement.

For Sri Lanka, its future in SAPTA/SAFTA has to be re-examined along with an assessment of its external trade policy strategy. Sri Lanka appears to be examining the possibility of bilateral trading arrangements with a host of countries, the majority of whom are former CIS states of Kazakhstan, Uzbekistan, Georgia, Moldova, Armenia and Belarus.[23] It would appear that these countries have been targeted purely as a means of gaining preferential market access for Sri Lanka's tea exports. But the wider question is whether bilateral trade agreements should be driven purely on a single commodity basis. In addition to bilateral agreements, Sri Lanka is also committed to membership of other regional blocs such as BIMST-EC and IOR-ARC, which include some but not all SAARC member countries. If multiple trade pacts are to be justified, then they must clearly indicate future benefits, both in trade and welfare terms. This means that Sri Lanka must of necessity be more selective in choosing the countries with which it seeks to sign trade pacts. The alternative is that the country will be swamped by multiple agreements with their own rules of origin requirements and other clauses. At present, of the 5700 tariff lines (at 6-digit), Sri Lanka offers duty free access on 2011 tariff lines (36 per cent of total tariff lines). Proposed changes on duty reductions are expected to increase this percentage to around 50 per cent. Thus, Sri Lanka will be hard pressed to offer attractive trade concessions in negotiating bilateral or regional pacts in the near future. Therefore, Sri Lanka has to carefully balance its domestic tariff rationalization with its agenda on bilateral and regional trade commitments.

[23] See Central Bank of Sri Lanka, Annual Report, p.185.

6. Conclusion

Although SAARC was slow to embrace the concept of economic cooperation, having done so, it moved swiftly thereafter to set itself an ambitious agenda. It could well be argued that its initial schedule of moving South Asia towards a free trade area within a the span of 5 years or so was too ambitious. It also had the unfortunate effect of raising expectations and of irrevocably tying the perceived success or failure of SAARC firmly to the achievements on the economic front. With hindsight, given the long history of political tension in the region, it appears that SAARC leaders were perhaps naïve in their belief that political differences could be set aside to allow headway on the economic front. Progress on economic cooperation has long been viewed as one means of building confidence by binding South Asian economic interests. But the experience of SAPTA negotiations indicate not only the lack of commitment of SAARC countries to open their markets to each other but also that economic cooperation is doomed to achieve little in the absence of political goodwill amongst member countries.

The introduction of bilateral free trade agreements among SAARC countries is likely to lead to further fragmentation of a common South Asian goal towards regional integration. For the Indian economy for example, its key strategic interests lie outside the region. India's willingness to sign the ILFTA and pursue its economic linkages with East Asia through membership of BIMST-EC -- of which Sri Lanka is also a member -- clearly indicates that it would prefer to forge closer ties between the two regions. For Sri Lanka too, having gained access to the Indian market through the ILFTA, its technology, investment and trade needs are more closely aligned to those of its East Asian neighbours than to Bangladesh, Bhutan, Nepal or the Maldives.

The question then remains whether economic cooperation within the framework of a regional arrangement in South Asia has any future. The first step that has to be taken is to acknowledge the limitations of past performance. In turn, it should lead to a healthy debate as to whether deeper economic integration is desired by all member countries. If SAARC countries are to go forward without loss of credibility, mere rhetoric on commitment to freer regional trade will not be sufficient. It will have to be matched at the negotiating table by a willingness to commit to a clearly delineated agenda. And that agenda has to be practical in its time frame and specific in terms of commitments of each country. Furthermore, such commitments will have to be adhered to irrespective of whether SAARC Summits are rescheduled to accommodate political developments. Only by insulating the economic agenda as far as possible from regional politics will it stand any chance of delivering the promised results.

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Appendix A1

Top 50 Exports from Sri Lanka to SAARC, 1999

Hs Code	Description	Value (Rs. mn.)	As a per cent of total value PK	IN	BD	NP	ML	Concessions granted under SAPTA PK	IN	BD	NP	ML	Total
90411	Pepper	723	3	96			1	x		x	x		1
90240	Other black tea	683	76	21			3						
120300	Copra	626	97		1	2		x					1
600242	Other knitted/crocheted fabrics – warp knit	606		1			99						
80290	Other nuts – arecanuts and other	387		99			1		x		x		1
400121	Natural rubber – smoked sheets	343	62	20	18			x					1
580620	Narrow woven fabrics – Other	318		1			99						
720429	Ferrous waste and scrap – alloy steel	272		100									
81340	Fruit - Tamarind and other	260	17	82				x	x		x		1
151311	Coconut (copra) oil and its fractions	228	15		83	1	1	x		x		x	1
890600	Other vessels, including warships and lifeboats	218					100						
90700	Cloves	207	3	96			1		x	x	x		1
392620	Other articles of plastics - Articles of apparel and clothing accessories	195	9	76	8	6				x	x		1
152000	Glycerol	181		100								x	1
470710	Unbleached kraft paper/paperboard/corrugated paper/paperboard	160		100									
520939	Woven fabrics of cotton – dyed, other fabrics	157		7	85		7				x		1
400129	Natural rubber – other	150	81	17	2			x					1
140490	Vegetable products – other	134	100							x			1
70990	Other vegetables	125					100						
80111	Coconuts – desiccated	120	99			1							
520932	Woven fabrics of cotton – dyed, plain weave	114			2		98				x		1
890590	Light vessels, fire floats, dredgers, floating cranes and other vessels – other	102					100						
90810	Nutmeg	101	20	80					x	x	x		1

Contd...../-

710239	Diamonds – non-industrial	91.4			100									
50800	Coral and similar materials	86.4	3	62	34									
80119	Coconuts – other	83.3	99				1							
540241	Synthetic filament yarn – other	69.9	24	48	28									
140390	Vegetable materials of kind used primarily brooms/brushes – other	59.1	100								x			1
540742	Woven fabrics of synthetic filament yarn – other	53	4	91	5									
80430	Pineapples	52	1				99					x		1
611790	Other made up clothing accessories – parts	50.9					100							
490700	Unused postage, revenue/similar stamps, stamp impressed paper; banknotes, cheque forms; stock share/bond certificates and similar documents of title	43				100								
520911	Woven fabrics of cotton – unbleached	40		82	17		1					x		1
690890	Glazed ceramic flags and paving hearth/wall tiles – other	39.5	1		69		30					x		1
40700	Birds' eggs, in shell, fresh. Preserved or cooked	37.5					100							
90820	Mace	36.7	8	92						x	x	x		1
600122	Pile fabrics – looped	35.8	4	96										
90230	Tea – black	35.7		10			90							
830910	Crown corks	34.8			16	78	6					x		1
740400	Copper waste and scrap	31.2		100										
470790	Recovered paper/paperboard – other	30.9		100										
482110	Paper/paperboard labels of all kinds – printed	30.2	14	72	7	1	5							
711319	Articles of jewellery and parts thereof – of precious metal	27.6					100							
600299	Other knitted/crocheted fabrics – other	27.2		100										
20220	Meat of bovine animals, frozen – other cuts with bone	26.5					100				x			1
230650	Oil cake and other solid residues – of coconut/copra	26.1	96	4							x			1
220110	Mineral waters and aerated waters	25.1					100						x	1
550810	Sewing thread of man-made staple fibres – synthetic	24.3		1			99							
300490	Medicaments – other	22.4		4			96	x				x		1
481910	Cartons, boxes and cases, of corrugated paper/paperboard	22.3		69			31							
Total		7552.8						1	6	5	10	14	3	24
Total exports to SAARC		8926.28												
Top 50 exports as a per cent of total exports to SAARC		84.61												

Appendix A2
Top 50 Imports to Sri Lanka from SAARC, 1999

HSCODE	Description	Value (Rs. mn.)	Concessions granted by Sri Lanka
100630	Semi-milled/wholly milled rice	2640	
71340	Lentils	2120	
70310	Onions and shallots	1670	
300490	Medicaments - other	1550	
30559	Dried fish	1520	x
70190	Potatoes - other	1410	
870321	Motor cars and other motor vehicles	1310	
90420	Chillies and other	1250	
870210	Motor vehicles for transport of ten/more persons	1240	
520511	Cotton yarn - single yarn, uncombed	1100	x
230400	Oil-cake and other solid residues	877	
480252	Wallpaper base - other	877	
520911	Woven fabrics of cotton, bleached, plain	656	
721391	Bars and rods of iron/non-alloy steel - other	549	
870600	Chassis fitted with engines	510	
520939	Woven fabrics of cotton, other fabrics	463	
870422	Motor vehicles for transport of goods	394	
620342	Trousers, bib and brace overalls, breeches and shorts, of cotton	356	
721049	Otherwise plated/coated with zinc - other	329	
870899	Parts and accessories of motor vehicles - other	311	x
840820	Engines of a kind used for the propulsion of vehicles	296	
520942	Woven fabrics of cotton, of yarn of different colours	284	
520521	Cotton yarn - single yarn, combed	271	x
871120	Motorcycles	271	x

Contd…/-

520811	Woven fabrics of cotton, unbleached	259	
621143	Other garments, women's/girls', of man-made fibres	257	
730630	Other tubes, pipes and hollow profiles of iron/steel	237	
520959	Woven fabrics of cotton, printed, other	236	
280300	Carbon	231	x
140490	Vegetable products - other	219	
520512	Cotton yarn - single yarn, uncombed	215	
520522	Cotton yarn - single yarn, combed	210	
252329	Portland cement - other	192	
300390	Medicaments - other	191	
551511	Other woven fabrics of synthetic staple fibres, of polyester	189	
600242	Other knitted/crocheted fabrics - other, warp knit	180	
630510	Sacks and bags, of jute/other textile	178	x
100640	Broken rice	170	
551219	Woven fabrics of synthetic staple fibres - other	155	
690890	Walltiles and other	154	
520921	Woven fabrics of cotton, unbleached, plain	153	
520951	Woven fabrics of cotton, printed, plain	151	
520931	Woven fabrics of cotton, dyed	147	
91030	Turmeric	145	
870790	Bodies for motor vehicles	142	
401120	New pneumatic tyres	140	
853922	Other filament lamps	139	
190190	Malt extract; food preparations of flour, meal, starch/malt extract - other	134	
710239	Diamonds, non-industrial	134	
281511	Sodium hydroxide (caustic soda) - solid	127	x
Total		26939	8
Total imports from SAARC		44267.67989	
Top 50 as a percent of total imports to SAARC		60.85	

Appendix B1
Major Exports from Sri Lanka to SAARC (chapter-wise:1999)

Chapter	Description	Value (Rs. mn.)	As a % of total exports to SAARC
9	Coffee, tea, mate and spices	1813.1	20.3
8	Edible fruit and nuts; peel of citrus fruit/melons	921.9	10.3
60	Knitted/crocheted fabrics	681.3	7.6
12	Oil seeds and oleaginous fruits, etc	628.5	7.0
40	Rubber and articles thereof	540.2	6.1
15	Animal/vegetable fats and oils, etc	417.3	4.7
52	Cotton	362.0	4.1
58	Special woven fabrics; tufted textile fabrics, etc	349.7	3.9
89	Ships, boats and floating structures	328.8	3.7
72	Iron and steel	298.1	3.3
39	Plastics and articles thereof	252.3	2.8
14	Vegetable plaiting materials, etc	193.0	2.2
47	Pulp of wood, etc	191.2	2.1
7	Edible vegetable and certain roots and tubers	166.3	1.9
54	Man-made filaments	152.0	1.7
71	Natural/cultured pearls, etc	137.9	1.6
85	Electrical machinery and equipment	93.8	1.1
5	Products of animal origin, etc	92.5	1.0
69	Ceramic products	91.4	1.0
	Total	7712.3	86.4

Source: Compiled from Sri Lanka Customs Database.

Appendix B2

Major Imports of Sri Lanka from SAARC (chapter-wise: 1999)

Chapter	Description	Value (Rs. mn.)	As a % of total imports from SAARC
52	Cotton	5592.1	12.6
7	Edible vegetable and certain roots and tubers	5325.8	12.0
87	Vehicles other than railway/tramway rolling-stock, etc	4952.5	11.2
10	Cereals	2892.2	6.5
84	Nuclear reactors, etc	2772.5	6.3
72	Iron and steel	2167.0	4.9
30	Pharmaceutical products, etc	1914.6	4.3
85	Electrical machinery and equipment, etc	1610.6	3.6
3	Fish and crustaceans, etc	1587.1	3.6
9	Coffee, tea, mate and spices	1549.8	3.5
48	Paper and paperboards	1208.8	2.7
73	Articles of iron/steel	1011.7	2.3
62	Articles of apparel and clothing accessories	985.1	2.2
23	Residues and waste from food industries, etc	985.1	2.2
55	Man-made staple fibres	880.6	2.0
39	Plastics and articles thereof	737.5	1.7
28	Inorganic chemicals, etc	661.1	1.5
	Total	36834.9	83.2

Source: Compiled from Sri Lanka Customs Database.