TOWARDS AN ASIAN CENTURY

Future of Economic Cooperation in SAARC Countries

Islamabad Policy Research Institute

Towards an Asian Century: Future of Economic Cooperation in SAARC Countries

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Acronyms

ADB	Asian Development Bank
ASEAN	Agreement of South East Asian Nations
EDB	Engineering Development Board
EU	European Union
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
FTT	Free Trade Talks
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GVC	Global Value Chain
HSF	Hanns Seidel Foundation
IMF	International Monetary Fund
IT	Information Technology
MFN	Most Favoured Nation
MNCs	Multinational Corporations
NTBs	Non-Tariff Barriers
NTC	National Tariff Commission
PPMA	Pakistan Pharmaceutical Manufacturers Association
PTAs	Preferential Trade Agreements
R&D	Research and Development
RECP	Regional Comprehensive Economic Partnership
RIC	Regional Investment Cooperation

ROK	Republic of Korea
RTA	Regional Trade Agreement
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asia Free Trade Agreement
SCCI	SAARC Chamber of Commerce & Industry
SCOE	SAFTA Committee of Experts
SPS	Sanitary and Phytosanitary
SRO	Statutory Rules and Orders
TBT	Technical Barriers to Trade
TTP	Trans-Pacific Partnership
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Introduction

Ambassador (R) Sohail Amin
Col. (R) Muhammad Hanif and Muhammad Nawaz Khan

This volume is based on the papers and presentations made at the two-day International Conference on "Towards an Asian Century: Future of Economic Cooperation in SAARC Countries" jointly organised by Islamabad Policy Research Institute (IPRI) and Hanns Seidel Foundation (HSF), Germany at the Islamabad Hotel, Islamabad on November 20-21, 2013. Prominent scholars, academicians and policy-makers from Afghanistan, Bangladesh, China, India, Nepal, Pakistan, Sri Lanka and European Union (Germany) participated in the conference and shared their views on different aspects of future of economic cooperation in SAARC countries. The discussions focused on political and economic developments in the SAARC countries in the last 30 years and the future outlook with regard to peace and progress towards closer economic integration in South Asia.

The emergence of China as a rising economic power and dynamism of the East Asian economies as engines of growth of the global economy together with the oil wealth of West Asian countries, the twenty-first century is being termed as the Asian century. This economic progress has helped millions of people of the Asian continent to come out of their abject poverty. Asia's economy is expected to expand at robust rates and it is likely to account for more than half of global output by the year 2050. A 2011 study by the Asian Development Bank found that an additional three billion Asians could enjoy living standards similar to those in Europe today. If this projected position is realized by Asia, its average per capita income could rise above US$ 40,000 (in constant purchasing power parity terms). The Asian century will, however, be realized if the continent's growth is broad-based and its prosperity extends across the continent to South Asia, Central Asia and the Pacific Islands.

South Asia's growth rate in the recent past makes the subcontinent currently the fastest growing region in the world. It has experienced six per cent average economic growth annually over the past twenty years which has resulted in impressive improvement in human development indicators. The present decline in growth rates in South Asia appears to be a temporary phase. Some analysts predict that South Asia's growth rate will rise again and progress at six to eight per cent until 2030. Comparing this to the declining growth of the global economy, analysts believe that South Asia will play a major role in future development of the continent.

South Asian leaders are of the view that high and sustained growth rate can be speedily achieved by pooling regional resources through mutual economic cooperation. The Addu Declaration issued at the end of the SAARC Summit at Addu, Maldives in November 2011, firmly resolves to realize the objective of regional economic cooperation.

So far South Asia has lagged behind other regions of the world, despite the fact that SAARC leaders have taken various concrete steps, such as signing of South Asian Free Trade Agreement (SAFTA) in 2004. The slow progress in achieving regional cooperation has been due to various reasons like underdeveloped infrastructure, poor connectivity, bureaucratic hurdles in decision making, preoccupation with security issues and political instability.

Pakistan as a SAARC member is convinced that regional economic collaboration will benefit all South Asian countries in their economic development and in alleviating poverty in the region. To pave the way for this objective, Pakistan wants that mutual political differences and disputes impeding the process of economic cooperation should be resolved as a priority with sincerity and mutual accommodation through result oriented dialogue. This is the only way out unless South Asia wants to remain stuck with old disputes that have done no good to people of the subcontinent who certainly deserve better. Pakistan also considers that to achieve the objective of regional economic cooperation, SAARC countries can benefit from China's close and expanding economic relations with South Asian countries and also learn from EU's experience of achieving economic integration. This calls for pragmatism and taking practical measures. The international conference titled "Towards an Asian Century: Future of Economic Cooperation in SAARC Countries" organised by IPRI on 20-21 November 2013 was an effort in that very direction. The proceedings of that conference are now being published in the form of a book.

The book has two parts. The first includes the Welcome Address by Ambassador (R) Sohail Amin, President IPRI, Opening Remarks by Mr. Kristof W. Duwaerts, Resident Representative, Hanns Seidel Foundation, Islamabad, Inaugural Address by the Chief Guest, Ambassador Riaz Mohammad Khan, former Secretary, Ministry of Foreign Affairs, Government of Pakistan and Concluding Address by Dr. Ishrat Husain, former Governor, State Bank of Pakistan, Dean and Director, Institute of Business Administration (IBA), Karachi. The second part of the book consists of 16 papers read and presentations made at the conference by scholars from Bangladesh, China, Nepal, Sir Lanka and EU (Germany), Afghanistan and India in addition to local scholars.. The proceedings of the Conference are briefly described below:

In his welcome address, **Ambassador (R) Sohail Amin** greeted the speakers, guests and audience and highlighted the significance of the theme of the conference. He said that one of the main objectives of the SAARC was to address issues of poverty and economic development in South Asia by accelerating economic growth through cooperation with emphasis on intra-regional trade in goods and services, energy, food security and water resource management. But despite the South Asia Free Trade Agreement having been signed in 2004 and the existence of institutional arrangements such as SAFTA Ministerial Council, SAFTA Committee of Experts and SAARC Chamber of Commerce and Industry, the volume of trade between SAARC member states had not exceeded three billion US dollars by September 2013 which was much below the region's potential. He stressed that SAARC countries needed to hasten the resolution of their bilateral issues and disputes which were the main hurdle in meeting this objective of the SAARC.

In his opening remarks, **Mr. Kristof Duwaerts wondered if** like the 20th Century — which some had called the American century — the 21st Century might not eventually become the "Asian century" or rather the "Chinese century". Despite the remarkable economic growth of several Asian countries, unlike the EU, the SAARC was still falling behind to a large extent. So, at the moment at least, the "Chinese century" epithet looked more probable, he said. Integration was easier done in stages, topic and region wise i.e., compartmentally, as through integration of SAARC countries in south Asia. Yet despite the present difficulties, Asia was still the most significant Continent of the current century because of its important role in world politics economics and history. Mr. Kristof added that the Hanns Seidel Foundation had recognized that early which was reflected in its wide ranging activities across the continent through 31 offices that were collaborating with Asian think tanks and other such organizations. He said the holding of the international conference on "Towards an Asian Century: Future of Economic Cooperation in SAARC Countries" by IPRI and HSF was an important step towards that goal. Mr. Kristof thanked all participants of the conference.

In his inaugural address, **Ambassador (R) Riaz Mohammad Khan** said that the most distinctive feature of the twenty-first century was regional cooperation for accelerated trade and economic development as in the post-cold war scenario the imperatives of geo-economics had attained primacy over geo-politics. He mentioned the impressive growth of many Asian countries in the last 30 years and of South Asian countries in the last 10 years as the determining features of the "Asian century" concept.

Discussing reasons why SAARC was lagging behind other regional groups he mentioned the meagre intra-regional trade which indicated the problems that needed to be overcome. He added that the challenges faced by South Asia were poverty alleviation, illiteracy, population control and employment of the world's largest youth bulge. In addition there were issues of environmental degradation, climate change, water and food security. Ambassador Riaz said that all these challenges could be addressed through regional cooperation. He thought that SAARC's slow progress was due to the member nations' inability to fuse their domestic agendas with the SAARC agenda. There was little in terms of concrete SAARC projects and enterprises that could fire the imagination of South Asians. He emphasised on not letting political issues impede the progress of trade among the members. He advocated giving priority to cooperation in energy, connectivity, environment and water management. He said that the organizational structure of SAARC and its capabilities with respect to economic cooperation should be exploited by all SAARC member states to transform SAARC into a vibrant organization worthy of the shared history, heritage and culture.

In his concluding address, **Dr. Ishrat Husain** remarked that South Asia had not achieved one-third of the its potential in 60 years despite the fact that Asia was the prime mover of the global economic growth in 2013. The 2008 financial crisis proved the resilience of the Asian states. He said that global or regional cooperation was the derivative of what each nation wanted to do for itself. Looking at each regional grouping, there was a pivot and that pivot played an important role in either making the region work or destroying it completely. He said that India was the pivot in South Asia, so whatever happened in India had its repercussion on the whole region. He blamed India for not playing its due role in the region. India had to be more magnanimous and more generous in its approach as far as economic activity was concerned. It was in the interest of India to act as a pivot for South Asian economies which in fact was a win-win and not a zero-sum game. He pointed out that every time Pakistan agreed to phase out the negative list, some non-economic factor cropped up and derailed the entire process of normalization. He was of the view that political normalization should not be made a precondition and Pakistan should try to normalize its economic relations which would lead to political normalization also. And in this context he cited the example of India and China in improving their bilateral relations despite their political disputes over Laddakh and Arunchal Pradesh. As a result their bilateral trade had gone up to US$ 75 billion. Dr. Ishrat Hussain emphasised that SAARC states, particularly India, should urgently remove nontariff barriers to trade.

In his paper on **"Regional Trade: Driver for Economic Growth"**, **Dr. Kamal Monnoo** analyses the South Asian economies that are now increasingly exploiting the benefits of greater market openness, although their performance still lags behind other regions and SAARC is one of the least integrated regions in the world. He says that regions that failed to offer space for joint production and common productivity development, tended to lose in the long run. The fact is that bilateral trade on equitable terms can be very beneficial for both Pakistan and India and increased trade, investment and joint ventures within the SAARC countries can be the main driver of growth for the entire South Asian region. In fact the dynamics of smooth intra-regional trade if brought into play can be pivotal in strengthening the economies of all South Asian countries by unleashing a soft process that might create a helpful environment for resolving long standing political issues between SAARC countries which would further boost mutual economic cooperation.

In his paper, **Dr. Janak Lal Karmacharya** on **"Meeting Energy Requirements Potential for Intra-regional Energy Trade"**, highlights that SAARC states have diverse sources of energy yet the energy situation is acute in the region. The energy sector must grow on an average rate of 2-3 per cent over the GDP growth rate just to sustain the prevailing SAARC economy. He notes that there is huge potential for intra-state electricity trade among the SAARC countries which is reflected in the formation of SAARC Working Group on Energy. Besides, the creation of a Power Pool would enable the region to utilize its sources of electricity optimally by balancing the demand and supply. This could make electricity cheap and reliable. Moreover, this would create interdependence among SAARC nations. Dr. Janak says that this was the way to a win-win solution.

Ms. Arshi Saleem Hashmi, in her paper on **"Building Regional Transport and Communication Infrastructure"**, emphasises the importance of transport as the backbone of economic activity and social development. For improving connectivity, each mode of transport — roads, railways, maritime shipping and aviation, has its own physical and operational characteristics. She explains that connectivity challenges in South Asia include both hard (structural issues) and soft (agreements, legal framework) issues that require better understanding and adequate support. She discusses numerous challenges to regional connectivity in South Asia such as restrictive policy regimes and institutional issues. She says that South Asian countries are racing more towards globalization than regionalization. Ms. Arshi believes that the region, with its geographical contiguity, has a great potential for cooperation in the connectivity sector.

Prof. Savita Pande, in her paper on **"Developing Energy Corridor from Central and West Asia to South Asia",** explains that cross-border trade in energy is a strategic issue. It has a great potential for creating cooperation among the states. Energy trade is a win-win situation for every state as it is an economic gain for importer and exporter alike as well as for the transit country. The afore-mentioned dividends may be classified as "relative gains" — a theory that governs international relations. She further highlights that Pakistan is facing energy crisis because it lacks infrastructure to import natural gas. Besides, she elaborates that Iran-Pakistan-India (IPI) pipeline could only be economical for Pakistan if India enters in the deal. She terms IPI as the mother of all CBMs between Pakistan and India if it ever materializes. Since India has not officially withdrawn from IPI so it is expected that sooner or later India will join it. But there are challenges like the security situation in Balochistan. She admits that geo-strategically the IPI project gave leverage to Pakistan over India as far as energy corridor politics is concerned. She also points out that China will not join IPI as there is a dispute over costs and also because of the US factor. On Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline she is of the opinion that although it will boost economic cooperation in the region yet there are some issues as well. The quantity of gas available in Turkmenistan is not known, the issue of pricing is not settled, and above all the security situation in Afghanistan is a big challenge

In their joint paper, **"The New Silk Road Initiative: Economic Dividends"**, **Mr. Mohammad Yousuf Saber and Mr. Nabi Sarooh** call the "New Silk Road" strategy as the best option for economic and regional cooperation. This economic initiative will open business markets for the Central and South Asian countries to interact with each other and integrate their economies. Pakistan has a great role in that as the second land-bridge between Central Asia and India, and further with the rest of the South Asian countries. The "Modern Silk Road" strategy was proposed by many European, Asian and Afghan economists' decades ago, but the vision could not materialize. This "New Silk Road Initiative" has been proposed by the US to ensure economic growth and poverty reduction in Afghanistan. The integration of Afghanistan with neighbouring states is being postulated as the foremost task within the framework of the "New Silk Road" strategy. Both the speakers note that the strategy might open India to Afghanistan and Central Asia through Pakistan.

Dr. Liu Zongyi, in his paper on **"China's Growing Economic Relations with South Asia: A Positive Development"**, explains that although the economic relations between China and SAARC have developed at a very fast pace in the past ten years, economic integration between China and SAARC is the slowest compared to other regional economic organizations around China. China's prosperous economy is the best driving force for South Asian countries' development and SAARC integration. Chinese leaders have put forward plans for the Silk Road Economic Belt, BCIM economic corridor, and China-Pakistan economic corridor (CPEC) to enhance Sino-SAARC cooperation. China's trade volumes with SAARC countries grew very fast between 2001 and 2012. The bilateral trade volume expanded from 6.5 billion US$ in 2001 to 73.9 billion US$ in 2012, with an average growth rate of 26 per cent. Despite this healthy development Mr. Liu sees some problems in China-SAARC bilateral trade such as the imbalanced trade structure in which most South Asian countries have trade deficit with China which is increasing gradually. The Chinese scholar explains various large-scale economic projects which China is undertaking in Bangladesh, Sri Lanka, Afghanistan, Nepal and Pakistan. He also describes the significance of the Chinese long term plan of constructing Pakistan-China Economic Corridor costing approximately US$18 billion. About China-India economic relations, Mr. Liu notes that Sino-Indian relations are becoming better and mutual trade volumes are increasing but the relations are still fragile due to lack of strategic trust. The Indian strategic and security community remains concerned about China's activities in South Asian countries and the Indian Ocean. Mr. Liu explains that this distrust is mainly due to the Western countries' propaganda manoeuvres to create differences between the two countries. One such example is the "string of pearls" theory which many India scholars have also started believing in.

In his paper on **"Fast Tracking Economic Collaboration in SAARC Countries"**, **Dr. Pervez Tahir** elaborates that trade, the characteristic feature of regional economic blocs, is missing as an area of cooperation in the SAARC Charter. It took six years to mandate economic cooperation in 1991. A number of stumbling blocks had slow-tracked the expansion of regional trade. One of the major hurdle has been the political issues and disputes between India and all other SAARC countries due to which mutual economic cooperation and implementation of various trade agreements have remained impeded. Non-Tariff Barriers (NTBs) have been another stumbling block and India has the longest list of NTBs. Pakistan has its own set of NTBs for reasons of national security, health, environment and religion. Dr. Pervez points out that South Asia is an energy deficient region, and no member is endowed with surpluses of fossil fuels. Fast tracking any regional initiative in the energy sector is a difficult proposition. Two extra-regional initiatives have a promise, but in this context any breakthrough in near future is unlikely. The first is Iran-Pakistan-India gas pipeline from which India has already pulled out and Pakistan has neither the money nor the hope that the United States would exempt it from sanctions. Similarly, the fate of the other project, Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline is linked with peace and stability in Afghanistan. Mutual trade also remains hampered due to poor regional connectivity. In this regard, he suggested that the road, rail, air and communication links needed to be improved.

In his presentation on **"Future of Economic Cooperation in SAARC Countries: A View from FPCCI" Mr. Muhammad Ali** identifies the most common Non-Tariff Measures (NTMs) which are holding back progress. These NTMs are: a strong focus on food security and self-sufficiency; complexities and variations in licensing; permits and tariffs; anti-dumping duties and quantitative restrictions; duties and charges over and above tariffs; import of specific products through specified ports only; transportation restrictions; import only by state trading agencies; and stringent visa regimes etc. He suggests that to enhance intra-regional trade SAARC countries should minimize these NTMS on priority basis.

Dr. Rashid Ahmad Khan, in his paper on **"Economic Cooperation among SAARC Countries: Political Constraints"**, discusses the political constraints in respect of trade and economic cooperation among the SAARC countries at the bilateral as well as multi-lateral levels. He elaborates that although bilateral connectivity shows signs of growth in the last decade, SAARC members are still hostage to political constraints; and unless efforts are made to mitigate them, the goal of regional integration would remain elusive. He identifies four types of political constraints in the economic field namely strategic discord emanating from divergent perceptions of India and its neighbours on issues of peace and security in the region; lingering bilateral disputes, especially between Pakistan and India; domestic political compulsions; and the influence of extra-regional powers pursuing their economic and strategic interests in the region. Dr. Rashid Ahmad recommends that for building sustainable regional economic cooperation, it is necessary for the SAARC member states to display flexibility and the spirit of give and take to resolve their long standing bilateral disputes

In his presentation on **"Implications of Bilateral and Sub-regional trade Agreements on Economic Cooperation: A Case Study of SAARC in South Asia"**, **Dr. Syed Akhtar Hussain Shah** said that regional or bilateral trade agreements have now become the dominant mode of international commerce and their significance continues to grow. Among SAARC countries, various trade and economic agreements exist at regional, sub-regional, multilateral and bilateral levels. He highlights the fact that multilateral agreements relating to economic development contribute towards socio-economic development of individual states leading to regional cooperation. While bilateral agreements in the short run could be worse being less competitive, less informed with weak marketing networks etc. in the long run these agreements would contribute more to regional cooperation.

Dr. Barkat-e-Khuda, in his paper on **"Implementation of SAFTA: Bottlenecks"**, holds that regional trade is being hampered by a number of issues that are in the way of SAFTA implementation. These are: sensitive lists; poor connectivity and transit crisis; insufficient transit; poor logistics affecting cost of export and import; institutional constraints; bi-lateral free trade agreements (FTAs); non-tariff and para-tariff barriers; exclusive focus on "trade in goods"; identical comparative advantage; fear of loss of revenue; lack of trust; and trading blocs with countries outside the region. To implement SAFTA on priority basis he recommends that these issues should be addressed by the SAARC member states mutually and through negotiations at SAARC level.

In his paper **Dr. Wolfgang-Peter Zingel** on **"Economic Cooperation among SAARC Countries: An EU Perspective"**, says that the initiative to form SAARC was welcomed in Europe. It is actively supported by European governments and especially by the European Commission. Since SAARC opened itself to other regional organizations and countries in 1995 to join it as observers and the European Union (EU) became an observer in 2006 its relations with SAARC have not been very active. EU's trade ties have been with SAARC nations but not with it on a regional basis. He cites EU trade deals with member countries only, none with SAARC. EU is not a blueprint for SAARC necessarily but there is lot to learn from each other's experiences. Mr. Wolfgang suggests that SAARC can hasten the process of economic cooperation by resolving their long standing political issues and disputes following the example of EU which addressed the old disputes that had caused among its members two world wars.

Dr. Salman Shah, in his paper on **"Implementing SAFTA and Joint Economic Ventures as CBMs"**, highlights the importance of understanding the 2011 report of the Asian Development Bank on Asian Century which says that the projected average per capita income in Asia will likely cross US$ 42000 by 2050 with Pakistan crossing US$ 7900 and India $42000. He suggests that it is in the interest of the region that all countries of South Asia put their own houses in order to be winners in the Asian Century by following the recommendations of the report and achieving mutual economic cooperation. Furthermore, the future of this cooperation is particularly affected by the overwhelming footprint of Pakistan-India relationship on the region. While in Pakistan there is a general consensus among the political parties of the need to achieve a breakthrough on trade issues with India and the current political leadership in Pakistan could claim to be champions for trade and peace, but no such trends are visible in India. In South Asia the main dilemma is that each country feels satisfied if it runs a trade surplus in its bilateral trade but feels cheated if it runs a big deficit in its trade balance. The bigger the deficit, the weaker is the political position of the proponents of free trade. Thus progress in implementing SAFTA and liberalized trade fall victim to the fear factor prevalent in each country that freer trade will strengthen the opposing country and swamp their domestic production. A clear joint venture that needs to be initiated in the SAARC region is to establish a competitiveness research hub that evaluates the relative competitiveness of SAARC countries and how they will fare in a free trade environment. In this regard, the establishment of a SAARC University could be a follow up activity. Secondly there is a need to promote travel and tourism within the SAARC region to build confidence amongst the people of the region for greater economic cooperation. There is a need to establish joint infrastructure funds to facilitate connectivity in the region. At some point in the future a joint investment company can be established to facilitate cross border investments. This could lead to establishment of a SAARC Bank to facilitate trade and investment.

In his paper **“Replacing Conflict with Peace in South Asia”**, **Ambassador (R) Nihal Rodrigo** asserts that Sri Lanka has replaced a violent conflict with productive peace in the Island following decades during which its people had to confront the separatist mono-ethnic terrorism of the so-called Liberation Tigers of Tamil Eelam (LTTE). The Tamil area has now successfully concluded elections to its Provincial Council in September 2013. He notes that virtually all SAARC countries are now committed to democratic norms. None of the SAARC countries are monolithic in their ethnic, religious or social composition. This has its impact, internally on governance, on bilateral relations and on conflicts with neighbours, as well as in respect of relations with other member states of SAARC. He suggests that genuine engagement of the people is essential to replace conflict with peace. He holds China as the major player in the current century as with the trumpets of the Asian Century blowing, a series of bilateral and multilateral engagements are being developed in considerable harmony by the world’s two largest economies, the US and China.

Prof. **Dr. Pervaiz Iqbal Cheema,** in his paper on **“Sustainable and Result-oriented Dispute Resolution Mechanism between Pakistan and India”**, elaborates that no dispute resolution mechanism can effectively work without demonstrated political will to resolve the disputes by the involved parties. It becomes even more difficult if there is a pronounced asymmetry between powers and the stronger party is not willing to renounce the use of force. Dr. Cheema discusses different approaches to conflict resolution i.e., negotiations, third party involvement (mediation), UN special representative's good offices, arbitration, and adjudication. Almost all of the above mentioned approaches have been employed in one form or the other with a view to resolving disputes in South Asia and more specifically between India and Pakistan. Among the relatively more prominent cases in which the mediation efforts successfully resolved the crises and in some cases reduced tension there is the Indus Water Treaty, Tashkent Declaration, Rann of Kutch Award and the four years of peace process (2004-2008). He points out that compared to ASEAN, SAARC has not been able to develop a conflict resolution mechanism. The SAARC does not have a forum like ASEAN Regional Forum (ARF) where the states of South Asia could discuss their political disputes with honesty of purpose. The annual summit and periodic ministerial meetings at SAARC level do provide an opportunity to member states to exchange views on controversial issues but that is all they do. Dr. Cheema further explains that no regional dispute resolving mechanism is likely to work if there does not exist the political will. In fact the future of all regional organizations is heavily dependent upon the goodwill of member countries, especially India, being a major country, in the case of SAARC.■

Welcome Address

Ambassador (R) Sohail Amin

Former Foreign Secretary Ambassador Riaz Mohammad Khan,
Resident Representative Hanns Seidel Foundation Mr. Kristof Duwaerts,

Honourable Parliamentarians,
Excellencies,
Distinguished Scholars,
Ladies and Gentlemen,
Good Morning!

I welcome former Foreign Secretary Ambassador Riaz Mohammad Khan who has kindly accepted our invitation to be the Chief Guest at this conference. I welcome distinguished scholars from SAARC member states including Pakistan and all others who have found time to enrich this conference with their valuable input. It is a matter of pride for the Islamabad Policy Research Institute and Hans Seidel Foundation for having been able to arrange such a distinguished gathering of able scholars, economists and researchers from the entire South Asian region.

Ladies and gentlemen,
This is the time when Islamabad is embracing the winter season after the monsoon rains. I am sure the distinguished guests from abroad will enjoy the beauty of our capital city.

Ladies and gentlemen,
Today and tomorrow, researchers and scholars from SAARC member states will be exploring the future of economic cooperation among SAARC countries.

One of the main objectives of SAARC is to accelerate economic growth among member states. Important drivers of growth that have already been identified by South Asian countries are trade in goods and services, greater cooperation in the energy sector, food security and water resource management.

We all know that the South Asia Free Trade Agreement was signed in January 2004 during the 12th SAARC Summit held in Pakistan. The Agreement entered into force two years later, and the trade liberalization programme commenced from 1st July 2006. Following the Agreement, the

SAFTA Ministerial Council comprising the Commerce Ministers of the member States was established which meets regularly. To assist the Ministers of Commerce, a SAFTA Committee of Experts (SCOE) also meets regularly and submits its report to SAFTA Ministerial Council every six months. Cooperation in the field of finance and related areas is discussed during the meeting of Finance Ministers, also held regularly. The

SAARC Agreement on Trade in Services came into force last year but adequate data on this is not yet available.

The SAARC Chamber of Commerce and Industry has also been also in place since 1992. It is comprised of the national federations of Chamber of Commerce and Industry of all the member states. It is meant to encourage development of business linkages "amongst entrepreneurs of South Asian region in the fields of trade, service, industry, small and medium enterprises, and agriculture. Developing global linkages is also a part of its outreach strategy.

Ladies and gentlemen,
As of Sept 2013, the volume of trade between SAARC member states has not exceeded 3 billion US dollars. This is still far below the desired level and the true potential of the region.

With all these institutional arrangements in place, SAARC should have been an important platform to acts as a facilitator in speeding up regional economic cooperation. Some believe that one of the impediments in regional cooperation is the variance in degree of economic development of member states which brings in the factor of incompatibility. Member states do not have the capacity to provide necessary support to economies of the less developed partners. Competition within South Asia is, therefore, the common practice. It does not, therefore, seem unusual that instead of benefitting from SAFT A, preference is given by member states to bilateral Free Trade Agreements.

Ladies and gentlemen,
There is a common consensus amongst analysts that bilateral problems have dwarfed the capacity of an otherwise vibrant organisation. The spirit to benefit from key SAARC economic processes is, therefore, lacking.

Today and tomorrow eminent scholars from South Asian countries and renowned economists from Pakistan will be discussing the future of economic cooperation among SAARC countries. Presentations will focus on intra and extra regional incentives for economic cooperation and also the impediments that need to be overcome through collective efforts of member states. Policy makers in SAARC countries will surely benefit from the recommendations made at this conference.

Ladies and gentlemen,
I take this opportunity to thank the Chairpersons who will be presiding over the four sessions of the Conference spread over two days. I am sure that all the participants will benefit from the expert views of the distinguished scholars who will be presenting their papers at this conference. Papers read here will later be compiled in the form of a book which Islamabad Policy Research Institute together with Hans Seidel Foundation will publish soon after the Conference.
Thank you.■

Opening Remarks

Kristof W. Duwaerts,
Resident Representative, Hanns Seidel Foundation, Islamabad

Dear everyone,

I would like to welcome you all very much to this conference on the "Future of Economic Cooperation in SAARC Countries". I am grateful and feel humbled for the presence of so many renowned scholars and practitioners in the field of regional South Asian integration. I am hopeful that your voices will be heard, this not only in Pakistan, but also beyond.

Whereas the 20th Century has been termed the American Century, many observers are wondering whether the 21st Century might eventually become the "Asian Century" or – alternatively - rather the "Chinese Century". Regional integration still falling behind to a large extent, at the moment the "Chinese Century" in my eyes is a much more likely option. Whereas Europe has made the big leap forward by integrating a whole continent into the European Union, today there is not yet one Asia, but rather several "Asias".

Kishore Mahbubani, a notable Sindhi-Singaporean proponent of "Asian values", and the future of the "Asian hemisphere" in this context talks about "the Chinese, Indians, Muslims, and others". I would go further and say that we observe in Asia today, at best, six different sub-regions, being Southeast Asia, East Asia, South Asia, and West Asia, the latter being a catch-phrase for many states, and not so much a political entity whatsoever. Then there is the former Soviet Republic with many relatively young nation states diversifying into new realms, and the Arab Peninsula. All in all we are talking about 49 countries or a population of roughly four billion people, or two thirds of mankind.

No wonder, the integration, or rather the integrations, take an enormous amount of time. We observe a huge span of economic, political, cultural differences, going far beyond Mahbubani's characterization. Integration in Europe was or rather is "only" about 28 states and the comparatively small number of half a billion people, with more or less the same cultural roots, and just look at how many shortcomings can be observed still today. In short, it is easier, i.e., much less time-intensive to describe what "Asian" states have in common, than to try to come up with the differences, which would fill libraries.

This common denominator in Asia is the remarkable economic rise those states have observed in recent years. A common denominator, which goes far beyond cultural, political or other barriers; a denominator which includes the whole population of Asia, and not only certain layers; a denominator which even can transcend political barriers, as observed in East Asia. The Peoples' Republic of China is — by far — the most important trade partner of Japan, but just take a look at the political standoffs, which have arisen between the two countries in recent years, in fact ever since the end of the Second World War.

The success of integration is much more likely when done compartmentally, both in terms of topics and regions. Again, let me quote the past: the European Union started off as a mere economic cooperation between six western European states, which can be traced back to the rapprochement between what was considered to be two hereditary enemies for more than six decades: France and Germany. And look at where we stand today: No borders, same currency, a European identity in the making. But, one caveat: It took us sixty years. Advancements cannot be made quickly, they need to be realized sustainably.

One thing is for sure, Asia plays an ever more important role in world politics, in world economics, in world history. Asia for the time being is important because its parts are important, not so much because the continent as such would evolve certain dynamics. The United States dominated the 20^{th} century both politically and economically as one unit.

Let's look at how to make a unit out of the Asian mosaic. Taking into account the compartmental argument, Asia as a continent with its 49 states cannot be integrated at once. So what about starting in South Asia, what about a regional forum, which has been in existence ever since 1985. What about SAARC, consisting of currently eight member states, most of who representatives are with us in this room? And what better topic could there be than economic cooperation? Economic cooperation between SAARC countries, which to a certain degree, share the same historical and economic past.

The Hanns Seidel Foundation had recognized the importance of Asia many years ago. All over the continent we currently run 31 offices and numerous projects in many fields pertinent to the current needs of the respective countries. We support projects which are conceptualized by people of the respective countries for people of the respective countries. What we don't run yet is any kind of regional office in Asia. The closest we can get to this is run in Indonesia, where we closely interrelate with the ASEAN secretariat. I would personally be very much thankful, if there were some good reasons for me to put before my headquarters in Munich to show the need for opening a SAARC regional office. I am really much looking forward to the results of this conference and the findings with regard to the means of economic cooperation between South Asian nations. I hope, this conference will be contributing towards the goal of regional integration in the field of economic cooperation, small as this contribution might be.

Let me thank our dear partner institute, the Islamabad Policy Research Institute for once again organizing an international conference on a very timely issue. Let me thank you, dear speakers from all over the SAARC region (and beyond) for making such an international conference possible and meaningful. Let me, last but not least, thank you, dear audience, dear ladies and gentlemen, for showing this conference, and thereby the topics discussed here, the interest which they certainly deserve. Thank you for showing us that you value the conferences which IPRI and HSF run together.■

Inaugural Address

Riaz Mohammad Khan
Former Foreign Secretary

Thanks for giving me the opportunity to share my views on a matter important to all of us in South Asia. I also welcome the many eminent scholars and personalities who have travelled to Islamabad to participate in this conference.

The topic "Towards an Asian Century: Future of Economic Cooperation in SAARC Countries" readily brings to mind two issues: What is shaping an Asian Century, and in that perspective where do west and as South Asia and as members of SAARC, our regional organization.

The Asian Century

The Twenty-First Century which is sometimes described as the Asian Century is being shaped by 'the post-Cold War dynamics with ascendency of geo-economics and the phenomenon of Globalization spurred by information and technological revolutions and manifest in unprecedented global interaction. A most distinctive feature is regional cooperation for accelerated trade and economic development. As a consequence, imperatives of geo-economics appear to override geo-political tensions.

With the end of the Cold War and the bipolar world, confrontational politics at the global level had subsided giving way to competition and cooperation among great powers in today's steadily emerging multi-polar world.

Surely, conflicts have not disappeared. Afghanistan, Iraq, many other parts of the world and recently of the Middle East have suffered conflict and turmoil while old disputes such as Palestine and Kashmir continue to defy resolution. The promise of peace associated with the end of the Cold War has proved to be elusive. There are ominous tensions surfacing around the Asia-Pacific sea board. In addition there is the menace of terrorism and extremism.

Yet, in Iraq and Afghanistan, we have witnessed the limitation of use of military power and the need for diplomacy and dialogue. Terrorism and extremism continue to ravage countries especially where they breed, but at the same time there is increasing international cooperation to counter this threat. In East China Sea and the South China Sea regions, recent tension has also given rise to concerns favouring circumspection and restraint and a deep and shared appreciation that tensions must not be allowed to compromise the momentous transformation and historic gains in East Asia especially during the past three decades.

On the whole, these developments are unlikely to reverse the trends for trade and economic cooperation set over the past three decades that have transformed many regions in the world, especially East Asia and South East Asia, into engines of global economic growth. Geo-economics has a powerful and inexorable logic. This coupled with the inspiration of building knowledge-based societies augurs well for Asia.

The Asian development has altered the political landscape of the world. If we compare with the world situation on the eve of the Twentieth Century, what we witness today was unthinkable then. The change is not just spectacular it has by any measure brought about a better world order which is more equitable, more prosperous and more participatory. Thus describing the current century as the Asian century is justified.

South Asia

Turning to South Asia, there is little doubt that the region has made progress. Economic growth rates have been considerable, in particular of India which has become a leading economy in the world. Despite problems, Pakistan also showed consistent growth for many years in the last decade. However, regional cooperation especially within the framework of SAARC leaves much to be desired. This is more poignant when we compare progress made by other regional organizations such as the ASEAN, GCC or MERCOSUR. Figures for inter-regional trade are tell-tale.

According to an estimate the intraregional trade within SAARC region is less than 5 per cent of its total trade. Compare this figure with20 per cent among members of ASEAN and 15 per cent among MERCOSUR members and 50 per cent among countries of East Asia including South East Asia and 20 per cent among countries of Latin America.

The figures point to both the potential and the problems that need to be overcome.

South Asia faces serious challenges that depend on regional cooperation for their alleviation and redress. Social indicators in the region are among the lowest in the world, despite the resources and resourcefulness of the South Asian people.

The examples of major challenges include:

- poverty alleviation, South Asia is home to the largest population in numbers living below the poverty line;

- addressing illiteracy, again South Asia has the largest population that remains deprived of basic education;
- population control, the population density in each of the South Asian countries underscores the magnitude of the problem;
- employment for the largest youth bulge in the world;
- the new challenges of environmental degradation, climate change, water issues, and food security.

On most issues related to these challenges, there are summit level declarations and decisions for forging and promoting cooperation. There is also institutional frame work with numerous technical committees, subgroups and designated centres to study and develop blue print for cooperation. However, progress is anything but substantive. There can be many views on the reasons for this predicament.

In my view, first and perhaps fundamentally, as member countries we have been unable to fuse SAARC agenda and priorities with domestic agenda which remains the primary vehicle in each country for socio-economic development as well as for identifying and addressing problems. Among ASEAN members, ASEAN affairs are treated as core policy matters even on domestic agenda.

Secondly, while there are agreements and recommendations and studies, there is relatively little in terms of concrete SAARC projects and enterprises that can fire the imagination of South Asians.

Thirdly, political problems among member states are seen as impediments but have been rightly kept outside the purview of the SAARC mandate and activities. Even though there exists a Convention for suppression of terrorism along with a 2004 Additional Protocol, cooperation in this arena, in whatever degree it is maintained, is mostly through bilateral channels. There is a pervasive view that bilateral problems especially those besetting Pakistan-India relations have stifled SAARC from realizing its potential. Conceding that this matter is outside the framework of SAARC, I will venture two observations:

First: problems among any two members should not weigh down on progress in cooperative endeavours among other members or programmes in other sub-regions of SAARC. Indeed, progress and success stories in one area could serve as an inducement for other areas. So in my view progress and levels of cooperation need not be symmetrical. By suggesting this modality I am stepping beyond the parameters of SAARC to a more flexible model for regional cooperation. But, I believe that such an approach can help expand the least common denominator which binds agreements and working within SAARC.

Second: In my experience of dealing with Pakistan-India issues, I have come to believe that resolution of political disputes and issues is not just the most effective confidence building essential for wide ranging cooperation. In the changed global environment of today, unlike in the past, territorial concerns need not necessarily be placed in the straitjacket of sovereignty. Innovative solutions are possible based on joint management that can become game changers and sound underpinnings for regional peace and development; thus problems can be turned into opportunities. What is needed is not generosity of spirit on the part of any of the protagonists, but openness to ideas and reasonableness.

Success in this direction and in areas that have been identified by SAARC and are unexceptionable such as environmental protection, water security, food security and poverty alleviation can place South Asia on the cusp of a promising new age setting a lead example on how to address seemingly intractable problems and manage affairs for mutual benefit.

Trade and Economic Cooperation

As for the economic future and potential for trade and economic cooperation in the SAARC region, the comparison with intra-regional trade within ASEAN and MERCOSUR alone gives an idea.

There is no dearth of agreements and technical committees and sub-groups. Free trade agreement SAFTA was enforced in 2006. It was followed by yet another agreement on trade in services (SATIS) as well as agreements for customs matters. There is a functioning SAARC Chambers of Commerce. All these arrangements aim at integrating the regional economy. There have been seven SAFTA meetings at ministerial level and nine meetings of SAFTA Committee of Experts between 2006 and 2013. A number of products on the sensitive list have been reduced by almost every member state (Pakistan brought these down from 1169 to 936 in 2012). Yet the regional trade under SAFTA remained under three billion dollars according to 2012 figures.

To be realistic, trade and economic cooperation develops if all participants profit and have a clear stake in the arrangements for facilitation. Theoretical models, however convincing, may not find traction if partnership yields one way advantage. Often the devil lies in the detail and much depends on rationalization of procedures and accommodation. Lack of political will is sometimes bureaucratic inertia, not uncommon in the South Asian administrative culture. While the case of Pakistan and India may have political baggage and therefore peculiar, the overall low SAFTA trade figures cannot be explained without reference to bureaucratic hurdles and absence of trade facilitation among other SAARC members. Causes for this sluggish state of affairs have to be looked into and bottlenecks removed.

Only recently, Pakistan and Afghanistan simplified procedures for overland transit trade removing encumbrances and providing better facilitation. As for Pakistan and India, trade has often mixed with political considerations. India faults Pakistan's ambivalence over MFN treatment. Pakistan on the other hand finds Indian tariff structures and procedures no less than non-tariff barrier to its trade. At a bilateral level, but in pursuance of the SAARC decision to enforce SAFTA, Pakistan and India have had discussions and reached framework agreements for rationalizing custom procedure, harmonizing standards and establishing banking facilities. Again progress on follow up is just typically slow. Pakistan’s proposal for reducing peak tariff to zero to 5 per cent by 2020, excluding about 100 tariff lines on sensitive list, deserves serious consideration.

Other Recommended Priority Sectors

In addition to promotion of trade and cooperation in numerous sectors identified over the years by SAARC including poverty alleviation and food security, I would like to highlight for priority attention the following four areas:

- Energy
- Connectivity
- Environment
- Water management

These sectors represent huge challenges where issues simply cannot be addressed within domestic framework; these have a vital intra-regional dimension.

Energy sector opens new and exciting prospects of cooperation that can benefit the entire region. It would require an infrastructure of not only transmission lines but public and private sector arrangements between buyers and sellers. The resulting interdependence and positive dividends for better confidence and understanding are obvious.

Since the establishment of a Technical Committee on Energy in January 2000, there have been technical and high level meetings to consider broad ranging intra-regional cooperation from promoting energy trade within SAARC to developing renewable energy resources. A SAARC Energy Centre has been established in Islamabad to act as a catalyst for collective activities on energy. It has developed a comprehensive ambitious plan for programme activities. However, traction in this sector will depend on implementation of concrete projects and private public sector involvement with active official facilitation.

Connectivity encompassing road and rail links, telecommunications and travel is a much discussed subject. It is without doubt an essential feature of regional economic growth. In the light of a SAARC Regional Multimodal Transport Study prepared with ADB funding, an inter-governmental group recommended the SAARC Secretariat to develop draft regional agreements on transport and transit, railways, and framework for multimodal transport operations. Two draft agreements respectively for railways and for motor vehicle transportation were offered by India and have been under consideration since 2007. I will limit myself by suggesting that in this area if necessary a staggered or sub-regional approach could work to set the ball rolling instead of permitting the overall enterprise be stalled because of peculiar conditions in anyone sub-region or the state of bilateral relations among any of the member states.

Environment is one area where we collectively have a heavy responsibility towards future generations. It is not just the issue of the fate of Maldives or of forests or clean air and clean water. From Afghanistan to Bangladesh, South Asia depends on the largesse of glaciers of the Hindu Kush, the Karakorams and the Himalayas. What the countries along these magnificent mountain ranges do today will secure the welfare and prosperity of succeeding generations tomorrow. The challenge of monitoring and protecting these glaciers cannot be overemphasized. Environment recognizes no boundaries nor inter-state conflicts and shenanigans; it has to be taken seriously.

Water management is linked but essentially a separate issue that demands intelligent and integrated domestic and intra-regional measures. The issues of upper and lower riparian countries are acute and portend danger. In addition there are problems relating to depleting aquifers. Increasing usage and demand have stressed availability of fresh water and point to the urgency of inter-state cooperation and adoption of best practices,

It will be naive to overlook impediments, but if we remain daunted by them, we risk losing opportunities that states have seized in other regions. Over three decades, SAARC has built a body of thought and institutional network. It provides a most valuable forum for its leadership to discuss both SAARC related and other vital political, bilateral and international issues. There is awareness of benefits of cooperation and willingness to move forward. We need to operationalize these ideas to transform SAARC into a vibrant organization worthy of the shared history, heritage and culture in our region.■

Concluding Address

Dr. Ishrat Hussain
Former Governor, State Bank of Pakistan, Dean and Director,
Institute of Business Admiration (IBA), Karachi

Addressing the concluding session as the Chief Guest Dr. Ishrat Hussain, former Governor, State Bank of Pakistan, Dean and Director, Institute of Business Admiration (IBA), Karachi, said that unfortunately South Asia had not achieved 1/3 of the its potential in 60 years despite the fact that Asia was the prime mover of the global economic growth in 2013. The 2008 financial crisis proved the resilience of the Asian states. Today among the top ten banks of the world, five were Chinese and the Industrial and Commercial Bank of China was on top. Even Africa was growing at five per cent per annum which was a remarkable change. The time had come to put our own house in order and remove the impediments and constraints to growth. He said that global or regional cooperation was the derivative of what each nation wanted to do for itself. Looking at each regional grouping, there was a pivot and that pivot played an important role in either making the regional cooperation work or destroying it completely. China was the pivot of East and Far East Asia; in Southern part of Africa, South Africa was the pivot; in West Africa, Nigeria was the pivot; in EU, Germany was the pivot; and India was the pivot in South Asia. India was the eight per cent of South Asia, so whatever happened in India had its repercussion in South Asia. He blamed India for not playing its role of leadership properly in the region. India had to be more magnanimous and more generous in its approach as far as economic activity was concerned. It was in the interest of India to act as a pivot for South Asian economic cooperation. It was a win-win game and not a zero-sum game, he said.

Dr. Ishrat Hussain noted that every time Pakistan agreed to phase out the negative list, some non-economic factor cropped in and completely derailed the process of normalization. Instead of putting pre-requisites of political normalization, Pakistan should try to normalize its economic relations first which, he hoped, would lead to political normalization. He cited the example of China and India having political issues relating to Laddakh and Arunachal Pardesh but the bilateral trade had moved up from almost nothing to US$ 75 billion. Bilateral surpluses were not always to be expected and if they were, that was economic nonsense, because there would be bilateral surpluses as well as bilateral deficits. Pakistan had huge bilateral deficits with China and that would remain so. Similarly, with India it would benefit Pakistan because trade expands the economy and this opens up new opportunities for the people. He also mentioned that the bogey of non-tariff barriers had been created by those who wanted to keep protectionism on.■

Concluding Remarks

Mr. Kristof W. Duwaerts

Mr. Kristof W. Duwaerts appreciated the high standard of the discourse at the conference, the input of all speakers and the useful discussions that took place.. He said that the conference had provided very workable recommendations in favour of regional economic cooperation among the SAARC member states.

Mr. Kristof mentioned that there was no need to get rid of political problems first. First, we needed to cooperate in the economic field, because it was good for all; political problems would take time to be solved and the process of resolution of disputes would be helped by economic relations which would soften up attitudes creating a spirit of give and take.

He thanked IPRI for organizing the conference and inviting 16 renowned speakers from ten countries. He favoured holding such conferences more frequently in the future and hoped scholars of regional countries would participate in such events with enthusiasm.■

Vote of Thanks

Ambassador Sohail Amin

Dr. Ishrat Husain, Former Governor State Bank of Pakistan and Director Institute of Business Administration
Resident Representative Hanns Siedel Foundation,
Mr. Kristof Duwaerts
Honourable Parliamentarians
Excellencies,
Distinguished Scholars,
Ladies and Gentlemen,
Good Afternoon

At the conclusion of this conference, I wish to state that these two days were full of sharing knowledge. The objective was to develop recommendations that could help in integrating the political, economic and social synergies of the region for collective growth and economic development. The Conference has come out with productive and useful recommendations based on the aims and objectives of the SAARC Charter whose goal is to achieve economic growth and social progress. The conference has presented a new vision for the region's progress and prosperity. Policy makers of the member states need to think afresh practicable means and strategies to quicken the achievement of mutual goals.

Holding this conference was a source of great joy and pride for the Islamabad Policy Research Institute.

I am grateful to Dr. Ishrat Husain for enlightening us with his sagacious thoughts on economic policy in the context of achieving SAARC objectives.

I take this opportunity to extend our sincere thanks to all our guest scholars who travelled from different countries to participate in the conference and make it a success with their valuable contribution. I wish them a safe return journey. I hope they enjoyed their stay in Islamabad.

I also wish to thank all the participants of the Conference and the eminent audience for enlivening the discussion with their thoughtful remarks and queries.

I thank the Hanns Seidel Foundation for making the conference possible. The Chief Guests at the inaugural and the concluding sessions, the Chairpersons of various sessions and the scholars who presented their papers are the real contributors to all that has been achieved at the Conference.

Before concluding, I wish to inform that the proceedings of this Conference will be compiled and published in the form of a book by the Islamabad Policy Research Institute very soon.

I thank you all.■

Recommendations

In the light of the views expressed by the conference participants, Ms. Saira Rehman, Assistant Editor, IPRI presented the following key recommendations:-

Economic Cooperation

There was consensus among the participants that it was not resource shortfall that constrained the evolution of SAARC as a meaningful economic entity but the regional leadership's lack of political will to move forward by resolving their political disputes. During the deliberations, approaches were cited that other regions adopted to achieve mutual economic cooperation despite the existence of disputes such as increased trade between China and Japan, China and Philippines and China and India. The second model fitted the case of SAARC where inter-state conflicts have taken the centre stage and trade and economic activity has been held hostage to their resolution. It was suggested that SAARC countries could also pursue mutual trade and investment-based economic cooperation without waiting for the resolution of inter-state disputes.

With adequate institutional arrangements in place, SAARC should have been a facilitator and enabler in speeding up regional economic cooperation but the volume of trade between member states is far below the desired level and the true potential of the region. The eight SAARC countries account for around a quarter of humanity, with a population of nearly 1.7 billion. However, SAARC only has a combined share of three per cent of world GDP, roughly two per cent of world exports and imports and around 1.7 per cent of world's inward FDI flow. It is dominated by India with 75 per cent of the population of the region, 63 per cent of land area and 81 per cent of the combined SAARC GDP. One of the impediments in regional cooperation is the variance in the degree of economic development of member states which leads to economic inequalities and even the developed member states do not have the capacity to restructure the economies of less developed partners. That is why, instead of benefitting from SAFTA, preference is given by member states to bilateral free trade agreements. Such a trend needs to be discouraged. South Asian economies still choose to trade with extra-regional economic partners like the US and EU. Pakistan and India need to set the tone right and lead the way by correcting their respective trading priorities and preferring to trade with each other and within the region.

- Within the region, resolving financial problems pertaining to intra-regional trade and investments should not be left to the central banks of a single country. To do that all member countries should co-opt their central banks to evolve compatible structures and regulatory mechanism.
- SAARC member states need to keep in view that economic dynamism through mutual economic reliance creates its own peace dynamics and generates growth. There is a need for carefully thought-out processes of negotiations and a comprehensive package of agreements followed by a sound monitoring & management mechanism that is practical, and efficient, capable of comprehensively addressing political disputes and existing impediments to economic cooperation.
- Micro economic fundamentals of the region reveal that these regional countries need to integrate production-investment-value-chain to boost overall growth. For this both government and private sectors need to be involved in setting the investment agenda for regional investment framework.
- SAFTA came into force on January 1, 2006.There are various elements and components which are supposed to be fully implemented by December 31, 2015. Therefore, it is important that all SAFTA agreements are implemented within the stipulated time. To implement SAFTA, every country should shorten its negative list as soon as possible and as far as feasible, especially regarding those products which are more economical to trade within South Asia. There is no mechanism in SAFTA for progressively reducing the negative lists. Such mechanism is needed.
- Despite numerous incentives, FDI is quite low in South Asia due to less than expected economic returns, infrastructural deficiencies, law and order situation, political instability etc. Therefore, SAARC governments should attach high priority to addressing the impediments.
- At present, all types of trade negotiations are taking place at the government level, both in the case of WTO and SAFTA. Business communities, the actual actors, have, by and large, been left out. To be able to identify the problems more clearly and to solve them efficiently, business communities and private sector representatives should be included in all trade negotiations to materialize the true spirit and benefits of SAFTA.

- Economic cooperation was the main driver behind European integration and it took sixty years for the EU to evolve into its present form, it would be difficult to have an Asian Union on the pattern of the European Union. It would be more feasible to strengthen SAARC by focusing on regional commonalities and economic cooperation.
- Afghanistan is a natural land-bridge and the new Silk Route initiative would help to integrate the regional economies with Afghanistan, helping it to stabilize its economy in the post 2014 situation.
- Liberalization of trade amongst SAARC countries would help in reducing smuggling and other forms of informal trade. Hence, gradual formalization of informal trade would benefit the mainstream national economies of SAARC states.
- SAARC must jointly establish a competitive research Hub to evaluate the relative competitiveness of SAARC countries and facilitate a free trade environment.
- Member states must develop complementarities in their economies so that they can move forward in a relatively smooth manner.
- SAARC should establish a joint investment company to facilitate cross border investments and this could ultimately lead to the establishment of a SAARC Bank to facilitate trade and investment.

Energy

- There are pockets of energy surplus and energy scarce areas within SAARC. Trade in energy sector can open new and exciting prospects of economic cooperation that can benefit the entire region. However, it would require extensive grid and transmission infrastructure upgradation.
- Energy trade would also give rise to interesting patterns of interdependence and yield positive dividends in the form of sustainable and robust CBMs.
- The SAARC Energy working Group should be more proactive to create infrastructure and regulatory mechanisms in SAARC.
- The creation of SAARC “Power Pool” will enable the region to utilize their collective resources of electricity/energy in an optimal way by balancing the demand and supply through various sources of electricity generation.

- To enhance inter-state trade in energy the practical hurdles need to be removed to encourage investment in the required infrastructure and upgradation of transmission grid systems.
- A dispute resolution mechanism should also be in place before cross-border energy transmission plan is developed.
- Energy pipelines would be a major CBM to create goodwill and mutual trust among member states.

Communication and Infrastructure

- Due to lack of connectivity, logistic costs in South Asia are very high ranging between 13-14% per cent of the commodity value, as compared to eight per cent in US. Connectivity encompassing road and rail links, telecommunications and travel is an essential prerequisite of regional economic growth.
- Improved infrastructure and growth through improved connectivity would allow South Asia to share its benefits more widely. The state of physical infrastructure in South Asia needs to be improved.
- To tackle the funding issue, cross-border projects need broader integration strategy, as demonstrated in projects like: the Almaty-Bishkek Regional Road Rehabilitation project funded by ADB under the Central Asia Regional Economic Cooperation (CAREC) programme or the Northern Economic Corridor of the Greater Mekong Sub-region (GMS). Stronger cooperation with both developing and developed countries is needed for technology sharing and financing to remove the missing links in creating regional networks such as Trans-Asian Railways (TAR).
- All South Asian countries should sign “Motor Vehicles Agreement” and “Regional Transport and Transit Agreement” and work to revive a regional overland road link from Istanbul to Yangon via Delhi. This can be revived for regional trade with little effort. A major part of this corridor is domestically operational, comprising a dual carriageway, and an integral part of the old Sher Shah Road, or Grand Trunk (GT) Road. The opening of the route will mark the revival of the old linkages which existed between South and South West Asia dating back to the British Period.

- Afghanistan-Pakistan-India-Bangladesh–Myanmar Transport Corridor (APIBM), aimed at making each and every country in South Asia as a transport hub for trade in broader Asian region deserves attention. Indeed APIBM corridor could be South Asia's new silk route bridging Central and West Asia to East Asia.
- Apart from transit revenues, there are huge gains associated with energy conservation due to transit through shortest and efficient routes.
- Opening border points such as Wagah-border and Ganda Singh border as well as revitalizing the old railway and road infrastructure can fast track mutual trade in South Asia. Trade between the two Punjabs and two Bengals can connect the whole region.
- There is a need to establish joint Infrastructure funds to facilitate connectivity in the region.

Trade

- A large segment of the Pakistani businessmen maintain that there are strong non-tariff barriers (NTB) on the Indian side, which do not allow fair opportunity for the Pakistani products to enter the Indian markets. They fear that with such a significant trade imbalance between the two countries granting MFN status to India may cause a huge negative impact.
- In theory, opening up of an economy is mostly considered to be beneficial as it promotes growth. However, as markets/economies open, competition stiffens and fresh challenges emerge. Hence, the regional trade boosting endeavour needs to be in sync with SAARC nations' aspirations. Trade should be conducted on terms that provide a level playing field to all stakeholders.
- SAARC should go beyond the mere Agreement on 'trade in goods'; and include regional co-operation mechanism in the areas of investment, finance, services' trade, trade facilitation and technology transfer.
- A substantial part of international trade involves trade in intermediate goods. Trade in intermediate goods is based on both comparative and absolute advantage. The South Asian

countries can engage in vertical specialization through production sharing arrangements.

- SAFTA has come into force on January 1, 2006; there are various elements and components which are supposed to be fully implemented by December 31, 2015. Therefore, it is important that all SAFTA agreements are implemented within the stipulated time.

Political Issues

- There is a view that implementation of SAFTA has been hindered by political disputes among SAARC countries especially between Pakistan and India; though other factors such as bureaucratic hurdles and absence of trade facilitation among SAARC members are also important, yet large scale economic cooperation and integration will only happen when these disputes have been resolved particularly between the two major states of South Asia.
- The nations of South Asia need to make concerted efforts to build mutual trust so that the process of regional cooperation can move forward. For this purpose especially Pakistan and India should display their resolve to tackle their major political disputes like Jammu and Kashmir through a sustainable dialogue framework within a given time frame. Such a comprehensive agreement will greatly help in creating trustworthy environment in South Asia and assist in achieving early economic cooperation among SAARC countries.
- There is also a need to enhance people-centric regional cooperation to create social harmony in South Asia. In this regard the establishment of a SAARC University would be an important step. There is a requirement to promote travel and tourism within the SAARC region as well to build confidence amongst the people of the region for greater economic cooperation. If tourism can take off, trade, investment and economic cooperation can follow. A joint Tourism infrastructure can be developed for facilitating travel and tourism.

Best Practices

- There are lessons to be learnt from successful examples of regional trade, Free Trade Areas (FTAs) and common currency zones in other regions of the world. As a result of regional linkage/integration, benefits ooze out in the form of tremendous synergies that unleash diverse strengths in manufacturing, resource development, trading and related services.
- SAARC as a region needs financial capital to meet its investment requirements. Of late, we have noticed that other regions (Far East, South East Asia, Asia Pacific, even EU and China (and now China and UK) are resorting to currency swap arrangements and agreements on mutually utilizing bilateral cum internal trade deficits. SAARC can benefit collectively through such innovations.
- Strong institutions and organizational structures are the main drivers and enablers of economic growth, regional integration and collective prosperity. The South Asian countries need to build such institutions for which examples of regional organizations such as the EU and the ASEAN may be taken as a guide.
- In addition to promotion of trade and cooperation in numerous sectors, collective efforts can be made towards poverty alleviation, food and water security. Disaster management is another area of cooperation that needs collective effort by SAARC member countries. These countries could also work together to mitigate the effects of climate change.

Dispute Resolution

- Like the ASEAN Regional Forum which fosters constructive dialogue and consultation on political and security issues of common interest and concern, SAARC should also establish its Regional Forum where the states of South Asia could discuss their political disputes with honesty of purpose. Of course such a regional dispute resolving mechanism can only come into existence and operate with the political will of the disputing parties. Political will implies that they are ready to make concessions and work for a compromise formula in order to settle the issues or resolve the disputes. SAARC leaders should display such political will to create a dispute resolving mechanism and in this context, being a bigger state, India should lead by showing greater accommodation.■

CHAPTER 1

Regional Trade — Driver for Economic Growth

Dr. Kamal Monnoo

Executive Summary

The eight member countries of the South Asian Association for Regional Cooperation (SAARC) account for around a quarter of humanity, with a population of nearly 1.7 billion. However, SAARC only has a combined share of three per cent of world GDP, roughly two per cent of world exports and imports and around 1.7 per cent of world inward FDI. It is dominated by India with 75 per cent of the population of the region, 63 per cent of land area and 81 per cent of the combined GDP.

Although, the South Asian economies are now increasingly looking to exploit the benefits of greater market openness, their performance lags behind other regions. While trade as a percentage of GDP has risen from 19 per cent to 30 per cent between 1994 and 2010, it is still well below other regions like East Asia (58%) and Europe (66%). They exhibit a similar tepid performance when it comes to trade and investment integration within the region and with the rest of the world — Intraregional trade for the SAARC region stands at a low 2 per cent of GDP compared to 40 per cent for the South East Asian region. SAARC is one of the least integrated regions in the world. It is also amongst the poorest. Almost 30 per cent of SAARC population lives on less than $ 1 per day — representing 40 per cent of the world's poor in general. Despite the advantages of physical proximity, South Asian economies still choose to trade with the more distant economies of the United States and European Union. And it is here where Pakistan and India need to set the tone right and lead the way by correcting their respective trading priorities and preferring to trade with each other and within the region over others.

Countries these days are being seen to be moving back towards protectionism, opting increasingly for bilateral trade agreements (like preferential trade agreements, free trade agreements, mutual tariff arrangements, etc.) instead of pushing to conclude the larger pending Doha Agreement on overall global trade. These mushrooming FTAs (Free Trade Agreements) and PTAs (Preferential Trade Agreements), often referred to as the 'Noodle Bowl' effect, are eating away at the very spirit of WTO.

Large developed economies which are already considered as Knowledge-based economies are endeavouring to go back several ‘stages of growth’ in arguing that a certain level of manufacturing base should always be maintained in an economy to hedge against unemployment, inflation and restricting undesirable imports.

However, on a positive note, of late, apart from the international pressure and WTO compulsions for freeing up bilateral trade between Pakistan and India, what we are seeing is a commitment and will by the two neighbours themselves to seriously work on a sustainable process of Indo-Pak trade liberalization. A realization by both Pakistan and India that in enhancement of economic cooperation not only lies the key to resolving their long standing issues, but also the opportunity for realizing their true economic potential. Only developed Pakistan and India can provide the future for their citizens that they deserve but have been deprived of thus far. It is heartening to note that three key agreements were signed on September 21, 2012 in order to embark upon the course of removing three main irritants or NTBs. 1) The Customs Cooperation Agreement, to avoid arbitrary stoppages of goods at each other’s ports and facilitate bilateral trade, 2) Mutual Recognition Agreement, for acceptance of certificates of internationally accredited laboratories, and seek harmonization in each other’s standards and certifications and 3) Redressal of Grievances Agreement, for resolving matters in case of any disagreements. Another agreement between the Export Inspection Council of India and Pakistan Standard and Quality Control Authority is also likely to be signed soon. If the logjam in the trade relations between Pakistan and India can somehow be resolved, it will automatically pave the way for enhanced trade within the SAARC region per se.

Protectionism according to a study by the famous Lawrence and Edwards (Harvard professors) is a high-cost option in an interdependent environment and the socialist countries of the post-World War II era learnt this the hard way. They basically argue on how increased but prudent imports induce indigenous industries to be more competitive. Ultimately this enhanced competitiveness leads to increase in exports of the country shunning protectionism. In the 18th century, a French social critic and political philosopher, Montesquieu, thought that commerce improves manners and cures most destructive prejudices. The concept is now gaining currency that intra-regional as well as inter-regional trade will lead to peace among nations that have conflicts and have seen many wars. Not only does trade promote peace, but the enhanced trading relations also multiply collective benefits for all stakeholders. There is no denying the fact that bilateral trade on equitable terms will surely be very beneficial to both Pakistan and India and increased trade within SAARC can be the main driver of growth for the entire South Asian region. The dynamics of smooth intra-regional trade can not only play a pivotal role in strengthening the economies of all South Asian countries, but also unleash a soft process, which over time can be the key to resolving long standing sticky issues between countries. However, when it comes to taking bold initiatives between Pakistan and India, a careful cum proper homework needs to be done before embarking on the same. Too often have such endeavours failed simply because the key drivers in such attempts failed to adequately grapple with the elements of reciprocity and fair play to provide a level playing field to all parties. Only a carefully thought out process of negotiations and a comprehensive package of agreements followed by a sound monitoring & management mechanism that is practical, efficient and comprehensively addresses long standing concerns amongst the SAARC nations (especially between Pakistan and India) can bring about sustainable progress and a win-win for both countries. History tells us that the window of opportunity in Pakistan-India affairs is generally very small!

There is increasing historical evidence that classical geopolitical threats get influenced and mitigated by forms of economic collaboration and mutual dependence through trade. Countries that get connected through trade and resultant supply-chains across the border tend to then understand the risk premiums they have if they were to indulge in anything adventurous. If one follows the evolution of supply chains, one sees the prosperity and stability they promoted first in Japan, and then in South Korea and Taiwan, and now in Malaysia, Singapore, Philippines, Thailand, Indonesia and China. Once countries get embedded in these regional and global supply chains, they feel part of something much bigger than their own limited markets. In broader terms one can distinguish three types of connection between economic development and security of a region: a) The immediate impact of security/insecurity on wellbeing and consequently on development achievements or the ways in which security forms part of the definition of overall economic development; b) The way that insecurity (non-security) affects elements of developments and economic growth or the way development affects security; and c) Most importantly, how economic linkages and trade bring together both security and development/growth.

Recent economic history is full of examples where countries have achieved higher growth through enhanced economic and trade linkages; in fact the world economy itself over the last decade has mostly grown on the back of enhanced global trade. Perhaps the most notable recent work in this respect comes from the Nobel Laureate economist, Paul Krugman. What Krugman really explained in his Nobel winning work was that in reality when trade barriers fall and trade increases, firms gain access to bigger markets, allowing them to expand production and reap economies of scale, but at the same time, openness also exposes them to competition from rival foreign firms, paring their margins. Some firms may go out of business, however, between the domestic survivors and the foreign entrants, consumers (meaning people) still have more to choose from. Thus the gains from trade arise not from specialization, but from ‘scale economies’, fiercer competition and cornucopia of choice that globalization provides. This concept of scale economies for the first time gives economics a sense of space. For example, he himself argues that, night-time satellite photos of Europe reveal the distinctive contours of economic activity: bright lights cluster around metropolitan centres, shinning particularly more brightly around the triangle of Brussels, Amsterdam and Dortmund. Earlier, economists struggled to explain these images as they didn’t fall in line with the crux of the theory itself. They were accustomed to assuming that firms face constant returns to scale and yet if this was to be true then every person could essentially create his own little backhouse production chain and there would be no need for an economy to divide into a farm belt and an industrial belt?

As we all know that big factories benefit from lower costs of production. Manufacturing firms might therefore cluster near to a large market, leaving behind a sparsely populated hinterland, in order to make the most of scale economies and minimize the cost of transporting goods to their customers. Earlier theorists reasoned that firms herd together to benefit from some kind of “spillover”, i.e. perhaps firms pick up tricks of the trade and other know-how from their neighbours. But this argument appeared somewhat unsatisfying, because largely spillover could neither be measured nor could their scope be delimited. However, what in essence we have learned today from Mr. Krugman’s work is that regional focus, proximity and neighbourhood cooperation instead yield new yet tangible kinds of benefits and strengths. The opportunity for firms to locate in respective regional strong areas is a gift to other firms in the area, because in attracting new workers it also brings new customers. Unlike a technological spillover, the real physical proximity of firms and real production work taking place in common areas of interest leave a paper trail, showing up in firms’ growth in general, thus benefiting the entire region by making it more competitive in a global environment.

Finally, to put all this simply, by contrast, the gross importance of regional cooperation for the first time has come to the global fore front. We have a leading Economist who is advocating with concrete and tangible empirical evidence the following three focus points:

1) Regions, which fail to offer space for joint production and common productivity development, tend to lose out in the long run.
2) Negative spillovers cannot be avoided. Meaning, a neighbour's loss cannot be your gain and a regional partner's problem cannot be bottled up within the geographical boundaries of that country.
3) And the most important: Poverty alleviation is a geographical challenge and therefore needs to be tackled at a regional level.

Regrettably, the short history of Pakistan and India stands mired in an unhealthy rivalry, mistrust, needless animosity and frivolous point scoring, which is not only adversely affecting their economic progress, but is also holding hostage the economic potential of the entire South Asian region. Instead of some honest soul searching, the will to find solutions, and to evolve strategies to further open up trade for the sake of mutual development and growth, what we see is a culture of blame game – One step forward and two backwards. And it is this barrier we have to cross in order to bring about prosperity to the South Asian region as a whole.

Free Trade is God's diplomacy. There is no other certain way of uniting people in the bonds of peace and prosperity. ~ British politician Richard Cobden, 1857.

Regional Trade — Driver for Economic Growth

It is both interesting and at the same time heartening to note that we are talking about regional trade (and not protectionism) as a driver of growth. Post 2008 financial crisis (the 'Great Recession' as it is being called by many economists) the debates, once considered 'closed and shut', pertaining to: unbridled free trade cum modern day globalization versus controlled imports, minimum footprint of the state versus finding the right mix between private sector and state capitalism in an economy, and pursuing a complete laissez-faire cum a minimally monitored markets model versus the comparatively controlled and monitored markets model, have all been recently brought back to life and earlier conclusions are being questioned and challenged vociferously by a number of well-known economists, Joseph Stiglitz included. Countries these days are being seen to be moving back towards protectionism, opting increasingly for bilateral trade agreements (like preferential trade agreements, free trade agreements, mutual tariff arrangements, etc.) instead of pushing to conclude the larger pending Doha Agreement on overall global trade. These mushrooming FTAs (Free Trade Agreements) and PTAs (Preferential Trade Agreements), often referred to as the 'Noodle Bowl' effect, are eating away at the very spirit of WTO. Large Developed economies which are already considered as Knowledge-based economies are endeavouring to go back several 'stages of growth' in arguing that a certain level of manufacturing base should always be maintained in an economy to hedge against unemployment, inflation and restricting undesirable imports. The United States of America (USA) as we know after a long time has renewed its focus on shoring up American manufacturing in order to replace some of its imports and boost its exports and in the European Union (EU) we see a lot of anger and criticism on Germany running a large surplus at the expense of deficits in the other Euro-Zone economies. A case seems to be building in the EU against a pattern of trade that unfairly favours a single country and it is threatening the very unity of the region as a whole. Given this changed global environment where countries these days are more focused on protecting their own backyard rather than undertaking international engagement, a move by SAARC (and especially Pakistan and India) to instead opt for opening their respective markets to each other will surely be termed as rather brave. More so for the countries that run a regional trading account deficit, which virtually means all members except India. As an example, Pakistan being the second largest member, to date its products have struggled to find a significant place in the Indian markets, whereas, the Indian products have done rather well in the Pakistani markets.

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However, the timing, pace and the endeavour itself of freeing trade with India draw a mixed reaction from all quarters, Industrialists, Business Community at large, Agriculturists and Security Analysts. While on the one hand there is this lobby, which argues that by doing so not only do we get access to a robust market of more than a billion people, but more importantly the free trade dynamics will unleash a future of mutual dependence, in turn minimizing cross border security concerns; on the other hand is a large cross section of nervous manufacturers, struggling farmers and skeptical security personnel who all remain equally fearful of Indian regional designs in particular and India's poor track record on bilateral trade in general.

Amidst these conflicting views and confusing international trends the average Pakistanis stand quite confused that if their government doing the right thing by wanting to liberalize with its arch rival and if not, then given Pakistan’s commitment to backing the global free trade dynamics under the WTO what policy options are available to our government vis-à-vis the MFN status and trade with India. To answer this properly, perhaps the right approach would be to first analyse the existing realities in each area of relevance or concern and then try to discuss the pros and cons of the MFN reality from 2013 onwards.

Things as they Stand Today

The total trade volume between Pakistan and India in 2009-10 was around $ 1.45 billion, out of which Pakistan’s exports to India accounted for only $ 275 million (19% of the total bilateral trade), whereas, the Indian exports to Pakistan stood at more than $ 1.20 billion (81%). In the current year, the trade is said to have crossed the $ 2 billion mark, but the balance of trade has tilted further in favour of India. In addition, experts believe that Pakistan absorbs about $ 3 to 4 billion of Indian imports through unofficial channels like smuggling and indirect routing through countries like Dubai, Singapore, Thailand, etc.

The pro MFN lobby argues that not only can the government of Pakistan earn crucial revenue by bringing the illegal trade into the official fold, but also reduce its import burden by sourcing (closer to home) cheaper Indian products and by tapping into the huge trade potential (estimates by various trade bodies on potential of mutual trade range from $ 10 to $ 20 billion) that exists between our two neighbouring countries. On the other hand the reality is that although India granted the MFN status to Pakistan way back in 1996 the gesture has not helped Pakistan much in increasing its exports to India. A large segment of the Pakistani businessmen maintain that there exist strong non-tariff barriers (NTB) on the Indian side, which do not allow fair opportunity for the Pakistani products to enter the Indian markets. They fear that with such a significant existing imbalance of trade between the two countries despite not having granted India the MFN status, no rocket science is required to gauge the gravity of the impact once the MFN status is bestowed!

As for the NTB, according to the WTO, there exists no agreed or definitive definition. In principle, NTB include all measures, besides tariffs, which are used to protect a domestic activity (industry). They normally refer to ‘government imposed’ or ‘government sponsored’ measures. The panel of Eminent Persons as set up by the United Nations Central Product Classification proposed a comprehensive and detailed classification of NTB in 2005. Fifteen types of NTBs have been identified by them including Sanitary and Phytosanitary (SPS), Technical Barriers to Trade (TBT), other technical measures, price control measures, quantity control measures, para-tariff measures, finance measures, anti-competitive measures, export-related investment measures, distribution restrictions, restriction on post sales services, subsidies, government procurement restrictions, intellectual property and rules of origin. A similar classification has been developed by UNCTAD of procedural obstacles to trade and include the following categories: arbitrary or inconsistent behaviour, discriminatory behaviour favouring specific producers or suppliers, inefficiency or cases of outright obstruction, non-transparent practices, legal obstacles and unusually high fees or charges.

Some Non-Tariff Barriers of India:

i) Sanitary and phytosanitary measures: Applied through a number of laws and mostly covering food items.
ii) India's strong focus on internal food security and self-sufficiency.
iii) The licensing, permit and tariff regimes are complex, varying according to product or user.
iv) India is one of the most active users of anti-dumping measures. A number of safeguard measures have also been imposed, including quantitative restrictions.
v) India applies a number of duties and charges, over and above tariffs.
vi) Reference prices have been established for some products, which are revised every two weeks to align with international market prices.
vii) Some goods can only be imported through specified ports.

Agricultural products and textiles are of special interest to actual and potential Pakistani exporters to India. The former face the largest number of NTB on imports from all sources, including import licensing, quota or prohibition, transportation restrictions, import only by state trading agencies, application of SPS and TBT measures and quarantine requirements.

Textile exports generally to India also face a number of NTB including pre-shipment inspection, high para-tariff, SPS measures along with relatively high tariffs. *Note: Quite a number of these are currently under review.*

The question is: Are these barriers applied in a discriminatory manner or in a trade restrictive manner on imports mainly from Pakistan? Overall, Pakistan exporters face special restrictions in trade with India including problems in transportation, financial transactions and stringent visa requirements. Also, there are apprehensions that India applies NTB more strictly on Pakistani imports, motivated partly by security considerations.

India also appears to be heavily subsidizing inputs into agricultural production, including fertilizers, electricity, irrigation, etc. According to WTO (2011) the total subsidies in 2008-09 aggregated to US$53 billion, over five per cent of the GDP and have probably continued to show rapid growth up to 2010-11. The subsidy per hectare was almost US$300. The comparable figures for Pakistan for 2010-11 are agricultural subsidies of US$2.70 billion, equivalent to 1.20 per cent of GDP and per hectare $118. Meaning, going by these figures the agricultural subsidies are almost three times higher in India in comparison to Pakistan.

Some Non-Tariff Barriers of Pakistan

i) Pakistan's main trade policy instrument is the tariff regime. Industrial policy is influenced by a large number of SRO (Statutory Rules and Orders), which specify concessions/exemptions in tariffs by end use and products.
ii) Import prohibitions and licensing are applied for health, safety, security, religious and environmental reasons.
iii) Some imports under SRO require approval by relevant ministries/agencies, like the EDB (Engineering Development Board) for the import of components and parts for the automotive sector, finished pharmaceuticals by the Ministry of Health and Ministry of Food and Agriculture for import of wheat flour.
iv) The NTC (National Tariff Commission) conducts anti-dumping, countervailing and safeguard investigations.
v) Pakistan has 27,000 national standards, covering mainly agriculture, food stuffs, chemicals, civil and mechanical engineering and textiles.
vi) There are 25 notifications covering mainly sampling and testing procedures as well as labelling, package, storage and transport of a number of food products, pharmaceuticals, etc.
vii) Pakistan's SPS-related legislation is relatively outdated.

NTB in Pakistan tend to be somewhat more focused on manufacturing goods, especially with regards to customs valuation, pre-shipment inspection, import licensing by a number of ministries/agencies, quantitative restrictions, indigenization, anti-dumping and quality certification. Transportation links between the two countries are weak. There are several bottlenecks on the road and rail route, too.

The road route is open to exports for a limited number of commodities from India. Currently, Indian banks are not allowed to have branches in Pakistan and Pakistan also like India follows a restrictive visa regime for the Indians.

Prior to the agreements signed last month in September 2012, the number of importable products, which India allows from Pakistan, consists of 850 items, while Pakistan already allows non-MFN India 1,945 items. According to a World Bank report, by allowing India the MFN status, Pakistan must then restrict to the following three options: gradually expanding the positive list, replacing a positive list with a short negative/sensitive list, or completely eliminating the positive list.

Note: the position on this has already changed with both countries for the time being resorting to reach only a shortened negative list and doing away with respective positive lists.

The fear or concerns on the Pakistani side are that whereas, India talks about freeing regional trade within SAARC, in reality it is the hegemonic policies and designs of India that is holding back free, fair and open trade within the South Asian region. Simply (further) freeing up of trade between Pakistan and India, without first entering comprehensive agreements on regional (SAARC) trade as a whole, the cause of promoting intra-region trade will not be promoted. In fact, this may be counter-productive since India already enjoys favourable trading accounts with all SAARC countries and after also gaining complete access to Pakistani markets there will be very little or no interest left for India to adjust the regional trade equation in a way that makes trade within SAARC more ‘equitable’.

Pakistanis are Further Concerned that,

- Liberalization of imports couldn’t have come at a worst possible time: Pakistan’s repayments to IMF have already started kicking in, The current account balance has become a serious concern in recent months, Foreign Direct Investment (FDI) reduced to a mere $ 359 million (6 months ending November 2011) from $ 7 billion in 2006-07 and exports, which only a few months back were nearly 75 per cent of imports have been reduced to virtually half that of today’s total import bill. Under the circumstances the measures policy makers should be contemplating should be on somehow restricting the import regime and not expanding it!

- Pakistan Pharmaceutical Manufacturers Association (PPMA) has expressed serious concern on granting the MFN to India. According to them the move will significantly affect the home industry, possibly forcing it to close down altogether. It strongly feels that that all medicines should be on the negative list as the industry forms the second line of defence in case of war, natural disasters, or epidemics — PPMA meets around 90 per cent of the country's demand of finished medicine. According to them the Indians already have very solid non-tariff barriers in place to protect their home industry and the size of the Indian pharmaceutical market is ten times larger than the Pakistani market, which has allowed Indian industries to become global players, and therefore the Pakistani pharmaceutical industry will stand no chance unless it can either compete on a level playing field or get similar state support & protection.
- A comparative analysis on the agriculture sectors of both countries has already been presented above, which shows a huge difference between the competitiveness of both sides due to the asymmetry of subsidies extended to the respective farmers and the unequal availability of water resources. Further, Pakistan is far behind India when it comes to supporting its farmers by way of comparative prices of fertilizers, availability of modern machinery, energy resources for electric tube wells and the sheer allocation of respective governmental budgetary funds for the agriculture sector. The existing scarcity of water and an alarming pace at which its availability continues to shrink further compounds the disadvantage for the Pakistanis who believe that India continues to play games on this vital issue of concern to Pakistan by blaming environmental developments for the reduction of water flows in the Indus Basin, whereas, the reality points to new water diversions created by India through construction of dams on the rivers in Pakistan's share.
- Finally, there is significant segment of Pakistani experts on security, defence and foreign affairs who genuinely believe that unless the MFN and a resultant liberalized trading regime is managed very closely and prudently the negatives will far outweigh the positives. In their opinion, aside from the concerns on an absence of or a rather compromised Pakistan's internal defence mechanism in the spheres of health, seed development, yields and export competitiveness, there prevails a sense of scepticism over the Indian double game. We hear about the underlying potential of the flow of goods across the borders, but not a word is said about

the necessity of creating long term important linkages such as technology transfer, joint resource management mechanism, cross border investments, financial connectivity, regional anti-trust treaties, equal opportunity amongst SAARC nations, and devising joint regional legislations on rules of doing business. Also, on one side India talks about cementing mutual ties through the instrument of trade, while on the other side their political moves tend to exacerbate the long standing security issues between the two countries. Bilateral issues continue to be viewed by them under a unilateral light and recently, the Indo-Afghan Agreement, which covers a wide ambit from humanitarian assistance ranging from education to capacity development to development of natural resources to security, can easily be interpreted to portray an India that still remains more focused on isolating or encircling Pakistan than to become its vibrant economic partner. They maintain that as always, we see an India eager to gain direct access to Central Asia and Europe, but not willing to offer any such reciprocal accessibility to Pakistan on its Eastern and Northern sides.

WTO Corner — Latest

While we contemplate our economic moves and trade relationship within our region, it is also important to keep a close eye on what is happening to the trading patterns in general around the world, as this will in-turn help us in making the right bilateral and regional choices. Economic fear and insecurity seems to be the order of the day not just in South Asia, but also in the most developed economies of the world. The high moral ground that once drove the richer nations towards a commitment to make this world a better living place for all inhabitants, by providing equal opportunities through a WTO rule-based framework of free and fair trading practices, seems to have taken a serious dent since the financial crisis of 2008. As the focus shifts more and more on internal economic challenges the tune of 'inclusiveness' moves further into the background. Self-focused statements like, "Without a solution to the Euro Zone crisis the world economy will be swept into a downward spiral of collapsing confidence, weaker growth, and fewer jobs. We all have to help them resolve their problems as we have a stake in their crisis" — Christine Lagarde & "We cannot let our industry down at a time when we need to create jobs at home. Inward before Outward" — Banners at the last Republican Party primaries, raise alarm bells about the future of free trading practices in general and a visibly weakening foundation of WTO in particular. Ironically, the trouble is brewing in the very quarters that once championed the cause of turning the world into a large 'global village' and romanticized about eradication of poverty through enhanced trade and equal opportunity!

What we see today is an atmosphere where the larger WTO membership appears reconciled to the fact that the Doha Round will remain inconclusive for some time or at least till such time that a) the world economy is less turbulent, b) some significant members like the USA and EU are out of their present financial predicaments, c) previous priorities are reinforced, d) global issues and concerns are realigned and e) a global political climate is recreated that once again instils the spirit of enhanced trade and inter-dependence within the world economies instead of the prevailing tilt towards protectionism. So, at a time when the Doha Round of the WTO has run into a virtual stalemate and there are already murmurs about modifying the very basis of the Doha Talks and replacing it with the Bali round of talks featuring a more toned down version of free trade, one wonders what the future of the world trade will be like in the years to come. Moreover, criticism that is often hurled at the WTO relates to the menace of prevalent global inflation, which is at present particularly hurting the poor nations. The argument states, that firstly under the garb of free trade and enhanced market access the rich nations go on to capture the developing markets by granting disguised subsidies to home corporations, which then later on increase their selling prices to maximize internal profits and secondly, the economically emerging countries also play their part in aiding global inflation by raising stakes in their over-zealous pursuit of growth and enhanced market access. Examples being, the present surge in global food and agricultural prices and the spiralling price of oil, respectively.

Contradictions cum Confusions

a) In theory, opening up of an economy is mostly considered to be beneficial as it promotes growth. In this context the most frequently quoted example is that of Singapore, which successfully resurrected its faltering growth by undertaking a new set of revolutionary economic reforms back in 2005 that further liberalized the Singaporean economy. However, as we know that as markets/economies open, competition stiffens and a fresh challenge emerges on successfully managing the evolving situation through good governance cum sound economic management — all SAARC nations need to feel confident within themselves that they are capable of managing healthy and fair competition and are willing to accept the challenges of trade liberalization.

b) Theoretically, there exists some confusion about clear linkages between trade and growth and then between growth and poverty reduction or with growth's correlation to the real life benefits for the poor. Ironically, the new person nominated by the US to head the World Bank, Mr. Jim Yong Kim, also belongs to this school of thought, which believes growth does little to help the poor and Mr. Kim has also published a book in 2000, arguing his case. C) Will the focus on regional trade come at the expense of losing out from certain global markets? After all, like most developed and emerging economies (India & China included), shouldn't our emphasis also be on FTA and PTA that suit our product base and can help us grow our total trade and not just our regional trade? As discussed above, the 'noodle bowl' effect (mushrooming of bilateral and regional agreements while the overall global trade agreement takes a back seat), is already in play amongst leading world economies.

Trade in Finance

One of the principal growth constraints facing South Asia is lack of financial capital. Post 2008 financial crisis it has become difficult to raise finance from the international markets and given an existing scarcity of resources at home, but a dire need to improve infrastructure, SAARC as a region needs financial capital to meet its investment requirements. Of late, we have noticed that other regions (Far East, South East Asia, Asia Pacific, even EU and China and now China and UK) are resorting to currency swap arrangements and agreements on mutually utilizing bilateral cum internal trade deficits. Currency swaps in essence provide an additional pool of resources, which is stabilizing in its effect for the currencies of both the countries involved. According to a research paper released in 2012 by the People's Bank of China, for all countries enjoying a sizeable trade relation with China and aspiring to significantly build-up on this bilateral trade relationship (Pakistan certainly being the case), it will be very important that these countries also maintain RMB (Rinminbi, Chinese internationally trade able currency) based liquidity just as they keep US Dollar based liquidity in order to keep up with the desired increase in trade with China. As we know, China initiated its first bilateral 'local' currency swap with the Republic of Korea (ROK) back in 2008 and has never looked back since. The move was a win-win for both countries, especially for the junior partner ROK, as the arrangement provided ROK much support during the global financial crisis in 2008. Ironically, ROK never practically utilized this facility, but it provided ROK with a sense of liquidity and confidence amidst some very testing times. In 2009, China signed similar agreements with Malaysia, Indonesia and Hong Kong. To date China has signed about

18 bilateral swap agreements for a total amount exceeding RMB 1.6 trillion by June 2012.

The point is that solving an economy's financial problems should not be left to the central banks of a single country. Regional blocs should work in partnership with central banks in finding pathways for solving financial problems in evolving economies. As a current example of this model, an out of box solution on these lines is at present being worked out between China and India. Indo-China trade, which was virtually zero about 10 years back has today increased to nearly US$ 100 billion. However, the pattern of this trade is asymmetric, since India in this relationship undergoes an annual $ 30-40 billion trade deficit putting a heavy burden on its already large current account deficit. At the same time India has large infrastructure requirements and against this backdrop, it has been signing several agreements with China on high speed rail, power and other infrastructure needs. In such a scenario it is only logical that China should be investing in Indian infrastructure in local currency.

Keeping to this an agreement is being put in place where China will initiate a long-term debt fund that will invest in India and hence for India local currency lost through the current account can be invested back in India through the capital account transactions. Such a bond will carry a pre-negotiated interest rate, hence also benefiting China, as it will ensure steady returns, whereas, India would get access to long-term infrastructure funds that are not denominated in US Dollars. Similar arrangements of cooperation should also be worked out within the ambit of SAARC. There have been some efforts under the auspices of SAARC to draft and conclude an agreement on promotion and protection of investment across the region. This draft still awaits approval since 2007 despite the 17th SAARC Summit calling for fast-tracking of regional investment cooperation and creation of regional production chains.

Further, there is increasing historical evidence that classical geopolitical threats get influenced and mitigated by forms of economic collaboration and mutual dependence through trade. Countries that get connected through trade and resultant supply-chains across the border tend to then understand the risk premiums they have if they were to indulge in anything adventurous. If one follows the evolution of supply chains, one sees the prosperity and stability they promoted first in Japan, and then in South Korea and Taiwan, and now in Malaysia, Singapore, Philippines, Thailand, Indonesia and China. Once countries get embedded in these regional and global supply chains, they feel part of something much bigger than their own limited markets. In broader terms one can distinguish three types of connection between economic development and security of a region: a) The immediate impact of security/insecurity on well-being and consequently on development achievements or the ways in which security forms part of the definition of overall economic development; b) The way that insecurity (non-security) affects elements of developments and economic growth or the way development affects security; and c) Most importantly, how economic linkages and trade bring together both security and development/growth.

While surely every country needs to manage its imports very carefully and ensure that it is not undertaking trade that hurts national interests and job creation at home, however when working out the modalities of its trade, what it also needs to keep in mind is that protectionism can almost never be a sustainable solution for a country's economic growth and prosperity. A recent study by international trade experts, Robert Z. Lawrence and Lawrence Edwards, shows that there exists a good correlation between import and employment growth. The study argues that if imports can be managed successfully, they can in fact increase productivity and in cases also make domestic manufacturing more competitive. The prime example these experts use to define this logic is by applying the model to the field of Services in the US. They argue that the export of another country to the US or the import of the US in IT & ITES helps American corporations improve their cost competitiveness.

For example, Indian IT majors, generally considered to move jobs away from the US, have in fact created direct and indirect employment opportunities for the Americans. According to a recent CII survey, in the last five years, Indian companies in the US have invested US$ 26 billion, and created 100,000 jobs. A healthy percentage of employees of Indian software companies like TCS, Wipro or Infosys in the US are non-Indians. Protectionism according to the study is a high-cost option in an interdependent environment and the socialist countries of the post-World War II era learnt this the hard way. The Lawrence and Edwards lesson basically argues on how increased but prudent imports induce indigenous industries to be more competitive. Ultimately this enhanced competitiveness leads to increase in exports and again they quote the example of India. Post liberalization, India's exports have increased from US$ 18.50 billion in 1990-91 to US$ 251.1 billion in 2010-11. Further, protectionism especially for high debt countries carries higher dangers. Unsustainable debt situation invariably forces reduction in domestic consumption, which in-turn increases reliance on the export markets for growth. And if the economic managers choose to resort to protectionism in such a scenario, it not only leaves the economy with a compromised growth outlook but also with serious social and economic issues arising from high unemployment. Nowhere more can one see a better example of such a realization than in the recent policy decisions of the new leadership of China.

Today, the Chinese policymakers, after a long gap, are again feeling the need to bolster China's exports competitiveness. And for this rather than resorting to protectionism they have instead opted to go back to the basics: Establish more Free Trade Zones and this time also provide them with enhanced financial liberalization, both for domestic and foreign investors. The world's largest Shanghai free trade zone has already been announced and global investors are comparing it with the Chinese reform measures of the mid 70s and likening this step to the establishment of the Shenzhen special zone in 1979 that ultimately saw China's accession to WTO in 2001.

The regional trade boosting endeavour needs to be in sync with SAARC nations' aspirations of trade in the global arena. This will help them avoid any possible disruptions in the future. In fact enhanced trade should be conducted on terms that: complement efforts towards pushing for harmonized global norms on free and fair trade, provides a level playing field and access to all members and builds a position that allows South Asia to collectively play a more assertive role in seeing the successful culmination of the Doha Round of Talks. Further, a lot of studies at present are being conducted by academics and trade bodies on the merits, de-merits and potential of trade within SAARC. While these exercises may provide good material for a classroom discussion but in practical terms they serve scant little than just stating the obvious.

The point being that it does not require any genius to determine that trade if conducted fairly is a win-win for all stakeholders. Also, it is of little practical consequence that what numerical figure is gauged as a potential, because what truly matters is the trend and quality of mutual trade. When assessing nations' failure to achieve sustainable healthy growth the famous Austrian economist, Freidrich Hayek, only worried about two counts: Misallocation of 'Spending' and 'Trade' by countries. He argued that spending in the wrong areas, and trading in the wrong products and places can actually be extremely damaging to a country's economy and its people, let alone being beneficial in any way!

In the 18th century, a French social critic and political philosopher, Montesquieu, thought that commerce improves manners and cures most destructive prejudices. The concept is now gaining currency that intra-regional as well as inter-regional trade will lead to peace among nations that have conflicts and seen many wars. Not only does trade promote peace, but the enhanced trading relations also multiply collective benefits for all stakeholders. There is no denying the fact that furthering of regional trade on equitable terms will surely be very beneficial to solving long standing issues between Pakistan and India. The dynamics of smooth Pak-India bilateral trade in tandem with free flowing trade within the entire South Asian region can not only play a pivotal role in strengthening the economies of the region, but especially of Pakistan and India, by unleashing a soft process, which over time can be the key to resolving long standing sticky issues between the two sides. However, the culture of free and fair trade in essence stands for equal opportunity and can only succeed when there is a level playing field for all, including the smaller and developing nations, and an environment that generates unpredictable dynamic benefits of open markets cum access to more customers for everyone involved by allowing exporters from across the region to exploit economies of scale. Competition encourages not only specialization (known to be the classic result of more open trade), but also increased productivity.

Implementation Framework

Given a long standing history of conflict between India and Pakistan, the fact that Bangladesh is a break away arm of the former East & West Pakistan, continuous war in Afghanistan, the looming American withdrawal in 2014, and that Sri Lanka is still grappling with the after effects of a long drawn Tamil separatist war, it would be reasonable to fear that amidst such a politically charged environment, is there a way by which economic cooperation can truly be enhanced in the near-term within the troubled South Asian region? And provided that there indeed is such a possibility to independently kick-start economic cooperation before solving existing political/territorial disputes, then what should be the framework for such cooperation?

As for the first question the inspiration should be taken from China on how it conducted itself in its different neighbourly disputes in the East China Sea with Japan and in the South China Sea with the Philippines. Under Deng Xiaoping, when China truly began to emerge as a global economic power, the policy on territorial disputes was to set them to one side and where required, to also work with the opposing party to exploit mutual resources and potential. Sovereignty could be dealt with later. Back in 1978 Deng said that the Diaoyu/Senkaku (with Japan) tangle could be unravelled by “a future generation”. And this indeed is being done today - to China’s wishes — since today they have worked their way up to being the biggest boy in the neighbourhood! In fact, so confident are the Chinese today of their ability to secure their rightful boundaries that in spite of knowing fully well that it is they who are calling the shots, their current leader, Xi Jinping, after assuming power has once again reaffirmed Deng’s approach. Mr. Jinping maintains that today’s transformed China gives as much weight to maintaining stability in the region as to safeguarding China's rights. So if countries around us can cast aside territorial disputes (at least in the short term) to address poverty and lack of development at home, so why can't we do it in our region?

On the second question, on what should be the framework of our mutual cooperation, there are again lessons to be learned from successful examples of regional trade, Free Trade Areas (FTAs) and common currency zones. We must remember that at the heart of the linkage/integration benefits are the tremendous synergies that exist among regional with distributed and diverse strengths in manufacturing, resource development, and trading and related services. The underlying benefits of integrating markets with large populations — especially the ones that in addition are also quickly climbing the wealth ladder — become visible over longer term in the shape of emergence of optimized and highly competitive regional supply chains. On the other hand, so are the challenges of integrating such markets and supply chains, and these challenges mainly come down to the sheer willingness and ability of nations to balance national interests with the benefits of bilateral economic linkages. The three key issues that thus emerge from this are: 1) Identification of the existing frameworks of regional, sub-regional and bilateral cooperation, 2) Reflections on the path-making. Here, China-Japan- Republic of Korea (ROK) Free Trade Talks (FTT) can be used as a model, and 3) Implications of Pakistan-India economic linkages and an invitation for new thinking on SAARC integration.

Discussing points one and two, a detailed paper written in 2012, by Steve Howard, Secretary General, The Global Foundation, provides a good insight into these aspects. He argues, that unlike other countries across the globe, exports of both India and Pakistan were less affected during the time of the financial crisis and it is with this positive in mind that the leading multinational corporations (MNCs) should be lured to invest by expanding their operations in the Sub-Continent in particular and South Asia in general; thereby treating it as a single market. For this it will be necessary to put in place the right and common systems in the areas of technology and research & development (R&D). And to do this he recommends a 'job-specific' study group to ensure implementation.

Further, the history and role of the Trilateral Cooperation Secretariats: A North-East Asian inter-governmental organization comprising China, Japan and ROK, where participating countries agreed to establish a permanent organization to systemize and institutionalize cooperation between the three countries, can also be replicated by Pakistan and India. The other similar frameworks in Asia include: Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RECP). He emphasizes that especially in the case of Pakistan and India there is no need to reinvent the wheel and to just learn from the success of other cooperating countries. History is full of examples, which tell us that despite diversity in market-size, openness, expectations and strategies of each country, a larger common market-size by itself boosts each member country's international trade and investment. Further, benefits of economic linkages are not just limited to economic aspects, but also tend to promote institutional development and the global leverage of every cooperating country. In essence economic integration or enhanced economic linkages should always be viewed as a long-term solution to build mutual trust.

Finally, the SAARC framework should jointly look at and work on food security and water solutions, since given the high population growth rate in the region this will in years to come become the biggest common issue. Mr. Howard also talks about the need for reorganization in cooperation (both between Pakistan and India and also within SAARC) to determine how to grow, distribute and consume food in the coming years. The true challenge according to him is for economic cooperation to create investment driven relations within the ambit of a liberalized trade environment. Such a linkage would in fact imply that bilateral cooperation would not just remain limited to regional boundaries, but if properly leveraged can also be directed to incorporate a global view that in-turn can yield positive global dividends for the entire South Asian region. In order to succeed though, the litmus test here will be to agree and "draft" a comprehensive economic framework, which ensures that the nature of respective national regulations directly affects the ability of the region as a whole to cooperate freely and build sustainable economic linkages. Regulations are invariably national in nature, whereas, large scale activities in both real and financial economies are increasingly transnational. As a result, the nature of national-regulations bears directly on the ability to work synergistically. In the end it will all boil down to our (Pak-India) willingness and courage to come up with a framework that allows trade, efficient flow of resources and judicious use of capital across the region.

Finally, to conclude I come to the question, which is invariably asked at the end of every debate or discussion: All very well, but how to do it? The straight and simple answer to this question is that we the people must make it happen. We have to look to ourselves to create a sustainable, just, peaceful and a secure neighbourhood. We cannot sit back and expect the respective or anyone else to rescue us. The political will needs to be created by us because simply on their own our political leaders cannot do it. Quoting from Franklin D. Roosevelt's memoirs he revealed that, "After 4 hours of meeting with the labour leaders back in 1934, I told them, you have convinced me that you are right. Now go out there and FORCE ME

TO DO IT." What he meant was that pressures on the leadership to stay with the status quo are enormous and to move in a different direction it needs vociferous forces to push it in the direction it wishes to go itself. The leadership also counts on the public opinion to be confident that it is doing the right thing. Abraham Lincoln's confidence about, "government of the people, by the people, for the people, shall not perish from the earth", was only possible through the active participation of the American citizens for abolishing slavery and creating a just, peaceful, secure America where economic stability could be available to all its inhabitants.

What the SAARC leaders need to remember is that economic dynamism through mutual economic reliance creates its own peace dynamics and generates growth. However, only a carefully thought out process of negotiations and a comprehensive package of agreements followed by a sound monitoring & management mechanism that is practical, efficient and comprehensively addresses long standing concerns of all nations can bring about sustainable progress and a win-win for the region. In an entirely different setting altogether the second round of talks between China, Japan and South Korea for a trilateral free trade agreement (FTA) ended on August 16th, 2013, in Shanghai. As expected, the three nations made virtually no progress worth reporting during these talks, but it does not mean that the talks achieved nothing. The three nations are scheduled to hold a third round of talks in Japan by the end of this year, which in itself indicates the strong willingness to connect the three nations by cementing their mutual trade and economic inter-linkages. The post talks joint communiqué simply stated: "China-Japan-South Korea Free Trade Agreement is irreversible" — SAARC ought to learn from their resolve!

Free Trade is God's diplomacy. There is no other certain way of uniting people in the bonds of peace and prosperity. ~ British politician Richard Cobden, 1857.

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CHAPTER 2

Meeting Energy Requirement: Potential For Intra-regional Energy Trade

Dr. Janak Lal Karmacharya

Abstract

More than one-fifth of the global population resides in South Asia which embraces Nepal, India, Pakistan, Sri Lanka, Bhutan, Bangladesh, Afghanistan and Maldives. Despite rapid economic growth of six per cent since 1990, the nations of the group are having among the lowest per capita income in the world. The region is endowed with diverse sources of energy out of heaven (solar, wind, hydro) and hell (coal, fossil fuel). Few countries have more resources than its requirements such as Bhutan and Nepal while others are lacking the appropriate sources to meet the diversified need of the country. Analysis of daily load curves of these nations' power system demonstrates that there is complementarity in the demand and availability of specific type of power. If these power systems are integrated, obviously there is availability of supply of the requisite type of power for the intra-regional energy trade. Further, the need is to develop infrastructure, establish regulatory framework and energy trade-friendly policies to harvest there quire benefit. South Asian countries will suffer from energy security if collective measures to avoid the situation are not planned and implemented. Harmonization of energy policies, facilitating cross-border trade, providing non discriminating open access for transmission and developing a model for commercial negotiation of power purchase are the major steps to be realized for pooling the resources and distributing the output in the region as on-required basis in commercially competitive price and establishment of power pool could be the answer to serve as SAARC Electricity Market.

Introduction

More than one-fifth of the global population resides in the South Asia region, which embraces Nepal, India, Pakistan, Sri Lanka, Bhutan, Bangladesh, Afghanistan and Maldives. The region nations have diversified source of energy such as coal, natural gas, hydroelectricity, petroleum and renewable energy source such as wind and solar energy. However, the energy situation is acute in this region. The energy sector must grow on an average of 2-3 per cent over the GDP growth rate just to sustain the prevailing economy.

The present access to electricity supply is also decimal with as low as 8 per cent of the population having access to electricity in Afghanistan. The maximum access to electricity to population is in Sri Lanka with 70 per cent followed by India and Bhutan. About 45 per cent Nepalese population has access to electricity. The per capita consumption is one of the lowest in the world — 8kwh/annum to 644kwh/annum. Nepal's per capita consumption of electricity is recorded as 93 kwh/capita. (See table 1)

Table-1
Energy/Electricity Scenario of SAARC Countries

Bangladesh	**149.00**	**81.470**	**25.810**	**5.6900**	**41.47**	**279**
India	755.0	1170.0	1246.0	518.67	181.44	644
Nepal	29.960	10.070	8.900	1.3200	2.780	93.0
Pakistan	173.59	134.80	64.30	20.300	79.27	457
Sri Lanka	20.860	33.250	5.540	4.1000	9.28	445
Afghanistan	15.500	14.480			2.00	
Bhutan	0.6500					
Maldives	0.3500					

Source: International Energy Association Key Global Energy Statistics 2012

As earlier mentioned, the SAARC countries have diversified sources of energy both from “Heaven” as well as “Hell”. Naturally the energy source originating from “heaven” are clean, renewable and cheap in terms of life cycle analysis (wind, solar, hydro) whereas those originating from “hell” are non-renewable, costly to operate and maintain. The former types of resources are nature dependent and therefore unpredictable whereas the latter are human-exploited and therefore predictable so far as the availability is concerned. If proper balance between these two sources in utilization can be maintained, combination of these sources of energy can create an optimum generation mix.

Presently, the SAARC-region is fed by energy, predominantly from the following source: coal43 per cent, petroleum 35 per cent, natural gas13 per cent, hydroelectricity 8 per cent and nuclear 1 per cent. The contribution to the energy generation by different sources is not balanced and does not provide a cheap generation mix. Especially the hydroelectricity is poorly exploited even in the global context, where it generates about 16 per cent of global electricity and by 2020 is expected to exceed 1400 GW, which is barely one third of the global hydro potentiality. The regional generation mixis obviously not representative of the generation mix of individual countries of the region. (See table 2)

Table-2
Generation Min SAARC Countries (in percentage)

Country	Gas	Petrol	Coal	Hydro	Renewable	Nuclear
Afghanistan	N/A	N/A	N/A	N/A	N/A	N/A
Bangladesh	73.7	20.6	4.10	1.20		
Bhutan	1.00	99.0				
India	19.0	9.00	57.0	19.0	12.0	2.0
Maldives		100				
Nepal		5.00		95.0		
Pakistan		65.0		31.0		4.0
Srilanka		31.0	20.0	42.0	7.00	
SAARC	13.0	35.0	43.0	8.00		1.0

The trend in the utilization of electricity generating sources shows that each individual country of the region is dependent on one source of electricity. While Bhutan and Nepal are entirely hydro-powered, India predominantly relies on coal. The hydro source contributes significantly to the Pakistan and Srilanka electricity generation. By 2015 Sri Lanka envisages to increase the share of coal to 54 per cent and drop the share of oil to 8 per cent and hydroelectricity to 28 per cent.

Present Power Scenario of SAARC Countries

The nations of SAARC are at different levels of economic development and therefore have different requirements for electricity. However, there is one common element — each nation finds it difficult to sustain the present level of economic development because of the lack of adequate power. The average annual growth in the demand of power is about 7-8 per cent. With the growing pace of industrialization and urbanization the growth is likely to increase. Therefore, every nation in the region has ambitious growth of electricity demand.

Bangladesh is targeted to achieve a GNP growth of about 8.7 per cent for which the peak electricity dem and is projected at 17500 MW and energy growth of 92402 Gwh in the reference scenario. Even in low economic growth scenario, the anticipated peak load of electricity is 11794 MW and 61988 Gwh of electrical energy by the year 2020.

Bhutan has set the goal of electricity for all by 2020. By the end of the year, Bhutan aims at exporting additional 10000 MW on top of its domestic need.

India will be the major producer as well as user of electricity in the region. In the high growth scenario to support a GDP growth rate of 9 per cent, the capacity required in Indian system is at 337GW in 2017, to grow to 488 GW in 2022 and 685 GW in 2027.

Nepal's market is starved of electricity. Its total installed capacity is 762 MW of which 708MW is hydro and 54 MW is thermal. The load shedding has been a regular feature for last 10years. Presently, the system peak is about 1000 MW, resulting in system peak deficit of 238MW. As Nepal is unsaturated market of electricity, the annual demand growth is expected to be 10 per cent on an average. According to the load forecast carried out by Nepal Electricity Authority in2011, the projected peak load is about 1400 MW to be increased to 2052 MW in the year 2020and 3680 MW in the year 2027. In comparison to the hydropower potentiality of 83000 MW, the demand is a small fraction of the resource potential.

Pakistan is facing crisis in electricity supply as electricity generation has shrunk by up to 50 per cent in recent years due to heavy reliance on fossil fuels. The production fell by 6000 MW resulting in supply deficit by 15 per cent. Today its total installed capacity is 21000 MW, mainly generated by fossil fuels (65 %), hydro (31 %), and nuclear (4 %). The independent power producers have contributed significantly by generating 7070 MW. According to the water vision 2025 of WAPDA, it is expected to generate 16000 MW of hydropower. As per the PEPCO normal load forecast by 2020 the load demand will grow to 41192 MW and to 84832 MW by the year 2030.

Sri Lanka: The challenge of Sri Lanka is to maintain a strategic balance between indigenous energy resources and imported fossil fuels. The same is true for the electricity supply. Sri Lankan electricity supply relies heavily on imported fossil fuels, which at present is used to generate above 45 per cent of electricity need while hydropower meets 52 per cent of the electricity system.

Actually Sri Lanka’s strategy is to reduce the imported fuels to and boost the use of indigenous sources. The annual load growth is registered at about 6 per cent.

Review of Daily Load Demand Curve

The demand of electricity is sensitive to the climate, human activity, type of consumers and level of development of a country. The SAARC nations have diverse demand in different time of month and day. This spatial and temporal diversity impacts the demand pattern of the electricity, which if integrated in a single market can create complimentary role in satisfying the electricity demand with proper load management.

Bangladesh

Bangladesh experiences a shortage of about 270 MW per day on an average. The daily load of Bangladesh Power Development Board shows an increase in demand from 6 pm to 9 pm otherwise the load curve is comparatively flat. Usually the ratio of the base to peak load is 0.5 and the peak period is relatively static. There are morning sub-peaks, when the demand load grows to1.16 times, the base load is however less by 1.2 times than the peak-load. The picture is likely to change once coverage of electricity grows, which at present is 32 per cent of the population. Industrial and household demand is at par with over 40 per cent of total load for each sector. (Annex-1)

Bhutan

Bhutan’s electricity is produced almost entirely by hydroplants. Its river dependence has a strong seasonality. In not so distant past, Bhutan’s load was dictated by domestic/residential load. However, because of growth of industrial load, the load curve has undergone some changes. The load curve has a peak extending from 7 pm to mid-night. The demand of the so called base load is about 5 times less than the average peak load. Bhutan’s main challenge is to establish an optimum generation mixin view of the volatile hydrological behaviour of rivers. (Annex-2)

India

India is the comparatively more developed country of the SAARC region. This developed status impacts the daily load curve of Indian system, where it has significant load even in daytime from 9 am to 18 pm, because of industrial activities. It has a distinct peak from 19 pm to 23 pm.

The ratio between the peak and between the load of 9 am to 18 pm is lightly more than 1.There is a period between 1 am to 8 pm when load curve is lowest, which is about 0.9 per cent of the peak. However, it has got to be noted that the figure is based on the Typical All India Daily Load Curve which may not represent the opportunity of power trade because of the federal nature of the country and electricity trade is not under federal jurisdiction. It is reported that India is suffering from peak load deficit of 11 per cent which translates into about 22000 MW. (Annex-3)

Nepal

Nepal’s Power System load curve is dominated by a prominent peak load starting from 18 pm and lasting for 3 hours. The peak load on November 13, 2012 was recorded at 1094 MW and the base load during day was about 400 MW. This peak to base ratio of 2.8 dictates to manage load through reasonably planned generation mix. The problem is further complicated as Nepalis solely dependent on hydropower generation for its electricity supply. The total installed electricity capacity is about 765 MW which results in the deficit of 320 MW during peak hours.

With upgrading of transmission lines in major interconnection points, Nepal is importing 256MW of electricity from India. Even this import does not meet the peak load and suffers deficits of 64 MW. Nepal has to resort to load shedding. (Annex-4)

Pakistan

In its daily load curve, Pakistan has a small hump during 21-23 pm during summer and 18-20 hours during winter. In summer time, the peak load is 1.17 times higher than the base load. The load curve does not have prominent shape at peak time. The total installed capacity of Pakistan's Power System is 21000 MW projected to reach 85000 MW in 2030. (Annex-5)

Sri Lanka

The daily load pattern of Sri Lanka Power System shows two peaks, the magnitude of both the peaks seems to be the same. The lesser peak occurs daily 5:30 to 6:30 in the morning and the other peak between 7:00 to 8:00 in the evening. The morning peak is attributed to domestic activities such as washing machine operation, ironing load etc. Industrial load occurs predominantly during day time starting from 8 am till 18 pm. The evening and morning peak loads are basically due to domestic activities and uses of domestic appliances. Electricity Board is putting emphasis on energy efficiency of the appliances and demand side management to smooth out the demand curve. (Annex-6)

The following table summarizes the peak timing of the various SAARC nations' electricity system:

Table-3
Daily Load Curve in SAARC Countries

	Daily Load Curve		
Country	**Time**	**Type**	**Peak (MW)**
Bangladesh	19:00-21:00	Peak not so prominent	4567.0
Bhutan	08:00-22:00	Not so prominent Peak	38.000
India	19:00-23:00	Day time peak is also prominent	111558
Nepal	18:00-21:00 20:00-23:00	Morning and daytime load is smooth	1094.00
Pakistan	20:00-23:00 Summer time 18000.0 18:00-21:00	No prominent Peak	Winter time
Sri Lanka	5:30-6:30 Morning 7:00-8:00 Evening	Almost identical	3200.00

Resource of Electricity Generation in SAARC Countries

The primary sources of electricity generation in SAARC region are coal, petroleum products (gas and petrol), hydro and other renewable resources. The resources are distributed unevenly and few countries have to rely on a single source of electricity. The following table shows the resource for electricity generation in each country.

Table-4
Resources for Electricity Generation in South Asia Source

Source	Unit	Afghanistan	Bangladesh	Bhutan	India	Nepal	Pakistan	Sri Lanka
Coal	mt	NA	2715	0.000	245090	50.00	185000	0.00
Oil	mtoe	NA	0.960	0.000	660.00	0.000	3600.0	0.00
Gas	bm3	120	814.5	0.000	1380.0	0.000	1284.0	0.00
Hydro	MW	NA	775.0	30000	301000	43000	40000	2000

It is reported that these resources except for the renewable, are going to be consumed by SAAR Countries by 2020, if the expected electricity growth is to be met.

The generation mix of the SAARC countries does not correspond to the availability of natural resources for electricity generation.

Table-5
Types of Deficit and Generation Mix

Country	Generation Mix	Type of deficit
Afghanistan	Petroleum Products + Hydro	Overall acute
Bangladesh	Gas + Hydro	Peak deficit
Bhutan	Hydro Specific	peak deficit
India	Coal + petroleum products + gas + hydro +nuclear	Peak
Nepal	Hydro Overall	Acute
Pakistan	Hydro + Gas	Peak
Sri Lanka	Coal + Gas + Hydro Nominal	Deficit

SAARC Initiative for Intrastate Transmission

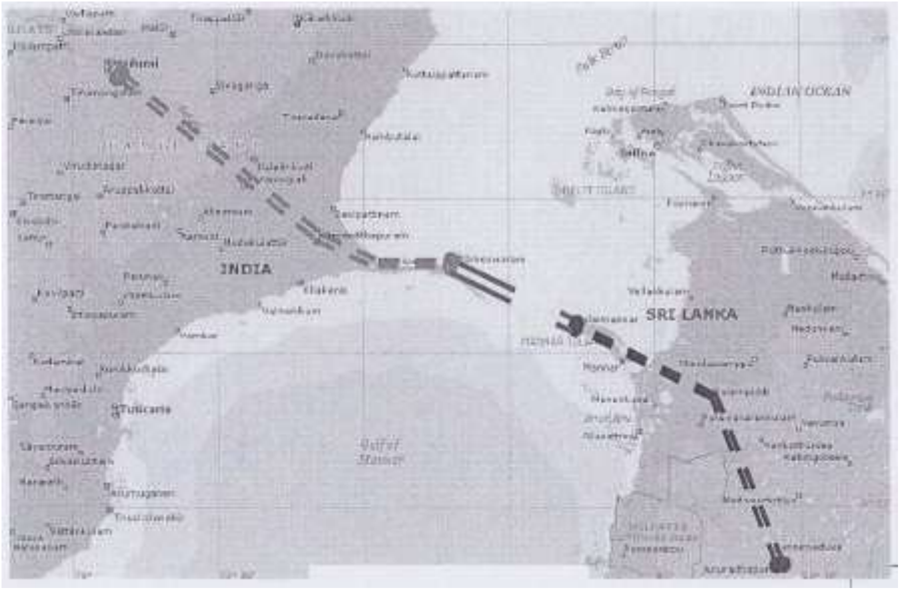
None of the SAARC countries suffer deficit due to lack of resources but because of either the financial resource constraints or wrong planning implementation. Nepal and Bhutan has hydropower potentiality which far exceeds the country's requirement. In case of other countries there is sporadic surplus which can be exported to other countries at a given time; however, such spot trade requires a power pool with the mandate to supply the power under economic dispatch concept. But before such pool comes into operation, the extensive transmission interconnection among the countries of SAARC will have to be effectively working.

In view of the need to have an effective transmission network, SAARC envisages to create SAARC energy ring in 2004. Prior to the conception of SAARC energy ring, studies were made to establish the viability of developing transmission connection in the region. In a two steps study, first interconnection was envisaged to be made between four countries of the region — Nepal, Bhutan, Bangladesh and India. The four-border interconnection was commissioned by South Asia Regional Initiative in Energy Programme in August 2001. The objective of this study was to develop and characterize alternatives for a cross border interconnection in terms of accessing the technical viability and the associated investment cash. It was projected that by 2010 India will require more than 4500 MW from regional power exchange. By 2007 Bangladesh's requirement for regional power exchange was estimated to be 1340 MW. By 2010, Bhutan will have about 1300 MW of surplus power available for regional exchange; by 2011 Nepal will have 550 MW of surplus power available for regional exchange. However, the study failed to gain universal acceptance, and thus could not go further.

Four Borders Interconnection Location

The viability of interconnection between India and Sri Lanka was studied in January 2002. Thus transmission interconnection between the two countries was expected to provide advantage to both the systems in terms of optimizing the installed capacity by way of utilization diversity in peak demand and thus optimize the overall generation mix. Various alternatives were examined in which Madhurai in India and Anuradhapura via Manner in Sri Lanka was considered to be having greater advantages. Sri Lanka generation plan, to a large extent, depends heavily on imported fuel and interconnection between the two countries is expected to have positive impact on the price of electricity.

India-Sri Lanka Interconnection



This Inter Connection was Envisaged through Laying a 84 km underwater transmission line. The Bangladesh-India interconnection will connect Bheramar to Behrampur and proceed to Farraka. Further development plan of the interconnection transmission line has yet to be agreed upon once the regional load dispatch centre is worked out. The picture presented in the foregoing paragraph is the preliminary strategy developed as concrete policy decision is yet to be made by the SAARC Energy Centre.

Contributing meaningfully to the interstate-electricity trade, each country will face different issues which should be urgently and effectively addressed. Each country has encountered specific type of problems and therefore there is no single formula to address the issues. For example, **Afghanistan** has suffered tremendous damage to the infrastructure related to electricity production and supply. The rehabilitation work of structures is a major task to quickly improve the electricity supply system. Small hydropower projects need to be established to give access to electricity to the people of isolated areas. To be an active player in regional electricity trade Afghanistan could play a major role by developing as a power transit route and also could serve as a pipeline corridor for natural gas trade from Turkmenistan to Pakistan and further down.

Bangladesh faces the problem of management of natural gas resources and it has also to improve the electricity access to the people. The accurate assessment of the gas reserves is one of the initial major tasks to establish universally acceptable gas reserves. Nepal can be a good source of hydroelectricity to replace part of the Bangladesh gas utilization for electricity. Hence Bangladesh has to focus itself to develop a regional electricity grid.

Bhutan has significantly improved its economy by exporting hydro-electricity to India. Bhutan has rightly focused on hydropower development with a target of adding of 10000 MW installed capacity within next 10 years. Bhutan has a unique opportunity to play a significant role in the electricity trade by diversifying electricity to export not only to India but to Bangladesh also.

India has an impressive GDP growth rate of above seven per cent. This has obliged it to increase electricity growth by nine per cent. This would mean to advance a growth of 650 GW in 2027. Its present total is slightly more than 200 GW. This is a real challenge. The electricity trade, basically importing electricity from its neighbouring countries has assumed an emergency dimension. The March 2013 initiative of India allowing multiple electricity traders to enter into electricity import from the neighbouring countries assumes special significance. Apart from this, India needs to exploit its hydropower potential estimated at 84000 MW. The electricity trade with Nepal and Bhutan has got to be expedited with rational approach for such transaction. India has surged ahead with the development of wind power and should continue to exploit more efficiently. Being a big consumer of electricity, the energy efficiency should be encouraged to increase the efficiency by more than five per cent. India is the country through which all roads to other SAARC countries pass.

This creates tremendous responsibility on India for developing ways to facilitate the electricity trade through its territory.

Nepal is wholly hydro-based electricity system. It has resources potentiality of about 83000MW of which 43000 MW has been established as technically and financially feasible. Its 23 storage projects with total of 25000 MW, puts in a commanding role of supplying peak hydroelectricity. Therefore, it has to encourage commercially feasible trade. Once a viable electricity grid is established, Nepal can be in a position to supply hydroelectricity to India, Bangladesh and Pakistan. Nepal has to exploit differences in resources endowment by interconnecting its hydro-dominated system to predominantly thermal system. The complementarity in energy resource endowments, hydropower in Nepal and Bhutan, gas in Bangladesh and Pakistan and coal in India is well established.

Pakistan has vast indigenous resources much of which have remained untapped. It has to sustain the development of natural gas, develop hydropower and increase the use of coal for electricity generation. A large portion of Pakistan population does not have access to electricity.

Pakistan has to pay special attention to the problem. For the economic benefit of the country, Pakistan-India cooperation in the electricity trade has got to be promoted. The realization of India-Pakistan electricity trade will facilitate Nepal-India-Bangladesh-Bhutan-Pakistan electricity trade as a follow-up of this opening.

In **Sri Lanka** hydropower which dominated the generation system has given way to thermal plants. The government is determined to check this trend. Sri Lanka is focusing on introducing fuel diversity in electricity generation. It has also attached importance to energy efficiency programme. This policy is aimed at reducing the impact of petroleum products and enhances the role of indigenous sources of electricity such as hydropower and alternative sources of electricity such as wind. The interconnection transmission lines Rameswaram-Manner will effectively connect Sri Lanka with South-Asia Power system.

The Way Forward

In general, all the countries of SAARC have not achieved “electricity for all” so far. Some countries have a figure of 70 per cent (Sri Lanka), while others like Afghanistan have only eight per cent. Almost all countries suffer load shedding, the magnitude of the shedding being different for different countries. In the scenario of constraints in domestic supply of electricity naturally the question generally asked is about attitude towards export of electricity. However, electricity trade is not limited to the access of electricity to the population but deals with the problem of the optimum generation mix in the region. One of the major benefits of the electricity pooling system is to make cheap electricity available to consumers through economic dispatch of electricity to the system.

It is evident that there is need and potentiality for intra-State electricity trade among SAARC countries. This realization is reflected in the formation of SAARC Working Group on Energy with a commitment to an open process to advise on the development of the market design. The market will be designed and developed in a rational manner that will optimize the resources of the member countries in an effective and secure manner. In order to achieve this objective, the draft Memorandum of Understanding on the Regional Energy Market in South Asia envisages to create National Electricity Market Model, State Electricity Authority, an Electricity Regulatory Authority, Transmission System Operators, and Distribution System Operators. However, the implementation of these steps is too slow and the weak policy and regulatory arrangement remains the major barrier for Regional Electricity Market. The lack of limited mutual understanding among key stakeholders on regional cooperation has been a major issue. In practical fronts also the inadequate policy and regulation for cross-border trade and limited cross-border transmission infrastructure has been a major hurdle.

The prerequisite to the establishment of a power pool is the need to tackle the practical issues related to this. The foremost and basic requirements are the development of open access policy to transmission, development of grid codes, wheeling charges and cross-border transmission plan.

Together with regulatory arrangement, a dispute resolution mechanism should also be at place before the cross-border transmission plan is developed. Institutional arrangement should be devised with establishment of a nodal agency to power trade and technical issues which should be addressed through some transmission utility forum. The SAARC Energy Working Group should be more proactive to create infrastructure regulatory forum in SAARC and work on details of the power pool.

The creation of Power Pool will enable the region to utilize their source of electricity in an optimum way by balancing the requirement and supply through various sources of electricity generation, could make the supply of electricity cheap and reliable by eliminating the need for a spinning reserve and balancing the source of peak and base power by way of avoiding costly peak power. Moreover, this will create a situation of interdependence among SAARC nations thus avoiding tensions and conflict in the region. This is the way to a peaceful development path and truly win-win solution.

Recommendations/Suggestions

It is obvious that each country of SAARC Region faces unique challenges to address before the concept of Regional Power Pool can take off. The specific steps required to be taken by each nation are suggested as follows:

Afghanistan

- fghanistan needs to improve/rehabilitate infrastructures related to electricity generation, transmission and distribution damaged by the civil war
- Electricity access to population needs to be expanded significantly

Bangladesh

- The most valuable asset-natural gas resources has got to be managed efficiently
- Access to electricity for population has got to be expanded significantly

Bhutan

- Supply of hydroelectricity has got to be diversified from one nation to multiple nations of SAARC countries

India

- There is a need to meet demand with proper generation mix specially to achieve a mix ratio of 40:60 for hydro and other sources
- Energy efficiency has got to be enhanced to save significant amount of electricity

Nepal

- Diversification of hydroelectricity market among neighboring countries
- Access of electricity to the population has to be enhanced

Pakistan

- Fuel diversity in electricity generation has to be introduced.
- Supply of electricity should be made more reliable and adequate.

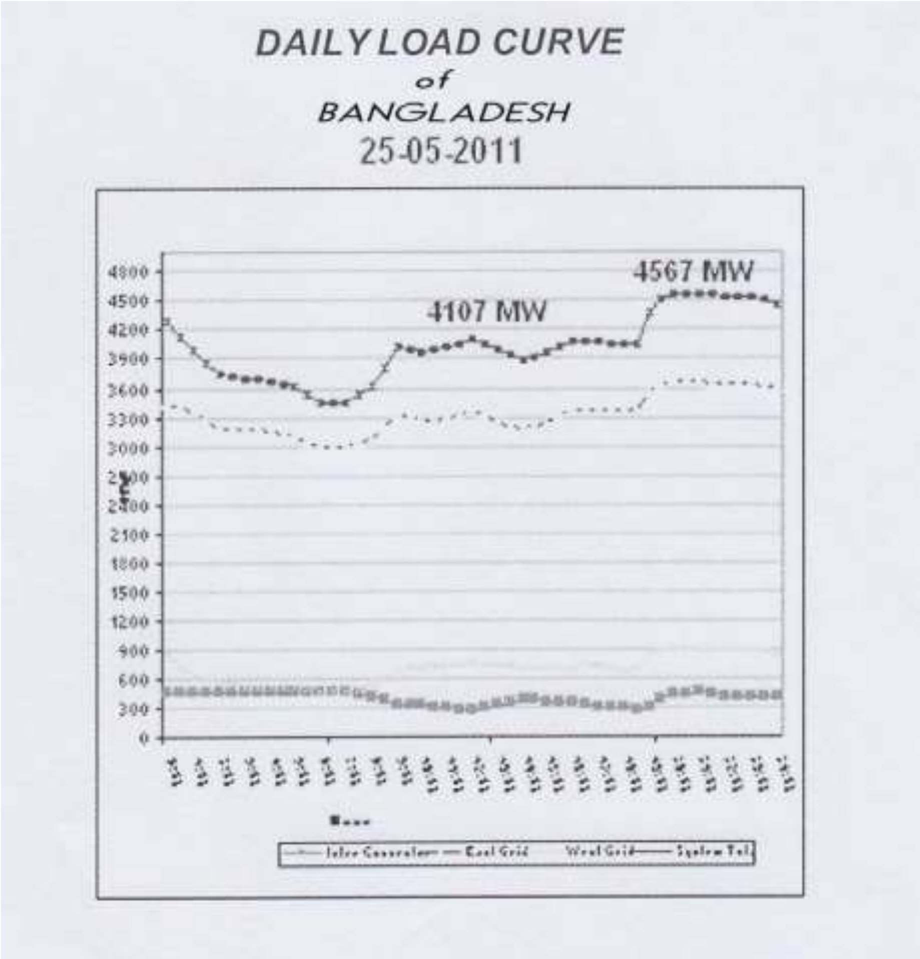
Sri Lanka

- Development of indigenous resources for electricity generation should be significantly promoted.
- Electricity efficiency for domestic as well as industrial uses should be enhanced.

Maldives

- As Maldives relies wholly on imported petroleum products to meet its electricity demand, the efficient use of electricity will go a long way in reducing its import bill of fossil fuels.

Annex: 1



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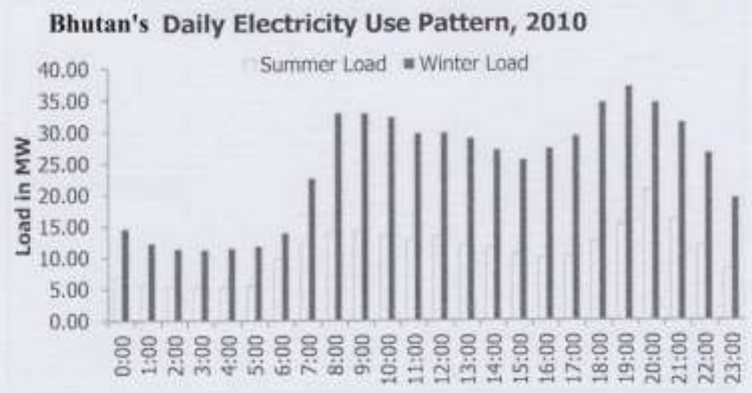
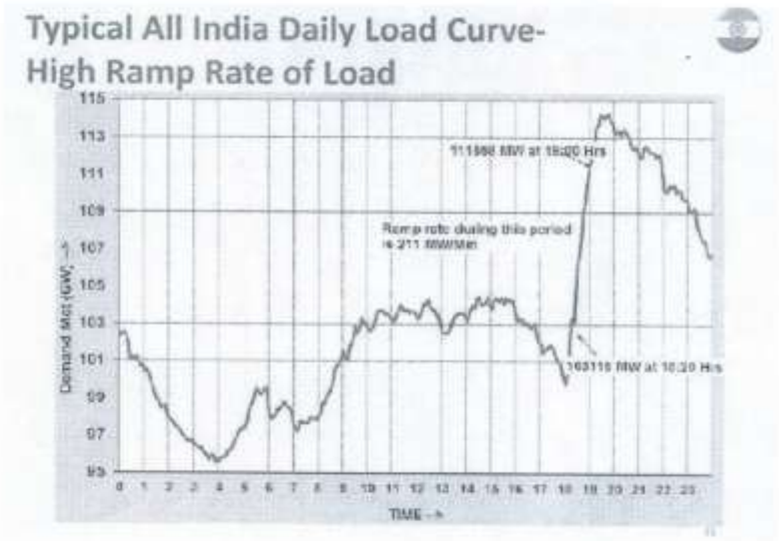


Figure 14: Daily Load Profile 2010, Power Data Book 2012

Annex: 3



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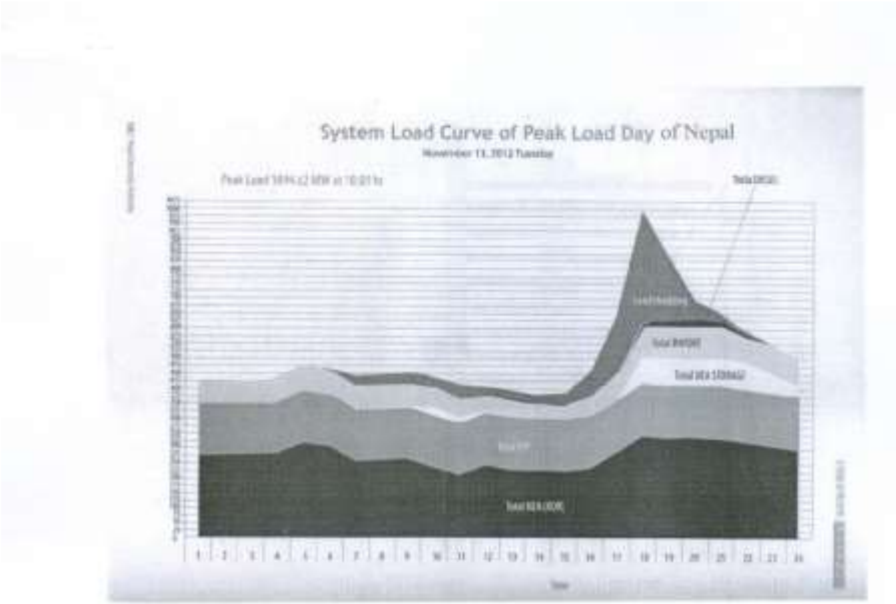

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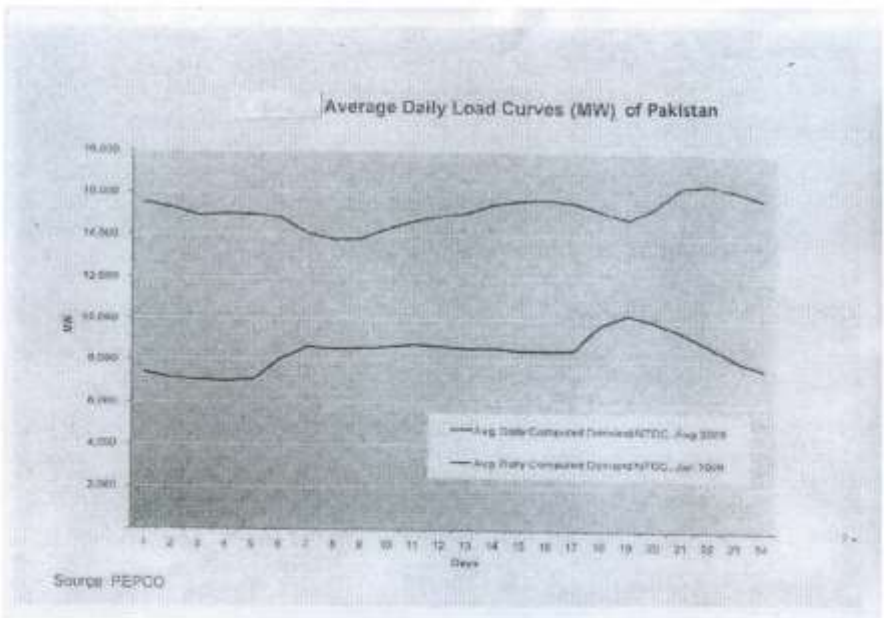

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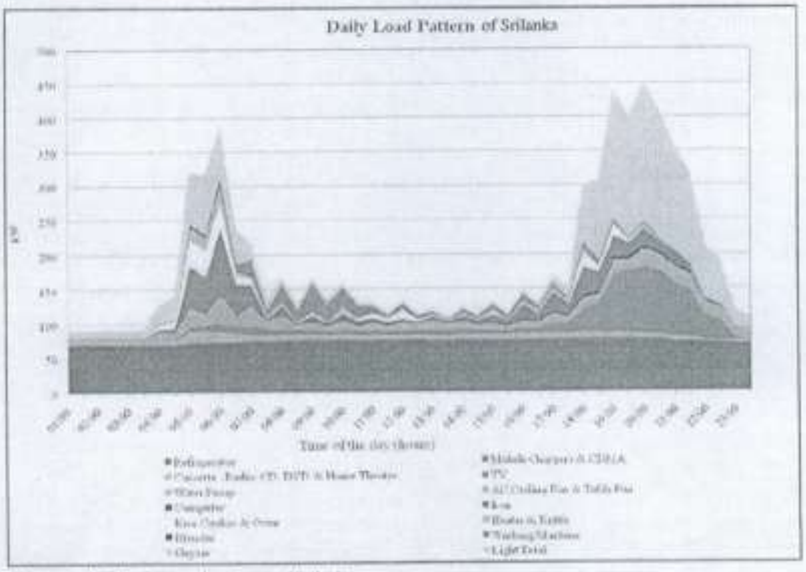

Figure 1: Daily demand pattern of Srilanka

CHAPTER 3

Building Regional Transport
And
Communication Infrastructure

Ms. Arshi Saleem Hashmi

Regional connectivity in South Asia can enhance regional trade, lower cost of transportation, benefit land lock countries and help access to remote areas. Poverty can be significantly reduced with the dissemination of benefits of economic growth. Regional leaders have been reluctant to actively pursue the case of regional integration for domestic political reasons. There has been slow progress to acknowledge their shared interests in development and security and resolution of complex issues confronted by them. The inaction raises the question of whether South Asia is, in fact, a region at all, it is argued by some that South Asia is a “natural region” by virtue of its geography and integrated pre-colonial history and culture, while others have argued that regions do not exist naturally.

Despite positive indicators in the economies of some of the countries in the region, there is severe lack of horizontal economic development in the region. Transport connectivity is directly linked with sustained regional trade and economic activity, however, an on-going problem is to ensure a good quality transportation system for the entire region. ASEAN is often quoted as a model for SAARC countries, it is noted that interregional trade in SAARC countries is only 5 per cent[1]of the total trade compared to 26 per cent of the ASEAN countries[2] and lack of transport and communication connectivity.

Transport is the backbone of economic activity and social development. When it comes to improving connectivity, each mode of

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[1] South Asia’s Challenges in Trade Integration and Growth, the World Bank , available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/EXTSARREGTOPINTECOTRA/0,,contentMDK:20313405~menuPK:579454~pagePK:34004173~piPK:34003707~theSitePK:579448,00.html

[2] Syetarn Hansakul , Asian Economic Community, Deutsche Bank, DB Research, June 14, 2013 , available at http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000315342.pdf, page 4

transport — roads, railways, maritime shipping and aviation — has its own physical and operational characteristics which require different considerations. The present level of connectivity reflects a restrictive policy regime. South Asia suffers from excessive direct costs and time taken to cross borders and from inefficiency in cross-border transactions, which ultimately affect trade negatively.

South Asia lacks in intra- and inter-regional connectivity. Infrastructure quality varies widely across countries, showing a huge gap between developing and LDCs in South Asia. Lack in connectivity undoubtedly plays a critical role for such a below average performance in regional trade. Better infrastructure would encourage fragmentation of production, enhance the regional and global trade, and help realize the integration process. Therefore, agreeing to a regional transit would mean a "win-win" gain for all the countries in the South Asian region. The paper is an attempt to identify the challenges and the contours of the potentials for regional cooperation in regional connectivity and trade facilitation and provides some policy perspectives.

Regional integration initiatives, according to Van Langenhove[3], should fulfil at least eight important functions:

- Strengthening of trade integration in the region
- Creation of an appropriate enabling environment for private sector development
- Development of infrastructure programmes in support of economic growth and regional integration
- Development of strong public sector institutions and good governance;
- Reduction of social exclusion and the development of an inclusive civil society
- Contribution to peace and security in the region
- Building of environment programmes at the regional level
- Strengthening of the region's interaction with other regions of the world.

Regional Integration through Regional Connectivity

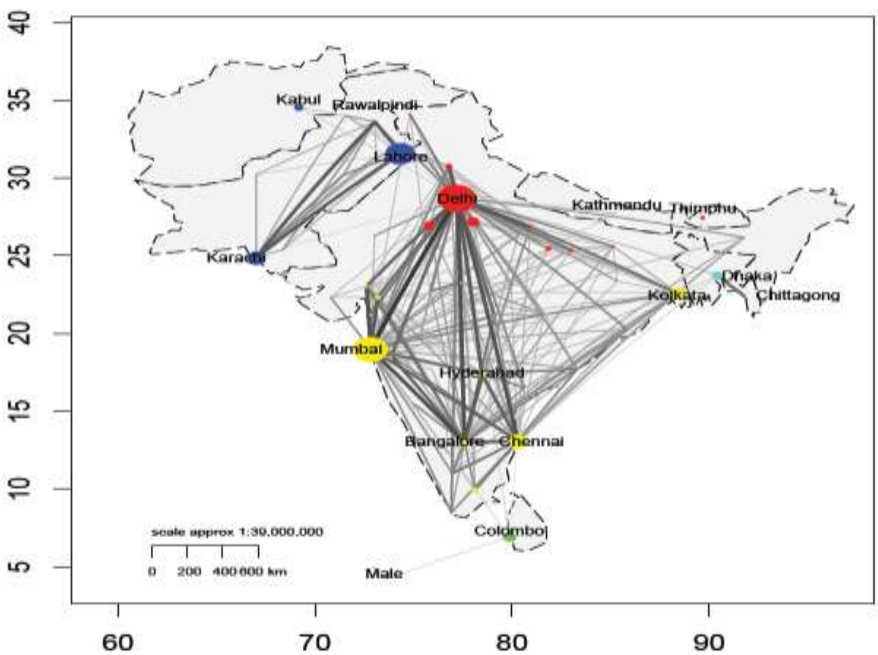
Regional integration is of long-standing concern in South Asia. Despite increasing general levels of prosperity observed in some of its countries, an on-going problem is how to ensure a good quality transportation system for the entire region. The economic integration moves well when rising intra-

[3] Van Langenhove Luk and Philippe De Lombaerde, "Regional Integration, Poverty and Social Policy," *Global Social Policy*, 7 (3)- 2007, pp 377-38.

regional trade is supported by developed infrastructure, stronger connectivity networks and improved trade facilitation measures. However, this is not the case in South Asia at present. South Asia has relatively stronger trade links with neighbouring regions, but it lacks in intra-and inter-regional connectivity.

Economic integration depends heavily on the density and quality of connectivity or regional infrastructure. A stronger connectivity not only strengthens the intra-and-inter-regional trade but also generates higher income and prosperity. What then holds the South region to realize a higher trade potential? Why regional integration across South Asia has been relatively slow? Lack of connectivity undoubtedly plays a critical role for such a below average performance in regional trade. Improved trade facilitation, better infrastructure, stronger connectivity, institutions, skilled human resources, etc. are the keys for success of regional integration process. More importantly, better infrastructure would encourage fragmentation of production, enhance the regional and global trade, and help realize the integration process.

Building Transport and Communication Infrastructure



Based on the study undertaken by B. Derudder, X. Liu, C. Kunaka and M. Roberts, this map summarizes information on the connectivity of 67 important South Asian cities in infrastructure networks. It combines four information layers to reveal a city's overall stature in the region's infrastructure networks, i.e. rail, road, air, and information technology networks. The map shows that major connections tend to be within-country linkages between large cities[4].

There are five communities in South Asia's urban infrastructure networks, which largely follow national borders. Delhi, Mumbai, Lahore, Karachi, Chennai, Colombo and Dhaka are shown to be important nodes for the infrastructural integration of South Asia, as these cities mediate flows between relatively unconnected communities and cities.

In contrast to other parts of the world, connectivity is very strongly impacted by national borders.

There are 5 communities in South Asia's infrastructure networks: there is a community bringing together Pakistan's cities plus Kabul; a northern and a southern Indian community, the former centred on Delhi and including Kathmandu and Thimphu and the latter including Mumbai, Kolkata, Hyderabad, Chennai, Bangalore; and two smaller communities for Dhaka and Chittagong in Bangladesh on the one hand and Male and Colombo on the other hand.

Lahore has a relative fast road link with Amritsar. In addition, there is also a (low-frequency) transnational train service between Lahore and Amritsar/Delhi and a (low-frequency) flight between Lahore and Delhi. This makes the Lahore-Amritsar and Lahore-Delhi connections, although not very strong *per se*, into vital links for interconnecting Pakistan and India, and explains the large values for Delhi, Lahore and Amritsar.

Dhaka's gateway function is the consequence of being the only go-between for Chittagong's (and probably also most other cities in Bangladesh if the population threshold were to be lowered) connections with the rest of the network. This in turn fuels Kolkata's position, as this city — together with Delhi — functions as Dhaka's main gateway to the rest of the network.

And finally, Colombo functions as a gateway to Male given dense airline connections between both cities on the one hand, and Colombo's relatively strong air transport connections to the Indian subcontinent on the other hand. Given Colombo's solid connections with Chennai, the latter city

[4] B. Derudder*, X. Liu, C. Kunaka and M. Roberts, "The Connectivity of South Asian Cities in Infrastructure Networks," Globalization and World Cities (GaWC) Research Network, http://www.lboro.ac.uk/gawc/rb/rb428.html

also plays an important mediating role between Male/Colombo and the rest of the network.

Non-tariff policy barriers have gained importance as tariff-based barriers to economic cooperation have generally declined. Demand for both national and international infrastructure services, for both production and consumption, and international trade purposes, has been rising in South Asia. If we fail to respond to this demand, the region's trade will slow down which would hamper the integration process. Development of cross-border infrastructure, especially transportation linkages and energy pipelines, across the region, will contribute to regional integration by reducing transportation costs and facilitating intra-regional trade. Therefore, the connectivity challenges, both hardware and software, before the South Asian countries, particularly those that are landlocked and island, require better understanding and adequate support.

Large-scale increases in production and trade have been made possible with advances in transport, such as the diffusion of containerization. When it comes to improving connectivity, each mode of transport — roads, railways, maritime shipping and aviation — has its own physical and operational characteristics which require different considerations.

Table 1 -Road Length in South Asia [5]

	Road density (km of road per 100 sq. km of surface area)			**Roads, paved (% of total roads)**
2000		**2010**	**2000**	**2011**
Afghanistan	*	6.00	23.66	*
Bangladesh	166.00	171.00	9.53	9.50
Bhutan	20.00	36.00	62.00	62.00
India	89.00	125.00	47.46	49.54
Maldives	29.00	*	*	100.00
Nepal	11.00	14.00	52.10	53.94
Pakistan	32.00	32.00	56.00	65.36
Sri Lanka	148.00	163.00	85.84	81.00

*Note: *Data not available -Source: WDI Online Database*

[5] Rabir De, "Connectivity, Trade Facilitation and Regional Cooperation in South Asia", Commonwealth Secretariat-April 2013, http://ris.org.in/images/RIS_images/pdf/South%20Asia%20meeting%202-3%20may%2020013%20PPT/Prabir%20De.pdf

Table 2
Railway Length in South Asia[6]

		Rail lines (total route-km)	Rail density (km per 1000 sq. km. of surface area)	
2000		2010	2000	2010
Afghanistan	*	*	*	*
Bangladesh	2768	2835	19.22	19.69
Bhutan	*	*	*	*
India	62759	63974	19.09	19.46
Maldives	*	*	*	*
Nepal	+	+	+	+
Pakistan	7791	7791	9.79	9.79

Notes: *Railway does not exist. +A negligible portion of railway.
Source: WDI Online Database

The performance of South Asian countries in land-based transport has been mixed. Tables (a) and (b) present road and railway lengths in South Asia, respectively. In particular, performance of India in improving road density in the last decade has been phenomenal. There is high potential in improving the road conditions since many South Asian countries are still having substantial unpaved roads. In railways, landlocked South Asian countries do not have any considerable presence of railways. Developing South Asian countries have relatively higher presence of railway network. However, railways in South Asia suffer from lack of safety and improved technology. This calls for a stronger cooperation with both developing and developed countries where both availability of technology and financing are available. At the same time, investment is greatly needed for strengthening national road and rail networks and removing the missing links in regional networks such as Trans-Asian Railways (TAR).

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[6] Ibid

Past Initiatives for South Asian Connectivity

SAARC Initiative

The Islamabad SAARC Summit (2004)'s decision to strength transport transit and communications, was followed by a SAARC Regional Multimodal Transport Study (SRMTS), completed June 2006.

SRMTS identified 10-road corridors, 5-Rail, 2-IWT corridors, 10-Maritime and 16 Aviation Gateways, for regional transport connectivity.

14th SAARC Summit in April 2007 in New Delhi adopted SRMTS recommendation and urged their Transport Ministers to oversee implementation and (a) extend SRMTS to include Afghanistan, and (b) to develop a model regional transit and transport agreement.

Sub-regional projects were proposed by Bhutan, India and Sri Lanka, and their implementation reviewed by Transport Ministers Meeting, Colombo, July 2009. A new activity "to run a demonstration container train from Pakistan to Bangladesh through India and Nepal" was also included. The Bhutan project focused on improvement of border crossing, immigration, parking, cargo handling at Phuentsholing. India's projects focused on (a) opening rail route: Birgunj-Katihar-Rohanpur-Mangla/ Chittagong with rail links to Biratnagar & Agartala (b) Agartala-Chittagong rail link (c) Improvement of Kathmandu-Birgunj-Kolkata/Haldia link and (d) Direct air connectivity: Male-New Delhi, Islamabad-New Delhi. The Sri Lanka project focused on opening up (a) rail corridor Colombo-Chennai (b) Ferry service; Colombo-Cochin, and Colombo-Tuticorn. However, progress in implementation has so far been marginal. A SAARC expert group is, however, pursing Motor Vehicle Agreement and a Railway Agreement.[7]

Recent Regional Road Initiatives

South Asian governments have invested in major national roads, as well as rural road networks. Some major rural road development initiatives have been implemented in, for example, Bangladesh, India and Sri Lanka. In addition, the Intergovernmental Agreement on the Asian Highway Network, adopted under the auspices of UN Economic and Social Commission for Asia and Pacific (UNESCAP) on 18 November 2003, established technical specifications for the regional road network. The Asian Highway Network

[7] Paper presented by Dr. M. Rahmatullah, "Strengthening Physical Connectivity in South Asia", International Conference on SAARC organized by IIC & RIS, 16-17 September, 2010, New Delhi.

now extends through 32 member States and comprises 142,000 km of highways.[8]

South Asian countries are also struggling to maintain their Asian Highway routes due to limited finances and institutional capacity. It is often difficult to fund cross-border projects unless such projects are part of a broader integration strategy, such as the Almaty-Bishkek Regional Road Rehabilitation project funded by ADB under the Central Asia Regional Economic Cooperation (CAREC) programme or the Northern Economic Corridor of the Greater Mekong Sub-region (GMS).

Asian Highway Route

Source: UN ESCAP

[8] "Towards Seamless Connectivity in South and South-West Asia," UN-ESCAP, South and South West Asia Office. August 2013, http://sswa.unescap.org/pdf/Towards_Seamless_Connectivity_in_South_and_South_West_Asia.pdf

UN-ESCAP


AFGHANISTAN
PESHAWAR
JAMMU
AND
KASHMIR
CHINA
LANZHOU
WAGAH
ATTARI
CHAMAN
SPEZAND
NEW DELHI
NEPAL
RAXAUL
BHUTAN
LEKHAPANI
MATHURA
PARBATIPUR
MYITKYINA
KARACHI
PAKISTAN
INDIA
KUNMING
CALCUTTA
DOHAZARI
LASHIO
CHITTAGONG
MYANMAR
MANDALAY
LAO
PDR
ITARASI
MUMBAI
BANGLADESH
VIENTIANE
THAILAND
MADRAS
SISOPHON
POIPET
PHNOM
PENH
CAMBODIA
TALAIMANNAR
COLOMBO
MATARA
SRI LANKA
BANDA ACEH
KELANG


Kabul
Islamabad
New Delhi
Kathmandu
Chaba
har
Karach
i
Mumbai
Tamu

Important Regional Routes[9]

A number of regional routes that have been agreed upon if materialized would revolutionize the entire region. Unfortunately due to lack of political will, ad-hocism, lack of funds or security reasons, the proposed plans have not been implemented. For instance, Asian Highway (AH), SAARC Highway Corridor (SHC), BIMSTEC Road Corridor (BRC): (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation), SASEC Road Corridor (SRC): (South Asia Sub-regional Economic Cooperation), BCIM Route (BCIM): (Bangladesh–China–India–Myanmar Forum for Regional Cooperation). Here are some proposed connectivity routes:

SHC1, BRC1, SAS5A, AH1

Lahore, New Delhi, Kolkta-Petrapole/Benapole-Dhaka-khaura/Agartala
Connects Pakistan, India and Bangladesh
Length: 478 km

SHC1, BRC1, SAS5A, AH1

Kathmandu-Kakarvita-Phulbari-Banglabandha-Mongla/Chittagong
Connects Nepal, India, Bangladesh
Length: Mongla 1314 km, Chittagong 1394 km

BRC5, SHC5, AH1(A2)

Sandrup Jhonker-Shillong-Sylhet-Dhaka-Kolkata
Connects Bhutan, India, Bangladesh
Length: 906 km

BRC9, SHC9, SAS

Agartala-Akhaura-Chittagong
Connects India, Bangladesh
Length: 227 km

BRC9, SHC9, SAS

Thimphu-Phuentsholing-Jaigaon-Chngrabandha-
Burimari-Chittagong/Mongla

9 Connecting South Asia and Southeast Asia, Interim Report, A Joint Study of the Asian Development Bank and the Asian Development Bank Institute, 2013

Connects : India and Bangladesh
Length: Mogla 880 km, Chittagong 996 km

BRC, SHC9

Maldha-Shibgang-Jamuna Bridge
Connects India and Bangladesh
Length: 253 km

BRC11, AH41

Chittagong-Ramu-Cox's Bazaar- Teknaf- Maungdaw
Connects Myanmar and Bangladesh
Length: 225 km

BCIM, SHC5,BRC5, BRC1,SHC1, AS5A, AH1

Kunming-Mandalay-Imphal-Jaigaon-Sutarkandhi-Sylhet-Dhaka-Jessore-Kolkata
Connects Bangladesh, China, India and Myanmar
Length: 2800 km

Rail Links in South Asia

Rail connectivity can also be increased by developing more inland container depots and dry ports with rail connections. Afghanistan, Nepal, and Bhutan and inland parts of India and Pakistan should set-up more container depots and dry ports. Nepal has been successfully running a container depot at Birgunj (mainly for Nepal's international traffic) and another one is coming-up at Kakarbhitta (to facilitate Nepal's trade with eastern South Asia sub region)[10]. The same model can be extended to other parts of South Asia such as in Bhutan and Afghanistan.

[10] Towards Seamless Connectivity in South and South-West Asia, UNESCAP, August 2013, http://sswa.unescap.org/pdf/Towards_Seamless_Connectivity_in_South_and_South_West_Asia.pdf

Rail Connectivity

Source: UN-ESCAP

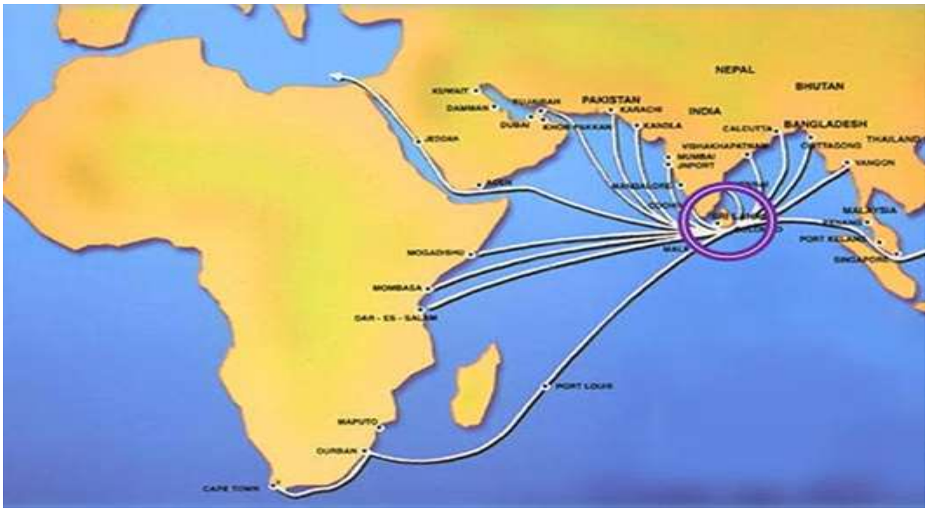
Some countries are expanding and improving their networks through the construction of new tracks, double tracking or electric signalling, but the region as a whole has yet to realize its rail potential. The Intergovernmental Agreement on the Trans-Asian Railway Network, which entered into force in 2009[11] has raised the profile of the region's railways and is encouraging governments and financing institutions to increase investment in the sector.

Air Connectivity in South Asia

Increase in passenger and cargo transported by air is partly due to the improvement of air transport connectivity in the region. During the past decade, more low-cost carriers have entered the market, flight frequencies have increased, and countries have invested in new and existing airports.
Most countries in South Asia are now linked, either directly or through hubs, and have taken progressive steps towards developing air service agreements and liberalizing their air transport industry. However, the region is yet to achieve full liberalization of air freight and passengers.

[11] Network Formalization Agreement, Intergovernmental Agreement on the Trans-Asian Railway Network, came into force on June 11, 2009, http://www.unescap.org/ttdw/common/tis/tar/TARintergovagreement.asp

Air Routes



Maritime Connectivity in South Asia

The expansion of international trade across the world has depended on building the capacity and efficiency of its major seaports, particularly container ports. For the past two decades, the container terminals in South Asian region have been handling increasing higher cargoes, dominated by Indian container terminals.

However, none of the world's top 10 busiest container ports is from South Asia.

Asia's most important liner routes, by volume, still run from Asia to Europe and North America. But there has been a substantial increase in intra-Asian shipping, particularly between India and Southeast and East Asian countries. Driven by trade between India and China, containerized trade in South Asia has also been growing rapidly. Almost all the coastal countries in South Asia are now linked by direct shipping services or by trans-shipment and transit operations through hub ports (e.g. Colombo). Nevertheless, there is significant inter-country variation; shipping connectivity is still poor between South Asian countries. According to the United Nations Conference on Trade and Development (UNCTAD) Liner Shipping Connectivity Index, which includes measures of the number and capacity of ships and the extent of services, between 2006 and 2011, shipping connectivity increased markedly in a number of South Asian economies such as Sri Lanka, Pakistan and India, while that for Maldives deteriorated.[12] To address the issue of insufficient shipping services, countries can achieve economies of scale through collective shipping arrangements. To start with, we can route the liner shipping services between the ports of Sri Lanka, Pakistan, Bangladesh, and India, and also with the ports in neighbouring countries in Southeast Asia and Gulf.

A regional commission in South Asia may be set-up at exchanging information on regulations and encouraging competition of shipping services. There is further scope to improve connectivity, particularly for landlocked countries through reduction of trade processes and procedures at transit ports. A faster port not only increases the productivity of home country but also improves the competitiveness of traded goods, more importantly the goods in transit for landlocked countries.

Maritime Connectivity

[12] Towards Seamless Connectivity in South and South-West Asia, UNESCAP, August 2013, http://sswa.unescap.org/pdf/Towards_Seamless_Connectivity_in_South_and_South_West_Asia.pdf

Connectivity through Trade and Transit[13]

The table shows the situation in South Asia. There are a number of agreements between the states, but instead of broad regional agreement, most of the connectivity is bilateral. While bilateral relationship is as important in international relations, for regions to prosper, bilateral interests should give way to regional interests which may help the least developed countries in the region and contribute to overall prosperity of the region.

Agreement	Type	MFN Trade	MFN Transit	WTO Signatories
India-Bangladesh	Bilateral	Yes	No	Yes
India-Nepal	Bilateral	Yes	Yes	Yes
India-Bhutan	Bilateral	Yes	Yes	India — member Bhutan — observer
India-Pakistan	Bilateral	Yes*	No	Yes
Pakistan-Afghanistan	Bilateral	Yes	Yes	Pakistan — member Afghanistan — observer
Bangladesh-Nepal	Bilateral	Yes	Yes	Yes
Bangladesh-Bhutan	Bilateral	Yes	Yes	Bangladesh — member Bhutan — observer
Bhutan-Nepal	Bilateral	Yes	No	Nepal — member Bhutan — observer

Courtesy: Prabir De, Abdur Rob Khan, Sachin Chaturvedi

[13] Prabir De, Abdur Rob Khan, Sachin Chaturvedi, "Transit and Trade Barriers in Eastern South Asia: A Review of the Transit Regime and Performance of Strategic Border-Crossings," Asia-Pacific Research and Training Network on Trade Working Paper Series, no. 56, June 2008.

Benefit of Regional Connectivity to Least Developed Countries (LDCs)

The benefits of regional transit favour the LDCs in the region such as Bangladesh. Bangladesh could earn hefty revenues (over US$ 1 billion) as transit fees from Indian vehicles plying to and from India's north-eastern region to the rest of India, using Bangladeshi territory through two corridors.[14] The amount may go up if other corridors between India and Bangladesh are also counted. Similarly, transit arrangement between India, Pakistan, and Afghanistan would provide hefty royalties to Pakistan for the movement of vehicles between India and Afghanistan, using Pakistani territory. Studies indicate that there are also huge gains associated with energy conservation due to transit and efficient use of resources.

Major Challenges in Regional Connectivity

The present level of connectivity reflects restrictive policy regime. It can be inferred both on the counts of geopolitics and geo-economics that South Asia is undergoing hiccups, if not outright constraints. It is taking time to create regional flavour, understanding, metaphors, trust, and socialization.

Institution building is far from satisfactory. Inter-state connectivity, when seen in the regional plane, is almost non-existent. South Asian countries are racing more towards globalization than regionalization. Due to lack of integration, logistic costs in South Asia are very high and range between 13-14 per cent of the commodity value, compared to 8 per cent in US. Intra-regional trade in SAARC is around 5 per cent, compared to 26 per cent in ASEAN, 58 per cent in EU, and 62 per cent in NAFTA.[15]

Political Challenges

The most critical challenge to integration in South Asia is the huge trust deficit. As the largest and most powerful state in the region, India has been unable to engender enough confidence among member states in its commitment to non-interference, to resolve bilateral disputes and to provide leadership.

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[14] Prabir De,Regional Cooperation for Regional Infrastructure Development: Challenges and Policy Options for South Asia, RIS-DP # 160, New Delhi

[15] Paper presented by M. Rahmatullah, former director UN-ESCAP, Bangkok, High Level Policy Dialogue on Regional Cooperation and Inclusive Development in SSWA held on 18-19 October, 2012, New Delhi, http://sswa.unescap.org/meeting/documents/High-level-forum/Rahmatullah.pdf

Public Perception

While an overall understanding of regional integration is there in SA, political and security issues do affect public opinion. Geographical proximity, travel and historical experiences have contributed in creating public perceptions on the issue of regional integration in South Asia.

Opinion of the stakeholders like business/industry members, lobbyists, bureaucracy leads to an unconvincing/reluctant approach towards increasing integration. In this context, it becomes particularly important to improve public perception through soft diplomacy and increased interaction. This will also bridge the information deficit among the South Asian Nations.

Structural Challenges

The major challenge facing South Asia in its quest for regional integration and increasing competitiveness is the poor quality and inefficient infrastructure services, both hardware and software, which raise costs of transportation and production and constrain the capacity of the South Asian economies to gain from a liberal trading environment. Cross-border and transit transport is still hampered by many non-physical barriers that lead to excessive delays, high costs and uncertainties. These are multiple technical standards, inconsistent and complex border-crossing procedures and excessive documentation. In addition, goods are often inspected on both sides of the borders by different authorities, and sometimes even while in transit, rather than being inspected either at loading or unloading points. The importance of tariffs as barriers to trade has gradually come down, however, high-tariffs still exist for certain sensitive products, and there is a strong presence of Non-Tariff Barriers (NTBs) including high border transaction costs in the region. Landlocked countries, which depend on inter-country land transport for much of their external trade, could benefit the most from multilateral facilitation; despite being connected to regional networks, they still depend for their transit on neighbouring countries for their goods to reach sea ports and beyond. Many organizations have been bringing stakeholders together to remove these barriers. ESCAP, for example, through resolution 48/11 adopted in 1992, has been urging member countries to accede to seven international conventions related to land transport facilitation.[16]

[16] Resolution 48/11, Facilitation Across International Borders, http://www.unescap.org/ttdw/Publications/TPTS_pubs/pub_2307/pub_2307_ch16.pdf

Among the major causes of high trade transaction costs in South Asia are the cumbersome and complex cross-border trading practices, which also increase the possibility of corruption.

The goods carried by road in South Asia are largely subject to trans-shipment at the borders, which is a serious impediment to regional and multilateral trade. The position is further compounded by lack of harmonization of technical standards. The foremost critical factor prohibiting South Asia in achieving its regional connectivity is absence of regional transit trade. South and South West Asia region does not have regional transit arrangement, although partial transit exists for landlocked countries like Afghanistan, Bhutan and Nepal. Therefore, transit is one of the central challenges facing the South Asian countries.

Overcoming the Challenges & Prospects

South Asian region, with its geographical contiguity, has great potential for cooperation in connectivity sector. Therefore, agreeing to a regional transit system would mean a “win-win” gain for all the countries in the South Asian region. Reasons are primarily as follows:

First, smaller countries in South Asia (e.g. Afghanistan, Bhutan, Bangladesh and Nepal) are having higher trade with the region. However, lack of transit trade is impeding their intra-regional trade and economic exchange to grow and integrate further. Connecting South Asia requires massive investment. It will be a difficult challenge to mobilize such a large investment particularly due to ongoing financial and economic crisis. This calls for an appropriate financing mechanism to mobilize the region’s huge savings for infrastructure development.

Second, bilateral transit trade (MFN type) does not exist among all the countries in South Asia on reciprocal basis due mainly to geographical asymmetry, political misunderstanding, among others. For example, India and Bangladesh or India and Pakistan do not have transit arrangement even though both the countries are adjacent and share a common border. At the same time, India has bilateral transit arrangement with Bhutan and Nepal, with which India share an international border.

Third, transit would help smaller countries to earn revenue, which could be utilized for social and infrastructure development and enterprises at border areas.

Fourth, South Asian countries have accorded a regional Free Trade Area (SAFTA) and they are signatories of GATT. The greater benefits of SAFTA and multilateral free trade are clearly contingent upon regional transit.

Time is ripe South Asian countries signed both a Motor Vehicles Agreement and Regional Transport and Transit Agreement together. A regional overland road link from Istanbul to Yangon via Delhi can be revived for regional trade with some effort. A major part of this corridor is domestically operational, as a dual carriageway, and an integral part of the old Sher Shah Road, or Grand Truck (GT) Road is in place. The opening of the route will mark a revival of the old linkages existing in South and South West Asia dating back to the British period. The APIBM corridor representing Afghanistan-Pakistan-India-Bangladesh-Myanmar Transport Corridor, is meant for making each and every country in South Asia as a transport hub for trade in the broader region; it deserves a high priority for operationalization.

The APIBM corridor would facilitate trade and investments in infrastructure sector in the Southern Asia, bring rich rewards for bordering regions; can make Pakistan and Afghanistan as hubs for India's trade with Iran, Middle East and Central Asia. However, that would need upgrading of infrastructure and Land Custom Stations (LCSs) at the Afghanistan border with the Central Asian countries (Turkmenistan, Uzbekistan and Tajikistan). Bangladesh will become a hub for India's trade with Myanmar and other Southeast Asian countries and a transit for India's North Eastern Region. Myanmar itself will become a transit hub for India's trade with other ASEAN countries. Sri Lanka is already well placed to be a maritime hub in South Asia with a lot of India's trade trans-shipped through the port of Colombo. Apart from transit revenues, there are huge gains associated with energy conservation due to transit and efficient use of resources. This APIBM corridor would be Asia's new silk route, linking Central and West Asia with East Asia, where South Asia is the land bridge and would play as the most vital corridor for expanded trade and transportation.[17]

Conclusion

A comprehensive approach and collaborative measures are needed to address the physical infrastructure issues, including roads, rail, inland waterways, maritime transport, dry ports, airports, seaports, and information and communication technology, and non-physical soft infrastructure issues like cross-border transit facilitation measures; customs clearance, and other facilitating policies and regulations.

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[17] APIBM corridor, "Restoring Afghanistan-Pakistan-India-Bangladesh-Myanmar (APIBM) Corridor: Towards a New Silk Road in Asia," Policy Brief March 30, 2007, *RIS Policy Brief*, New Delhi, http://www.ris.org.in/publications/policy-briefs/486

Political Will and Decision Making

A policy paradigm is needed to connect the contributions of the diverse countries into one whole — making them synergistic. The threefold situation, a mix of internal reforms, an increasing awareness of the region's socio-economic specificities, and external dimensions in the making, does not imply losing national identity. But it does suggest a path towards realising the strength of an efficient positive complimentary, cohesive and cumulative strategy which is a challenge faced by all the SAARC countries. SAARC requires transforming common policies and politics of economy and empowerment. It needs introduction of a strategic mix of emotions and economics towards incremental value chain creation for the individual countries and their people. Open and frequent bilateral and multilateral mobility of products and people will promote equitable and efficient benefit distribution. Hard politics is an acknowledged fact. Without confronting the hard politics upfront or minimizing its negative impacts economic integration in South Asia may be a difficult proposition. It is generally believed that the greater is the common threat perceptions, be it traditional or non-traditional, the better is the drive for coordination for regional integration as happened in the EU region.

To make regional integration work, member states, specifically the leading state, need to be sufficiently motivated. It must be realized that an approach of accommodation would be more productive than that of isolation, suspicion and mistrust. India is moving fast to assume globalization role but it has a great responsibility to take all other smaller nations of South Asia on board to enjoy the benefits. Bilateral connectivity slows down regional cooperation. Finally, to quicken regional connectivity, India and Pakistan should settle their issues as comprehensively as possible. Composite dialogue or other peace talks should move towards solution of long standing issues as lack of this prevents efforts taken in enhancing trade or connectivity.■

Chapter 4

Developing Energy Corridor from Central and West Asia to South Asia

Prof. Savita Pande

Cross-border energy trade is a strategic issue with high potential for cooperation. Unfortunately, this is also the reason why such energy trade has not taken place. The cooperation potential lies in "reduction of energy inequality in the region in question; a win-win scenario for the exporting country (by bringing in revenues), for the importing country (by reducing energy poverty), and for the transit countries, if any (by generating revenues through transit fees; the requisite infrastructure development across remote, difficult terrain of border areas, providing connectivity to inaccessible areas stimulating economic activities; and the cross border energy trade facilitates may improve political relationships among the trading and transit countries".[1] The challenge lies in the fact that while it is governed by supply-demand rules, it is also deeply steeped in security risks and investment economics. Creating energy corridors is no exception to the rule, those across South Asia included. This paper seeks to explore the issue in the context of South Asia — Central Asia as well as South Asia and West Asia energy corridors in the context of two proposed pipelines: the Iran-Pakistan (IP) (earlier Iran-Pakistan-India (IPI)) and the Turkmenistan Afghanistan Pakistan India Pipeline (TAPI).

The issue is treated in the background of the theory of relative gains which explains why cooperation between states takes place or does not take place, and tests how it works in the context of the two pipelines.

Theoretical Background: Relative Gains

Emphasis on Relative Gains has attracted much attention in the context of the International Relations Theory in general and the Realism and Neorealism theories in particular. Rejecting the claim of institutionalists that institutions would make states forego short term gains for the sake of

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[1] Hippu Salk Kristle Nathan,Sanket Sudhir Kulkarni, Dilip R. Ahuja, "Pipeline politics—A study of India′s Proposed Cross Border Gas Projects," *Energy Policy*, vol. 62, November 2013, pp145-46.

long term ones, realists like Grieco and Stephen Krasner have argued that anarchy forces states to think about both absolute gains and the distribution of gains among all. Simply stating, states aim not only to increase absolute wealth and power but also widen the gap between them and other states. To quote Walt, "If one state accrues more gains than its partners", it will gradually become stronger and its partners will eventually become more vulnerable."[2] Mearshimer says, "States are not primarily motivated by the desire to achieve prosperity. Although economic calculations are hardly trivial to them, states operate in both an international political and an international economic environment, and the former dominates the latter when the two systems come into conflict. Survival in an anarchic international political system is the highest goal a state can have."[3]

The pursuit of relative gains is rooted in anarchy and the resultant fear for survival independence and security. Waltz says states in anarchy "are compelled to ask not will both of us gain?' but 'who will gain more?' If an expected gain is to be divided say in a ratio of two to one, one state may use its disproportionate gain to implement a policy intended to damage or destroy the other. Even the prospects of large absolute gains for both parties does not elicit their cooperation so long as each fears how the other will use its increased capabilities."[4] Mearshimer also almost echoes it when he argues, "Competition for security makes it difficult for states to cooperate, which, according to the theory of economic liberalism, they must do. When security is scarce, states become more concerned about relative than about absolute gains. They ask of an exchange not "Will both of us gain?" but "Who will gain more?" They reject even cooperation that will yield an absolute economic gain if the other state will gain more, from fear that the other might convert its gain to military strength, and then use this strength to win by coercion in later rounds."[5]

Iran-Pakistan-India Pipeline

The trilateral Iran-Pakistan-India gas pipeline, or IPI as it is popularly called, has become a bilateral pipeline, between Iran and Pakistan, as the

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[2] Stephen M. Walt, "International Relations: One World, Many Theories," Foreign Policy, No. 110, Special Edition: Frontiers of Knowledge. (Spring, 1998), p35.

[3] John J. Mearsheimer The Atlantic Monthly; August 1990; Why We Will Soon Miss The Cold War; vol. 266, no. 2 http://mearsheimer.uchicago.edu/pdfs/A0014.pdf

[4] Kenneth N Waltz,. *Theory of International Politics* (New York: Random House.1979), p105

[5] John J. Mearsheimer Mearshimer The Atlantic Monthly; August 1990; Why We Will Soon Miss The Cold War; vol. 266, no. 2

two signed an agreement in March 2010, leaving options open, the questionable economic viability of the project notwithstanding.[6] The much debated and negotiated IPI pipeline was proposed to be 2,775-kms (1,724 miles) in length and if and when successfully completed is expected to deliver natural gas from Iran to Pakistan and India.

The Project

The pipeline idea dates as far back as 1989, when the then head of the Tata Energy Research Institute (TERI), R.K. Pachauri, invited Iran's former Deputy Foreign Minister Ali Shams Ardekani to New Delhi to deliver a paper on the subject. Pachauri recalls, "At that time, policy- makers and others thought of it as nothing more than a pipedream."[7] However, Abbas Maleki says the first serious proposal on natural gas export to India on land ("Asian Gas Pipeline") was presented to the Asian Energy Institute in 1989.[8]

Sometimes in 1990, former Iranian President Ali Akbar Hashemi Rafsanjani put forward the proposal for the IPI pipeline. Three years later India and Iran signed an MoU for the project and the focus was initially on laying an offshore pipeline outside the territorial waters of Pakistan.[9] Pipeline Engineering GMB of Germany and Sazeh consultant of Iran were given the job of feasibility study by the Joint Working Committee of the National Iranian Gas Company (NIGC) and Gas Authority of India Limited

[6] "Iran Gas Pipeline Not in Favour of Pakistan: Report," *Dawn*, October 24, 2013, http://dawn.com/news/1051432/iran-gas-pipeline-not-in-favour-of-pakistan-report

[7] Kanak Mani Dixit, "Within Grasp: Persian Gas for the Southasian Engine," *Himal Southasiuan, Reintroductory Issue,* http://www.himalmag.com/2005/july/cover_1.html

[8] Abbas Maleki, "Gas Pipelines: A bridge among Iran, Pakistan, and India," International Institute for Caspian Studies, http://www.caspianstudies.com/article/Gas-Pipline.htm. Accordingly, the "Asian Gas Pipeline" was presented as a scheme to construct a pipeline with the capacity of 36 billion cubic meters per year from Bandar Abbas in Iran to Calcutta. It was envisaged that 10 per cent of this gas would be consumed in the Iranian provinces en route, 20 per cent were to be used in Pakistan and the balance would be left in India's field.

[9] Neha Misra, "Pipelines in the Pipeline," *Regulateri*: *Quarterly Review of Regulatory Developments*, Issue 25, June, 2005 (The Energy and Resources Institute, New Delhi), p. 9; Shishir Gupta, "Peace Pipeline", *India Today*, June 26-July 2, vol. XXVI, no. 27, 2001, p.36.

(GAIL). As Pakistan did not allow work in its territorial waters, the study remained incomplete.[10]

Many analysts, however, trace the origin of the idea to 1993, when Iran and Pakistan declared their intention to construct a natural gas pipeline, which the former, subsequently, proposed extending into India and was popularly came to be known as the IPI or the so called “peace pipeline”, which starts from Asalouyeh in southern Iran and stretches 1,172 kilometres through the country; this(Iranian) section is known as Iran's Seventh Cross-Country Gas Pipeline and has already been constructed.[11] In Pakistan, the proposed length of the pipeline is 785 kilometres and is to pass through Baluchistan and Sindh. In Khuzdar, a branch would go to Karachi, while the main pipeline will continue towards Multan; from Multan, the pipeline may be expanded to Delhi.[12]

Initially, a total of 60 million cubic meters of gas was stated to be transported daily from Iran to Pakistan and India, (half for each), later it was to be raised to 150 million cubic meters.[13] Another estimate said, the proposed pipeline was expected to transport 90 million standard cubic meters of gas every day from Iran's South Pars fields to India from 2009-10 onwards while Pakistan would receive 60 million standard cubic meters.[14] Another estimate said the initial capacity of the pipeline was to be 22 billion cubic meters of natural gas per year, which was expected to be raised later to 55 billion cubic meters. However, as a bilateral project between Iran and Pakistan, the pipeline will carry only 8.7 billion cubic meters of gas per year as contracted and 40 billion cubic meters as the maximum capacity.[15]

[10] The preliminary data also showed a major technical obstacle when the pipeline reaches the area where Indus River pours into the Arabian Sea. See Abbas Maleki, “Gas Pipelines: A bridge among Iran, Pakistan, and India”, International Institute for Caspian Studies, http://www.caspianstudies.com/article/Gas-Pipline.htm

[11] Iran Calls on India, China to Join IP Gas Pipeline Project”, *Tasnim News agency*, http://www.tasnimnews.com/English/Home/Single/19385The first 902-kilometer part of this section runs from Asalouyeh to Iranshahr. The second 270-kilometer part runs from Iranshahr to the Iran–Pakistan border.6

[12] “Iran Calls on India, China to Join IP Gas Pipeline Project”, *Tasnim News Agency*, http://www.tasnimnews.com/English/Home/Single/193856

[13] Bappa Majumdar Nidhi Verma, “Iranian President Tries to Seal India Pipeline”, *Reuters*, April 29, 2008, http://www.reuters.com/article/idUSISL26015020080429

[14] Paranjoy Guha Thakurta, “Iran-Pakistan-India Gas Pipeline in Trouble”, *IPS News*, February 14, 2006, at http://ipsnews.net/news.asp?idnews=3215

[15] “Iran Calls on India, China to Join IP Gas Pipeline Project”, *Tasnim News Agency*, http://www.tasnimnews.com/English/Home/Single/193856

The construction of the pipeline is expected to cost $ 7.5 bn.[16] The pipeline talks remained deadlocked from 1999 to 2003 largely because of the state of Indo-Pakistani tensions, gained momentum only after the dialogue started between them in 2004. In July 2005, Indian and Pakistani officials after a meeting said that they plan to appoint separate legal and financial consultants to begin work on the project. The two-day talks in New Delhi also discussed issues such as financing and security of the pipeline, pricing and sharing of the gas.[17] A meeting to approve the tripartite agreement scheduled for December 31, 2005 was postponed because of delays in Iran-Pakistan talks and the October 2005 earthquake.[18]

The initial hurdle came in July 2006 when Iran demanded a price of $7.20 per million British thermal unit of gas against India's price of $4.20 per mBtu., The Iranian offer was 50 per cent above the prevailing market price in India.[19]India and Pakistan finally agreed in February 2007 to pay Iran US$ 4.93 per mBtu, while some details still needed to be resolved.[20]Since mid-2007, India has been boycotting trilateral meetings on the IPI pipeline, stating it first wanted to resolve the issues of transit fees and transportation tariffs with Pakistan.

Differences between parties over issues of pricing, transit fee and security have practically paralysed negotiations on the pipeline for quite some time. India wanted Iran to take responsibility for safe passage of gas through pipeline length in Pakistan and would pay for the fuel only when it is delivered at Pakistan – India border. Iran, on its part wanted this to be done by trilateral mechanism. Pakistan and Iran have now signed a gas pipeline accord, without India's participation according to which Iran is to give 750 million cubic feet of gas per day to Pakistan for the next 25

[16] "Alexander's Gas and Oil connections", *News and Trends,* Middle East, vol. 14, issue 17, December 18, 2009.

[17] Anjana Pasricha, "India, Pakistan Commit to Building Gas Pipeline," July 21, 2005, http://petrochemical.ihs.com/news-05Q3/india-pakistan-pipeline.jsp

[18] Sony Fatah, Will opposition from Washington block a 1,600-mile gas pipeline connecting Iran, Pakistan, and India?, The International Institute for Strategic Studies, December 26, 2005, http://www.iiss.org/whats-new/iiss-in-the-press/press-coverage-2005/december-2005/pipeline-or-a-pipe-dream

[19] "Iran Rejects Indian Price for Tripartite Gas Pipeline," *The Hindustan Times,* July 16, 2006, http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=9fd6c349-c4f6-48e6-825d-fd1782638ef8&ParentID=9c222620-7c82-40e6-a6bd-5a965f6d5807

[20] "Peace Pipeline Contract Soon, Gas Flow by 2011," *Iran Daily,* July 01, 2007, at http://iran-daily.com/1386/2880/html/economy.htm#s238905

years.[21]Another account says Iran-Pakistan pipeline “is supposed to deliver 21.5 million cubic metres of gas per day to Pakistan.”[22]

Iran has almost completed its side and the project got inaugurated by the presidents of both countries in March 2013 to mark the start of construction on Pakistan′s side of the pipeline.[23] When Pakistan signed the Gas Sales Purchase Agreement (GSPA) with Iran, both sides were required to complete the respective work by December 2014; however in August 2013 Pakistan’s oil minister said it would take two more years, i.e. 2015.[24] Media reports in March 2013 had said Iranian contractors will also construct the pipeline in Pakistan — Tehran-based Tadbir Energy Development Group would undertake all engineering procurement and construction work for the first segment of the project, which would start from the Iran-Pakistan border. The Iranian firm would also carry out the second segment of the project, while the remaining amount was expected to be generated by Pakistan through Gas Infrastructure Development Cess (GIDC).Tehran has agreed to lend Islamabad $500 million, or a third of the estimated $1.5 billion cost of the 750 km Pakistani section of the pipeline.[25] Iran's deputy oil minister, Ali Majedi, said in November 2013 that based on initial agreements each side “must bring its own share” in financing the project, adding the “Pakistanis need Iran's gas and they should accelerate their work.”[26] Both countries had agreed to commence the project before October 2012 and finish by December 2014. It was decided that Pakistan

[21] Zeeshan Haider, “Pakistan Iran Sign a Deal on Natural Gas Pipeline,” *Reuters*, March 17, 2010, http://uk.reuters.com/article/idUSTRE62G12C20100317?sp=true; also see, Syed Fazl-e-Haider, “Pakistan, Iran Sign Gas Pipeline Deal”, *Asia Times*, May 27, 2009, at http://www.atimes.com/atimes/South_Asia/KE27Df03.html

[22] Kunwar Khuldune Shahi, “The Pipeline Puzzle,” *The Daily Times*, http://www.dailytimes.com.pk/default.asp?page=2013\11\24\story_24-11-2013_pg3_3

[23] “Zardari, Ahmedinijad Inaugurate Pak-Iran Gas Pipeline Project”, *The Nation*, March 11, 2013 http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/national/11-Mar-2013/zardari-ahmedinijad-inaugurate-pak-iran-gas-pipeline-project

[24] “Iran-Pakistan project: Pakistan Section of Pipeline to Miss Deadline,” *The Express Tribune* August 20, 2013, http://tribune.com.pk/story/592598/iran-pakistan-project-pakistan-section-of-pipeline-to-miss-deadline/

[25] Pakistan, Iran break ground on pipeline project, *Dawn*, March 11, 2013, http://dawn.com/news/791865/

[26] PTI“ Iran Says Pakistan Must Finance Own Gas Pipeline”, *The Indian Express*, November 4, 2013, http://www.indianexpress.com/news/iran-says-pakistan-must-finance-own-gas-pipeline/1190844/

would import 750 million to one billion cubic feet of gas per day.[27] Media reports in November 2013 citing a report compiled by Pak Petroleum ministry said that India was still part of the Pipeline as, "modalities between Iran and India for the supply of gas, including gas price, were still under discussion."[28]

Benefits

Benefits are rooted in the fuel itself: apart from fuel efficiency and cost, it can be transported to customers without energy transformation and costly processing; transmissions are unaffected by climatic changes, environmentally friendly, non-toxic, etc.[29] Other benefits include employment creation along its route; improved political cooperation; promotion of multilateralism, and last, but certainly not the least, energy security — India and Pakistan are increasingly import-dependent for their energy needs, Iran's economy being what it is despite having the potential.[30]

A utopian extent is presented in the view the pipeline "could also serve as the mother of all confidence-building measures….. In one stroke, the joint stake-holding of an economic resource will defuse the five and a half decade long India-Pakistan hostility. Many tightly-wound bilateral problems, including the matter of Kashmir, will suddenly become manageable."[31]

This project benefits both Pakistan and Iran enormously. For Pakistan, the benefits are manifold: securing supply of two-thirds of the gas to be delivered to India, the remainder going to Pakistan; transit fees, and a control button over India's energy supply as well as a place in Indo-Iran relations.....Pakistan itself had hoped to earn about $14 billion in 30 years

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[27]Muhammad Daheem "Pakistan Iran Gas Pipeline Agreement," *The Frontier Post*, http://www.thefrontierpost.com/article/49122/

[28] ANI, "Tehran Confirms India still Part of Iran-Pak gas Pipeline Project", *Business Standard*, November 7, 2013, Tehran confirms India still part of Iran-Pak gas pipeline project

[29] "The Advantages of Natural Gas" http://www.pseg.com/customer/business/industrial/convert/advantages.jsp; also see R.K. Pachauri, "Not All Hot Air Indo-Pak Peace in the Pipeline" *The Times of India*, February 5, 2004, http://www.teriin.org/pub/articles/art36.pdf

[30] "Iran-India Gas Pipeline: Prospects Brighten for a 21st Century Silk Route", September 30, 2004, http://www.teriin.org/press_inside.php?id=10480; Paranjoy Guha Thakurta, "Iran-Pakistan-India Gas Pipeline in Trouble", *IPS News*, February 14, 2006, http://ipsnews.net/news.asp?idnews=3215

[31] Kanak Mani Dixit, "Within Grasp: Persian Gas for the Southasian Engine", *Himal Southasiuan, Reintroductory Issue* http://www.himalmag.com/2005/july/cover_1.html

from the project, including $8 billion in transit fees, $1 billion in taxes and $5 billion in savings.[32] Another estimate says Pakistan will earn $500 million per year as transportation charges from India other than about $200 million transit fee.[33]

Similarly for Iran, pipeline benefits include: (1) a major boost for job creation and economic prosperity of the provinces on the pipeline route; (2) the enhancement of Iran's strategic positioning and standing both regionally and on a global level; and (3) regional economic integration.[34]

Problems and Challenges

Depending upon time and negotiations, problems have ranged from massive financial implications, geo-political, environmental considerations, unsure confirmation of natural gas resources, pricing of supplied gas, pressure from the United States.[35]

Price of Gas/Cost of pipeline

Concerns raised about the price at which Pakistan would contractually purchase Iranian gas are "linked to international crude oil prices. Iran itself imports gas from Turkmenistan at USD 4/MMBtu while the price at which it would export to Pakistan is ..... USD 14/MMBtu…."[36] Questions have also been raised about the construction cost of the pipeline for Pakistan, "Pakistan needed $8 billion to lay the pipeline from Nawabshah to the Iranian border".[37]

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[32] Nadeem Iqbal, "New Era in Pakistan, Iran Ties," *Asia Times Online*, December 13, 2001, http://www.atimes.com/ind-pak/CL13Df04.html

[33] "Pakistan May Start laying its part of the Pipeline", *The News*, April 28, 2006, http://www.thenews.com.pk/print3.asp?id=519

[34] N. Ghorban, "Monetizing Iran's Gas Resources and the Debate Over Gas Export and Gas-Based Industries Options," *Middle East Economic Survey*, vol. 49, no. 28, (July 2006), pp. 25-29 cited in "The Iran-Pakistan-Iran Piprline Project: Cross Border Linkages," http://www.igu.org/knowledge/publications/mag/apr-09/igu_april_2009_pages_234-back.pdf

[35] For details, see, Asma Shakir Khawaja, "Iran-Pakistan-India Gas Pipeline Project: Paving Way for Regional Cooperation", *IPRI Journal*, p. 120.

[36] According to a recent report by Sustainable Development Policy Institute (SDPI), this would bring about a "death sentence" for Pakistan's economy. Abdullah Khurram, "The Iran-Pakistan pipeline: Finding the win-win for Pakistan" *Dawn*, November 9,2013, http://dawn.com/news/1055228/the-iran-pakistan-pipeline-finding-the-win-win-for-pakistan

[37] "Iran Gas Pipeline Not in Favour of Pakistan: Report," *Dawn*, October 24 ,2013, http://dawn.com/news/1051432/iran-gas-pipeline-not-in-favour-of-pakistan-report

US Opposition

The US stand on IPI is a subset of its Iran policy on the strategic issue of Iran's nuclear programme. In August 2006, the US Congress unanimously passed the "Iran, Libya Sanctions Act" (ILSA), which provides for imposition of US sanctions on companies, irrespective of their "corporate nationality" that invest more than $20 million annually in the Iranian oil and gas sector. In 2006, US Advisor on Caspian Energy Stephen Mann is reported to have said that although the US has been supporting pipelines in the Caspian region, but it "remains absolutely opposed to pipelines involving Iran."[38]

In April 2010, Robert Blake, Assistant Secretary of State for South and Central Asia, said that "we don't think that this is the time for such transactions to be taking place with Iran."[39]

China

In February 2010, Iranian Foreign Minister Manucher Mottaki reportedly urged Pakistan not to give away to American pressure, as it (Iran) was prepared to launch the pipeline at any time – even without India – *as China could soon replace India*.[40] As far as China's joining the pipeline is concerned, a Chinese firm sometimes in the past offered financing of $500 million for Iran-Pakistan (IP) gas pipeline. It has now pulled out of the project after Pakistan has expressed its unwillingness to extend the bid validity period. Pakistan now needs Iran's assistance in financing almost the entire project.[41] Conjectures have also been made about the Russian company Gazprom's interest in the deal expressing willingness to join the project. The Russian limited objectives are easy to discern: prevent Iran from competing with it in Europe, the pipeline would keep Iranian gas in South Asian markets.[42]

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[38] Abbas Maleki, "Iran-Pakistan-India Pipeline: Is It a Peace Pipeline?", Massachusetts Institute of Technology, Centre for International Studies, September 2007, at *http://web.mit.edu/cis/editorspick_maleki07_audit.html*

[39] "US warns India, Pak against Iran Pipeline Project", *The News*, April 3, 2010, http://www.thenews.com.pk/updates.asp?id=102078US

[40] Stephen Blank, "China hangs fire on Iran-Pakistan pipeline", *Asia Times*, March 9, 2010, http://www.atimes.com/atimes/China_Business/LC09Cb01.html

[41] Muhammad Daheem "Pakistan Iran Gas Pipeline Agreement", *The Frontier Post*, http://www.thefrontierpost.com/article/49122/

[42] "Gazprom eyes role in Iran-Pakistan gas pipeline", *The News*, May 29, 2009, http://www.thenews.com.pk/daily_detail.asp?id=179821

So, basically, for the IPP, Pakistan would first have to conjure up the $ 2 billion needed to construct its half of the pipeline, convince the US to keep the sanctions gun in its pocket, keep Balochistan peaceful and, at the end of it all, get natural gas at $ 10/MMBtu, more than what Iran pays when it imports gas from Turkmenistan — the country that has the Yolotan-Osman gas field, the origin of TAPI.

Turkmenistan Afghanistan Pakistan India (TAPI) Pipeline

The original plan for the gas pipeline linking Turkmenistan with southern neighbours extended only to Pakistan, through Afghanistan. Negotiations for the pipeline are traced to 1995 with the Turkmen government by an American Company UNOCAL, which considered the Taliban regime in Afghanistan as a guarantor to safe passage of oil and gas supplies; however they broke down, after bombing of the American embassies in Nairobi and Daar Es Salam.[43]As India joined it officially in April 2008, it became commonly known as the TAPI pipeline, reflecting the initials of the four participating countries – Turkmenistan, Afghanistan, Pakistan and India. An August 2008 report said India has quoted over $200 for Turkmen gas, competing with Russia's Gazprom's hikes.[44] The project has the backing of the United States, more on that a little later. The four participating countries have regular steering meetings with the ADB as facilitator which has conducted feasibility studies and provided technical assistance for the project.[45]

The Route(s)

The proposed route of TAPI pipeline traces an old trade route linking South and Central Asia to South Asia. The route for the TAPI pipeline would start from Turkmenistan′s Yoloten-Osman gas field. It would run through Herat and Kandahar province of Afghanistan, before entering Pakistan. In Pakistan, it will reach Multan via Quetta before ending at Fazilka (Punjab)

[43] G Monbiot. America's Pipe Dream, *Guardian*, October 23, 2001, cited in Hippu Salk Kristle Nathan,Sanket Sudhir Kulkarni, Dilip R. Ahuja, "Pipeline politics—A study of India′s Proposed Cross Border Gas Projects", *Energy Policy*, vol. 62, November 2013, pp. 145-156

[44]Bank Information Center, "Turkmenistan's Pipeline Prospects: China, Russia, India, or Europe?" August 11, 2008, http://www.bicusa.org/EN/Article.3870.aspx

[45]"Asian Development Bank and Turkmenistan," 2007 Fact Sheet on Turkmenistan, p 2, http://www.adb.org/Documents/Fact_Sheets/TKM.pdf

in India.[46] First mooted in the 90's, interest in the pipeline was shown by Argentinian company Bridas as well as American firm UNOCAL.[47] A BBC Report in 1997 said that "a senior delegation from the Taleban movement in Afghanistan was in the United States for talks with an international energy company that wanted to construct a gas pipeline from Turkmenistan across Afghanistan to Pakistan and that it was in competition with an Argentinian firm, Bridas for the purpose..."[48] The latter had in November 1997 announced that, "it was close to signing a two-billion dollar deal to build the pipeline, which would carry gas 1,300 kilometres from Turkmenistan to Pakistan, across Afghanistan."[49] A Taleban Radio had also reported visits by both delegations, the Taleban Minister of Information and Culture, Amir Khan Muttaqi, said the Taleban had "held talks with both American and Argentine-led consortia over transit rights but that no final agreement had yet been reached".[50] Negotiations failed as American embassies were bombed in 1998.[51]

In May 2002, the heads of state of three countries — Afghanistan, Pakistan, and Turkmenistan met in Islamabad and decided to cooperate on project implementation.[52] They set up a steering committee having oil and gas ministers from the participating countries. The latter, in its first meeting in Ashgabat in July 2002, requested the ADB to finance project-related

[46] G Monbiot, "America′s Pipe Dream," *Guardian*, October23, 2001, cited in Hippu Salk Kristle Nathan, Sanket Sudhir Kulkarni, Dilip R. Ahuja, "Pipeline politics — A study of India′s Proposed Cross Border Gas Projects," *Energy Policy*, vol. 62 (November 2013), pp. 145-156

[47] According to Ravi Batra , the project was mooted by the Argentinean company, Bridas, in 1992, the project ostensibly under pressure from the US was re-allocated in 1996 to Unocal, an American company, which subsequently withdrew from the project reportedly due to conditions in Afghanistan. Ravi Batra " *India's Energy Security,*", in *Natural Gas Pipelines*, (Routledge, 2013), p.91.

[48] "A spokesman for the company, Unocal, said the Taleban were expected to spend several days at the company's headquarters in Sugarland, Texas. Unocal says it has agreements both with Turkmenistan to sell its gas and with Pakistan to buy it". "Taleban in Texas for Talks on Gas Pipeline", *BBC News* , December 1997, http://news.bbc.co.uk/2/hi/world/west_asia/37021.stm

[49] Intersetingly While Unocal said it had "agreements both with Turkmenistan to sell its gas and with Pakistan to buy it. In May 1997, "Taleban in Texas for Talks on Gas Pipeline", *BBC News* , December 1997, http://news.bbc.co.uk/2/hi/world/west_asia/37021.stm

[50] "Taleban in Texas for Talks on Gas Pipeline", *BBC News* , December 1997, http://news.bbc.co.uk/2/hi/world/west_asia/37021.stm

[51] Nathan,H.S.K.,etal., "Pipeline Politics — A Study of India as Proposed Cross border Gas Projects.", *Energy Policy* (2013),

[52] Turkmen-Afghan-Pakistani gas pipeline accord published , *Alexander's Gas and Oil Connections* http://www.gasandoil.com/goc/news/nts22622.htm--

studies through the provision of regional technical assistance. Initially two routes were envisaged: One was from Dauletabad, Turkmenistan through southern Afghanistan (an area under strong control of the then Taliban government) before entering Pakistan, and second was through "north of the rigid and hostile Afghan terrain."[53]

In December 2002, ADB "approved the first technical assistance (Phase 1 TA) to prepare the Project by financing a techno-economic feasibility study that covered pipeline routing, preliminary design, cost estimates, and rapid environmental impact assessment, and to assess volume-price sensitivity" and in 2003 the ADB financed a technical feasibility study of the pipeline completed by a British consulting firm, Penspen, in 2004.[54] The official statement issued after the 2003 Steering Committee meeting said, "*Since the viability of the project depends upon the extension of the pipeline project to India*, it was agreed during the steering committee meeting that the parties acting jointly would forward the documents of the TAP to the government of India, inviting it to join the project."[55] On February 23, 2003, Turkmenistan, Afghanistan and Pakistan (TAP) signed a protocol for gas pipeline project, which the three and the ADB requested India to join.. The decision was formally announced after the fourth steering committee meeting of the three participating countries and the ADB, which was scheduled to complete feasibility study by September 2003.[56]

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[53] "India Urged to Join Trans-Afghanistan Gas Pipeline Project," *Alexander's Gas and Oil Connections, News & Trends E &SE Asia* vol. 8, issue #6, March 20, 2003 http://www.gasandoil.com/goc/news/nts31283.htm Source: INDOlink

[54] Regional Technical Assistance: 37018-01, RETA-6153 REG: Turkmenistan-Afghanistan Pakistan Natural Gas Pipeline (Phase II), December 2003. http://www.adb.org/projects/project.asp?id'37018 Phase 1 TA also supported a market study on demand for natural gas in Pakistan and northern India, and a risk analysis and risk mitigation study to address the concerns of gas-consuming countries and of downstream consumers in case gas; "Govt to Reactivate TAPI Gas Pipeline Project" *Daily Times* May 2009 , http://www.dailytimes.com.pk/default.asp?page=2009%5C05%5C14%5Cstory_14-5-2009_pg7_16

[55] "India Urged to Join Trans-Afghanistan Gas Pipeline Project," vol. 8, issue no. 6, March 20, 2003 *Alexander's Gas and Oil Connections, News & Trends E &SE Asia* Emphasis Added

[56] Chaudhry Naurez Shakoor, Pakistan's Minister for Petroleum and Natural Resources, Yully Qurbanmuradov, Deputy Prime Minister and Tagive Techberdi Minister for Petroleum of Turkmenistan and Afghan Mines and Industries Minister Juma Mohammad Mohammadi announced the decisions taken in the meeting. "All the three participating countries and the ADB have decided to request India to join in," said Naurez Shakoor. He said official request would be sent to the Indian government shortly. "India urged to join trans-Afghanistan gas

In the 2006 declaration adopted in New Delhi at a two-day regional economic cooperation forum on Afghanistan, which was attended by Afghan President Hamid Karzai, the four countries vowed to accelerate work on the four-nation project to bring natural gas from Turkmenistan to India.[57] The 2nd Technical Working Group Meeting and the 10th Steering Committee Meeting for the Project held in Islamabad on 21–24 April 2008 in which the ministers of petroleum from each participating country initialled the Gas Pipeline Framework Agreement, marked India's participation. At the 3rd Technical Working Group Meeting in Ashgabat in late May 2008, the Heads of Agreement was initialled.[58] The Inter-Governmental Framework Agreement (IGFA) signed in December 2002 was amended in April 2008 to facilitate Indian participation. At that meeting, the ADB presented an update of the feasibility study done three years ago. It noted that the estimated capital cost has doubled to $7.6 billion (2008 prices) but expressed willingness to submit the project to its Board for financing.[59] All four governments initiated the revised IGFA, but a formal signing of the agreement (awaiting completion of some 'enabling actions' required to be completed by Turkmenistan and Afghanistan), was completed in 2013.[60] In July 2013 Afghanistan signed an agreement with Turkmenistan for import of 500 million cubic feet per day (mmcfd) of gas; and contribution of $5 million to the company. All participants agreed to establish a consortium or a Special Purpose Vehicle (SPV) called TAPI Ltd., which is to include the national gas companies of the member countries. The sides agreed to prepare the constituent documents to register TAPI Ltd. by the end of 2013.[61] The participating countries also agreed to

pipeline project," *Alexander's Gas and Oil Connections, News & Trends E &SE Asia* vo. 8, issue no. 6, March 20, 2003, http://www.gasandoil.com/goc/news/nts31283.htm Source: INDOlink

[57] "Work on TAPI Gas Pipeline to be Accelerated," November 2006, Alexander's Gas and Oil Connections, News & Trends E &SE Asia volume 11, issue #24, December 21, 2006, http://www.gasandoil.com/goc/news/ntc65139.htm

[58] Technical Assistance Completion Report, http://www.adb.org/Documents/TACRs/ REG/37018-REG-TCR.pdf

[59] "Delay in TAPI Project Doubled Its Cost: ADB," *Daily Times*, April 24, 2008. http://www.dailytimes.com. pk/default.asp?page'2008%5C04%5C24%5Cstory_24-4-2008_pg5_2

[60] "TAPI Pipeline Gas Sale Agreement Signed," *The Hindu*, May 23, 2012, http://www.thehindu.com/business/Economy/tapi-pipeline-gas-sale-agreement-signed/article3449588.ece

[61] Tavus Rejepova , "Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline," *The Central Asia Caucasus Analyst*, August 9, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html

contribute $5 million as seed money to the TAPI Company.[62] Pakistan media reports said in October 2013 that the US energy giant Chevron had emerged as a potential leader in a consortium that will finance and run the transnational TAPI pipeline.[63]

The original estimate of the pipeline project in 2004 was $3.3 billion, which was revised to $7.6 billion in 2008. The price increase was due to sharp increase in the price of steel, construction cost and the cost of compressor stations.[64] In August 2013, the TAPI members agreed to sign an agreement with ADB as the TAPI transaction advisor, "which is expected to generate over US$ 7.5 billion to finance the project in the near future, though some energy analysts claim that the true cost of the pipeline construction is between US$ 10 and US$ 12 billion". [65]

Afghanistan is to get about 5.0 mmscmd during the first and second year and 14 mmscmd from the third year onwards, with the rest of the gas being equally shared by India and Pakistan. The gas is to be supplied from Douletabad and other fields in Turkmenistan applying the principle of unobstructed transit of natural gas; and the safety and security of the pipeline and related infrastructure is to be provided by the concerned governments in their respective territories and transport tariff will be based on the cost of service method.[66] As for the US role, a 2008 report said that the "United States was willing to police the pipeline infrastructure through permanent stationing of its troops in the region. The US Exim Bank, the Trade and Development Agency (TDA) and the Overseas Private Insurance

[62] Zafar Bhutta, "TAPI Pipeline: Project Participants Failed to Agree on Advisory Fee," *The Express Tribune*, July 3, 2013, http://tribune.com.pk/story/581006/tapi-pipeline-project-participants-adb-fail-to-agree-on-advisory-fee

[63] Zafar Bhutta, "TAPI pipeline: Chevron likely to lead consortium that will finance, run the project," *The Express Tribune*, October 08, 2013, http://tribune.com.pk/story/614839/tapi-pipeline-chevron-likely-to-lead-consortium-that-will-finance-run-the-project/

[64] Aftab Maken, "TAPI gas pipeline finalized," *News* April 25, 2008, http://www.thenews.com.pk/top_story_detail.asp?Id=14300

[65] Tavus Rejepova , "Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline," *The Central Asia Caucasus Analyst*, August 09, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html; Zafar Bhutta, "TAPI Pipeline: Project Participants Failed to Agree on Advisory Fee," *The Express Tribune*, July 23, 2013, http://tribune.com.pk/story/581006/tapi-pipeline-project-participants-adb-fail-to-agree-on-advisory-fee/

[66] Aftab Maken, "TAPI gas pipeline finalized," *News*, April 25, 2008, http://www.thenews.com.pk/top_story_detail.asp?Id=14300

Corporation (OPIC) had also shown readiness to finance such a project, if leading American energy giants came forward."[67]

According to reports, Afghanistan has planned more than 1,000 industrial units (300 of these units already been established) near the pipeline route and would need gas for their operation.[68] In May 2009, the Pakistan government decided to reactivate (TAPI) gas pipeline project, and is considering taking 25 per cent of the total amount from the ADB for this purpose.[69]

Problems and Concerns

Conditions in Afghanistan are the major cause for concern for the TAPI project. — 735 kilometres of the pipeline's total 1,735 kilometres will cross through the territory of Afghanistan.[70]

Taliban are active in the southwest of the country, near the pipeline's proposed route. Going by the current situation, mitigation of security threats is hardly a possibility in the near future. Leaders in Pakistan and India speak publicly about their concerns regarding pipeline safety and security. Afghanistan has assured stakeholders that all landmines will be cleared from the pipeline route within two years, and the route will be freed from Taliban influence.[71] Afghanistan's Petroleum and Mines Minister told journalists on July 17, 2013 that Afghanistan will ensure the security of the project by deploying 9,000-12,000 police for this purpose; Afghan media reports also said that Afghanistan will cover all the deployment expenses.[72]

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[67] Bank Information Center, "Turkmenistan's Pipeline Prospects: China, Russia, India, or Europe?" August 11, 2008, http://www.bicusa.org/EN/Article.3870.aspx

[68] "Delay in TAPI Project Doubled its Cost: ADB," *Daily Times*, http://www.dailytimes.com.pk/default.asp?page=2008%5C04%5C24%5Cstory_24-4-2008_pg5_2

[69] "Govt to Reactivate TAPI Gas Pipeline Project," *Daily Times*, May 2009, http://www.dailytimes.com.pk/default.asp?page=2009%5C05%5C14%5Cstory_14-5-2009_pg7_16

[70] Tavus Rejepova , "Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline," *The Central Asia Caucasus Analyst*, August 9, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html

[71] "Kabul to Clear Mines on TAPI Gasline Route in 2 yrs," *Daily Times*, Pakistan, June7, 2008. http://www.dailytimes.com.pk/default.asp?page=2008\06\07\story_7-6-2008_pg7_30

[72] Tavus Rejepova , "Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline," *The Central Asia Caucasus Analyst*, August 9, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html

The project is conditioned on India-Pakistan relations. On August 22, 2013, the US had invited Pakistan to participate in talks on the TAPI pipeline in India but Islamabad "refused to attend apparently because of tension with New Delhi, leading to postponement of the dialogue".[73] Interestingly the joint statement issued during Prime Minister Nawaz Sharif's US visit in October 2013, had welcomed progress on the TAPI pipeline project.[74]

The US has been pressing Pakistan to go ahead with the TAPI gas pipeline and shelve the Iran-Pakistan pipeline project, but Islamabad has been firm in its commitment on the IP project.

Experts are divided over the amount of gas reserves in Turkmenistan to meet all its assurances to China, Russia, Pakistan and India. The current trend of increase in output did not seem to correspond with the number of projects on the drawing board. Pipeline TAPI plans could unravel if Turkmenistan's gas reserves prove less than expected. Ashkabad produced 70 billion cubic meters of gas in 2007, which was short of the previous year's target by 10 billion cubic metres.[75]

Contrary to the claims of the Turkmen Government, energy experts opine that "it will be next to impossible to implement such a complex project without attracting major international oil and gas companies (IOCs) and that these IOCs are very reluctant to participate unless Turkmenistan agrees to some type of upstream concessions", although Turkmen media reported that companies such as Chevron, ExxonMobil, BG Group, BP, Petronas and many other companies are interested and are preparing their individual proposals to the government of Turkmenistan. [76]

In the July 2013 steering committee meeting, the four countries failed to negotiate the advisory fee for hiring the ADB as transaction adviser: the bank demanded $100 million as fee and $50,000 per month as retaining cost of the project. However, all the countries termed the fee too high and asked

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[73] Zafar Bhutta, "Tension with New Delhi: Pakistan Refuses to take Part in Talks on TAPI Pipeline," *Express Tribune*, http://tribune.com.pk/story/593834/tension-with-new-delhi-pakistan-refuses-to-take-part-in-talks-on-tapi-pipeline/

[74] Joint statement by US President Obama and PM Nawaz Sharif," *News*, October 25, 2013, http://www.thenews.com.pk/Todays-News-2-210047-Joint-statement-by-US-President-Obama-and-PM-Nawaz-Sharif

[75] "Govt to Reactivate TAPI Gas Pipeline Project," *Daily Times* May, 2009, http://www.dailytimes.com.pk/default.asp?page=2009%5C05%5C14%5Cstory_14-5-2009_pg7_16

[76] Tavus Rejepova , "Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline," *The Central Asia Caucasus Analyst*, August 9, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html

the ADB to cut it to $30 million. However, the bank agreed to reduce the fee to $50 million.[77]

India's stated reluctance has been that it was not sure the gas reserves in Dauletabad could service the requirements of all three countries over a period of 30 years. The unstated reasons though have as much to do with the politically unstable situation in Afghanistan and related security fears. The reserves feeding the TAPI pipeline were originally estimated at 1.7 TCM by Russian geologists. In an audit carried out by DeGolyer & MacNaughton along with Gaffney Cline in 2003, the estimated reserves were raised to 4.5 TCM, more than sufficient to meet a demand of 90 MMSCMD over 30 years. Nonetheless, in 2008 Gaffney Cline was asked to make an independent assessment of all of the country's gas reserves.[78]

Benefits

Calling it "transformative" in which "the United States is working closely with Turkmenistan to help move the project forward", the US Deputy Assistant Secretary, Bureau of South and Central Asian Affairs, Lynne M. Tracy listed the benefits as: TAPI's construction, operation, and maintenance would generate thousands of jobs, and the pipeline would represent a major step forward in economic cooperation between Pakistan and India."[79] Representatives of the ADB also call the project having crucial economic and political importance to the region. Besides bringing electricity to many Afghan families, the construction of the project is expected to create thousands of jobs along the route.

Yet, if the pipeline goes ahead successfully, it could be Afghanistan's largest development project. According to the Interim National Development Strategy for Afghanistan (2005), transit revenue could amount to US$160 million per year, or about half of the Afghan government's domestic revenue.[80] According to other estimates by energy

[77] Zafar Bhutta, "TAPI Pipeline: Project Participants Failed to Agree on Advisory Fee," *Express Tribune*, July 23, 2013, http://tribune.com.pk/story/581006/tapi-pipeline-project-participants-adb-fail-to-agree-on-advisory-fee/

[78] Batra Ravi Kumar (2009), "Natural Gas Pipelines: Geopolitics, Affordability, Security Dimensions," in Noronha, Ligia and Sudarshan Anant, (eds.). *India's Energy Security* (New York and Oxon: Routledge Contemporary South Asia), p. 92

[79] US Department of State "The United States and the New Silk Road," (Remarks Lynne M. Tracy Deputy Assistant Secretary, Bureau of South and Central Asian Affairs; Washington, DC October 25, 2013), http://www.state.gov/p/sca/rls/rmks/2013/215906.htm

[80] Government of Afghanistan, *Interim National Development Strategy*, Kabul, 2005, p. 85.

experts, Afghanistan will earn about US$ 500 million per year in transit fees through the pipeline.[81] The gas exported from Turkmenistan is reported “mainly [to] be used to generate power for homes and industry facilities along the villages in Herat and Kandahar provinces in Afghanistan. Afghan officials claim that ethnic Turkmens and Afghan people living in villages along the pipeline will help protect the pipeline in the future as they will generate electricity directly out of the Turkmen gas.”[82]

As the Turkmen President said, “The pipeline between Turkmenistan, Afghanistan, Pakistan and India will be a weighty contribution to the positive cooperation on this continent.”[83]

Conclusion

The issues and processes are far more complicated than perhaps even the Relative Gains theory can explain. These corridors between South Asia, Central Asia and West Asia, that is the pipelines, are at best pipedreams!■

http://www.ands.gov.af/admin/ands/ands_docs/upload/UploadFolder/IANDS%20Volume%20One%20-%20Final%20English.pdf

[81] Tavus Rejepova , “Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline,*” The Central Asia Caucasus Analyst,* August 9, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html

[82] Tavus Rejepova , “Turkmenistan and Afghanistan Sign Agreement Over TAPI Gas Pipeline,*” The Central Asia Caucasus Analyst,* August 9, 2013, http://www.cacianalyst.org/publications/field-reports/item/12790-turkmenistan-and-afghanistan-sign-agreement-over-tapi-gas-pipeline.html

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Chapter 5

New Silk Road Initiative: Economic Dividends

Mr. Nabi Sroosh & Mr. Yousuf Sabir

Introduction

This paper focuses on the economic impact of the "New Silk Road" plan which has attracted the attention of international actors and particularly of the South Asian region. Furthermore, it elaborates the logic behind the strengthening of economic and regional cooperation and integration among the Central and South Asian countries.

Afghanistan as a fragile state is vulnerable to many socio-economic changes, especially when international forces leave Afghanistan in 2014 and reduce their financial assistance to the government. In this critical timeframe, Afghanistan needs a strong economic development strategy to change the future of the country. The "New Silk Road" plan is the best option for the economic development of Afghanistan as well as for regional cooperation among the nations of South Asia.

For the past 12 years, Afghanistan has remained dependent on donors where 95 per cent of the development budget funded by them. While the mines sector is the most promising asset of Afghanistan which can make its economy strong and viable, it is a pity it has remained dormant without any long term plans for its development. According to US information sources, the United States of America has invested almost USD 1.2 trillion in the past 12 years. Had a small part of it been spent on this sector Afghanistan would have had something to look up to after the US withdrawal.

The US Geological Survey estimated that Afghanistan has more than $2.0 trillion worth of lithium mineral beside other valuable minerals that may value many more trillions. The exploitation of this mineral wealth could make Afghanistan a rich nation of the world. Therefore, Afghanistan needs a strategic development framework to develop its valuable assets for the prosperity of its economy. The "New Silk Road" strategy is the best option towards that end. This economic initiative will open business markets for the Central and South Asian countries to interact with each other and integrate their economy.

In this strategy, Afghanistan as a land-bridge between Central and South Asian countries can play its strategic role in integrating the regional economy. Furthermore, Pakistan has its great role as the second land-bridge between Central Asia and India, and further with the rest of the South Asian countries. Definitely, Iran as a strong economy in the region will be part of the economic and regional cooperation.

Afghanistan in Brief

What we have learned from the history, Afghanistan has been an ancient focal point of the Silk Road and human migration for thousands of years. Archaeologists have found evidence of human habitation from as far back as 50,000 BC. This land as a strategic corridor of the East and West has attracted the attention of the superpowers of the time and witnessed many military conquests since antiquity.

The "New Silk Road" Initiative: Economic Dividends

The 'New Silk Road' initiative in its current form was launched by Secretary of State Hillary Clinton in 2011 as one of the United States' major contributions to the post-2014 period in Afghanistan and designed to direct international investment to favour regional trade, linking South Asia and Central Asia. Hillary Clinton said: "Let's work together to create a New Silk Road. That means building more rail lines, highways, energy infrastructure, like the proposed pipeline to run from Turkmenistan, through Afghanistan, through Pakistan into India."

The New Silk Road would once again create trade routes between Central Asia and South Asia and furthermore, connect the Eastern with the Western world, and facilitate construction of modern highways, rail links, energy lines and pipelines.

The 'New Silk Road' Initiative would:

- Attract foreign investments.
- Integrate Afghanistan in the regional economic life.
- Welcome professional business opportunities to the market.
- Create trade incentives, job opportunities, people to people connection.
- Facilitate practical mechanisms to import energy, gas from Central Asia.

- Lead to construction of railway from Kazakhstan-Uzbekistan-Mazar-e-Sharif and from Turkmenistan-Herat-Kandahar-Pakistan-India.
- Reduce tariffs and trade barriers and increase economic cooperation and integration.

The hope and potential for the 'New Silk Road' is that there will be opportunity for the Central Asian countries to interact with South Asia, China and the Far East and with Europe and beyond. Opening the routes and reducing business transaction barriers will not be only improving lives of the Afghans, but the whole region. USA is focusing on economic renewal in Afghanistan through job creation, provision of basic services, infrastructure development, and fiscal sustainability.

The 'New Silk Road' strategy may change the mode of business and open India to Afghanistan and Central Asia through Pakistan and that is the tool which can bring peace and stability to the region. This strategy has the potential of creating significant economic growth and at the same time contributing greatly to the establishment of peace and security throughout the region.

Here we can use modern facilities to connect those 'silk road regions' again and promote better economic cooperation. We need to use the historical fact of the 'ancient silk road' to create a better sphere among the nations. Talking about the project General Patreus said: "Sound strategy demands the use of all the instruments of power. This vision for Afghanistan and the region makes a compelling case that transport and trade can help restore the central role of Afghanistan in Central Asia. By once again becoming a transport hub, Afghanistan can regain economic vitality and thrive as it did in the days of the Silk Road."

In the same vein Indian Pime Minister Dr. Manmohan Singh said: "I dream of a day, while retaining our respective identities, one can have breakfast in Amrtisar, lunch in Lahore, and dinner in Kabul. That is how my forefathers lived. That is how I want our grandchildren to live."

For the purpose of this paper all references to "Greater Central Asia" should be understood to include Afghanistan, India, Iran, Kazakhstan, the Kyrgyz Republic, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan. The inclusion of Pakistan and Iran is essential because of their proximity and territorial ties but the inclusion of India is of yet greater importance because of its significant presence in all aspects of regional life. In addition to the greater Central Asian region, a second group of relevant countries and regions include China, Russia, as well as the Middle East, Europe, Japan and the United States.

The countries in the Greater Central Asia region share many common economic characteristics such as difficult topography and lack of direct access to the seas. They are also characterized by underdeveloped transport infrastructure and commodity-oriented economies. However, many of the countries also share significant cultural, social, and ethnic bonds which make the further development of ties quite natural.

Despite many common characteristics, trade among countries of Greater Central Asia constitutes only a fraction of the region's total trade. Moreover, Central Asian countries are under-trading with Western Europe and South and East Asia compared to their potential. Economists use the so-called Afghanistan 35 "gravity model" to assess trade potential. This estimates potential bilateral trade using a simple model that takes into account two countries' relative economic size and the distance between them.

The results of such estimates can then be compared to actual trade flows to provide estimates of lost trade. For example, Babetskii finds that Kazakhstan, Kyrgyzstan, Turkmenistan and Uzbekistan traded much less from 1997 to 2002 than the countries of the European Union (EU), accounting for relative size, GDP, and distance from trading partners. Further, Elborgh-Woytek find that the countries of the Commonwealth of Independent States (CIS) sharply under-trade with the EU. In particular, the study found that the ratio of actual to potential trade in 2001 was only about 0.3.

Our understanding of the existence of "under trading" in the region compels us to examine its causes. Such an examination leads to the important realization that closer coordination and better trade policies will unlock significant, yet existing potentials and pave the way for regional and indeed continental trade to increase substantially.

Regional and Transcontinental Potential

Central Asian countries could benefit greatly from closer cooperation at the regional and continental levels. As mentioned, empirical studies indicate that landlocked countries are at a great natural disadvantage in achieving growth, which makes a liberal trading process and effective regional cooperation all the more important. Over the period 1960-92 landlocked developing countries grew at an average of 1.5 per cent per year, slower than countries that were not landlocked. Over a span of decades this weak growth adds up to a significant loss of opportunity for these developing and impoverished countries. Thus, examining alternatives become a requisite. Indeed, in a study of human development factors in Central Asian countries, the United Nations found that the largest aggregate economic gains come from reductions in the cost of trade, and the largest losses come from civil war.

This study reported that over ten years, the GDPs of Central Asian countries could be 50 per cent higher as a result of comprehensive and continuous regional cooperation. It follows that the growth and sustainability of the entire region is largely and directly dependent on strong and effective cooperation for genuine regional trade integration. In this regard, Afghanistan becomes particularly central to this endeavour as it has the potential of connecting traffic between Central and South Asia and of linking China to the Arabian Sea and beyond.

Through increased economic integration with the world beyond their regional borders, trading economies can acquire and diffuse new technologies from more advanced countries and help reduce poverty.

Infrastructure Development in Afghanistan

Infrastructure development can play an important role in expanding trade and commerce and allowing goods and services to move along the countries and find suitable markets. Indeed, the construction of canals, railways, and roads play a great role in strengthening economic and regional cooperation.
In the past 12 years, there has been a lot of good development in the infrastructure sector and future plans are aimed at achieving more results to pave the routes for better economic growth in this country.

Some Key Achievements in Transport Sector

- Regional Highways 3,360 KM.
- National Highways 6,100 KM.
- Provincial Roads 15,000 KM.
- Rural Roads 18,000 KM.
- Urban Roads 3,000 KM.
- Planned Target of Road Network 35000 KM.
- Railway Construction 106 KM, 5-Stations, Iran-Herat 120km is (Under construction)
- Railway planned Target 1,650 km (in the next 3 years)

Energy Sector

- Afghanistan has the potential to produce 23000 MW energy.
- At present it produces only 270 MW energy
- It imports 335 MW energy from the Central Asian countries.
- 700 water dams constructed and rehabilitated since 2002.

ICT Sector

- 6-telephone companies, 44-Internet companies, 6-postal companies.
- 19-million telephone subscribers covering (86%) of the population.
- 400 private tourist companies and 500-guest houses are in operation.

Financial Sector

- There are 17 banks in Afghanistan: 3 government banks, 9 private and 5 foreign.
- 45 per cent Operating Budget comes from Grants by donors
- 95% Development Budget comes from Grants by donors
- The ministries of defence, industry and education have the highest Operating Budgets.

Education Sector

- 14400 schools built in past 10-years.
- 9-million students enrolled (3.5mln) female,
- 185000 teachers are on duty (56000-female),
- 70 Government and Private universities,
- 285 faculties are operational,
- 62 technical and vocational institutes

Health Sector:

- 85 per cent of the population has access to basic health services.
- 65 per cent births delivered with non-skilled persons.
- 57 per cent people have access to sources of safe drinking water.
- 111/1000 Live Births (Infant Mortality Rate).
- 2.7 Doctors & 4.6 Medical Helpers/1000 People.
- 2025 hospital beds.
- $2.5 per capita / year (Government Financial Investment).

Macro-Economic Updates

GDP Growth Rate	: 10% (CSO Yr Bk, 2012)
GDP Per Capita	: 776 USD (CSO Yr Bk 2013)
Agriculture Sector	: 35% Contribution to GDP
Services Sector	: 35% Contribution to GDP
Industrial Sector	: 30% Contribution to GDP
(CPI) -Inflation	: 8.4% (CSO 2011/2012)
Poverty Rate	: 36% of the Population
Imports Value	: 7 billion -95% (MoCT 2013),
Exports Value	: 400 million -5% (MoCT 2013)
Domestic Revenue	: 2.2 Bln
Unemployment	: 37% (CSO 2011/2012)
Literacy Rate	: 25% (CSO 2012/13 Report)

Conclusion

Regional economic collaboration is for the benefit of all participating parties. The region as a whole must focus on setting the broad context for sustainable growth, because they all have an economic as well as a security incentive in doing so. And the international community must continue to find ways to support and encourage that growth. In Hillary Clinton's simple words, the "New Silk Road" vision "means upgrading the facilities at border crossings, such as India and Pakistan are now doing at Wagah.

The agreement will adopt international best practices at border crossings and harmonize customs arrangements, reduce smuggling, and increase government revenues from legitimate trade. Other initiatives seek to match energy from Central Asia with Pakistan and India — two markets with significant electricity needs. The TAPI pipeline project would bring on-shore natural gas from Turkmenistan across Afghanistan to markets in Pakistan and India. Other efforts would facilitate the transmission of electricity from Central Asia to Afghanistan, Pakistan, and India.

In closing, we must not forget that this effort is about bringing lasting peace to a country that has spent much of the past three decades at war.

America has lost many brave young men and women and spent billions and billions of dollars in Afghanistan over the past decade. It is important to know that continued investments are putting Afghanistan on the path to sustainable self-sufficiency.
We cannot forget that, as history has shown us, simply abandoning Afghanistan could potentially have terrible consequences for regional and global security. Therefore, putting our efforts together to ensure peace and economic prosperity in this country is for the best of the whole region.■

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CHAPTER 6

China's Growing Economic Relations with South Asia: A Positive Development

Liu Zongyi

Abstract:

Although economic relations between China and SAARC have developed very fast in the past ten years, economic integration between China and this regional grouping is the lowest compared to other regional organizations of the area. Many scholars have concluded that China's economic engagement with South Asia is consistent with normal economic interests. Now SAARC needs outside dynamics to realize its integration. As a neighbouring country joined by common mountains and rivers, China's prosperous economy is the best driving force for South Asian countries' development and SAARC integration. Chinese leaders have put forward plans like the Silk Road Economic Belt, BCIM economic corridor, and China-Pakistan Economic Corridor (CPEC) to enhance Sino-SAARC cooperation. Now the main obstacles are from SAARC and South Asian countries domestically. In order to realize economic and social development and SAARC integration, SAARC countries' political leaders must reach consensus on their own domestic reform and opening-up, achieve security stability in the region and in each country, and maintain smooth relations among all countries, also including Sino-Indian relations.

In the past years, some terms, such as 'Asian Century', 'the rise of Asia', 'the rise of China and India' have become very popular in international society. For international observers, these terms just reflect a global tendency; but for Asian people, they are better visions. As members of Asia, China and South Asian countries have responsibility to make these visions come true, and we are trying our best to do so.

The rise of China is the rise of her economy in nature. China has achieved a unique miracle in nearly 300-years of its history, with an average annual growth rate of nearly 10 per cent ever since the reform and opening-up[1]. China's GDP surpassed Japan's in 2010, and it became the second

[1] Li Yang(李扬), 2013, "Nuli shixian wu shuifen de jingji zengzhang" ("努力实现无水分的经济增长 ", Try to achieve economic growth without exaggeration), *Qiu Shi* (《求是》杂志), no.10.

largest economy in the world. Today, China is the largest merchandise exporter, second largest merchandise importer, second largest recipient of foreign direct investment (FDI) and the largest holder of foreign exchange reserves. The root reason for China's economic achievement by far is the reform and opening-up, which means reforming unsuitable rules, regulations and laws domestically, absorbing foreign investment, and involvement in world market. Now China's reform and opening-up is stepping into Version 2.0 after the third Plenary of 18th Central Committee of CPC.

Fast Growing Sino-SAARC Economic Cooperation and Its Problems

South Asia is a very important neighbouring region to China. China is one of the observers of SAARC. In the new century, the bilateral economic relations between China and SAARC countries developed very quickly. Firstly, China's trade volume with SAARC countries grew very fast between 2001 and 2012. As shown in Form 1, the bilateral trade volume expanded from 6.5 billion USD in 2001 to 73.9 billion USD in 2012, with an average growth rate of 26 per cent. This expansion surpasses the increase in China's world trade volume. The vast majority of China's trade growth with South Asian countries, however, was in exports to South Asian countries; their exports to China increased only slightly. China's exports to these countries combined made up 1.59 per cent of China's total exports in 2001; and it's 3.44 per cent in 2012. Although these countries' export growth to China has been swift, the starting point was very low. In 2001, China's import from South Asian countries combined made up 0.95 per cent of China's total import, and in 2012, this ratio is 1.29 per cent. In short, imports and exports by these five countries are of small importance to China's overall trade profile.[2]

[2] Ministry of Commerce of People's Republic of China, 2010 Statistical Bulletin of China's Outward Foreign Direct Investment.

Form-1
Bilateral Trade of China with South Asia (In million USD)

Year	Total Export to South Asia	Total Export to the World	Ratio of Total Export to SA to that to the World	China's Import from South Asia	China's Import from World	Ratio of Total Import from SA to that from the World
2001	4221.9	266098.2	1.59%	2312.7	243552.9	0.95%
2008	44389.9	1430693.1	3.10%	21468.2	1132562.2	1.90%
2009	41859.2	1201646.8	3.48%	15192.3	1005555.3	1.51%
2010	57607.3	1577763.6	3.65%	22963.6	1396001.6	1.64%
2011	71301.3	1898388.4	3.76%	26111.1	1743394.9	1.50%
2012	70424	2044258.1	3.44%	22634.8	1748665.3	1.29%
% change between 2001 and 2012	142	60.7		79.8	56.2	

(Ministry of Commerce of PRC: 2012年1-12月我对亚洲国家(地区)贸易统计)

But there are some problems in China-SAARC bilateral trade:

1. Trade balance problem: As shown in Form 2, almost every South Asian country has a trade deficit with China, and trade deficits have increased constantly. We can find from Form 2 that most countries' trade deficit with China in 2012 increased compared to that of 2011. Before 2005, India enjoyed trade surplus in the bilateral trade with China, but after that the trade deficit increased very fast.

Form-2
Bilateral Trade between China and SAARC Countries in 2012

	Total Million US$	Export million US$	Import Million US$	Trade Balance Million US$	
				2012	2011
South Asia	93067	70451	22616	47835	45190
India	66472	47673	18799	28874	27169
Pakistan	12417	9276	3140	6136	6316
Bangladesh	8451	7971	480	7491	7362
Sri Lanka	3168	3007	162	2845	2836
Nepal	1998	1968	30	1939	1167
Maldives	76.67	76.49	0.19	76.3	97
Bhutan	15.62	15.60	0.01	15.59	17
Afghanistan	469	464	5	459	226

(Data Source: Ministry of Commerce of PRC)

2. Unbalanced trade structure: We can find in Form 3 that the exported merchandise from China to South Asian countries comprise mainly machinery, electrical and electronic equipment, and nuclear reactors, and other manufactured products; while the imported goods from South Asia to China are mainly ores, slag and ash, cotton, copper, and some other raw materials. Almost every South Asian leader has complained about the trade deficit and this unbalanced trade structure. They believe that this situation is unsustainable.

Form-3
Product Composition in Bilateral Trade between China and SAARC Countries

Partner Country	Major Exported products of China	Major Imported Products of China
India	Machinery, nuclear reactors and boilers, electrical and electronic equipments, organic chemicals etc.	Ores, slag and ash, cotton, copper and articles thereof, pearls, organic chemicals etc.
Pakistan	Electrical and electronic equipments, machineries and rubber and articles thereof etc.	Cotton, cereals, copper and articles thereof, ores and slags etc.
Bangladesh	Cotton, machinery, electrical and electronic equipments, man-made staple fibres etc.	Vegetable textile fibres, articles of apparels, fish, crustaceans etc.
Sri Lanka	Knitted or crocheted fabric, vehicles other than railway, tramway, man-made staple fibre etc.	Vegetable textile fibres, coffee, tea, ores and slags, rubber and articles thereof etc.
Nepal	Articles of apparel and accessories, electrical and electronic equipments, footwear etc.	Oil seed, oleagic fruits, miscellaneous articles, raw hides and skin etc.
Maldives	Footwear, machinery, nuclear reactors, ceramic products, furniture etc.	Electrical and electronic equipments, fish, crustaceans, meat, printed books etc.
Bhutan	Manufactures of plaiting materials, furniture, electrical and electronic equipments, manmade staple fibres etc.	Machinery, miscellaneous articles, electrical and electronic equipments etc.
Afghanistan	Pharmaceutical products, articles of apparel and accessories, meat and edible meat, miscellaneous manufactured articles etc.	Wool, animal hair, oil seed, fruits, pearls, optical and medical apparatus etc.

(from Dr. K. G. Moazzem of Centre for Policy Dialogue, Bangladesh)

Secondly, in the past several years, China's ODI towards SAARC has also increased fast. Since the implementation of China's "Go Global" initiative in 2001, Chinese government has relaxed its foreign exchange controls, procedures, and investment restrictions. From 2003 onward, privately owned enterprises have been allowed to apply for permission to invest internationally. Since that time, Chinese ODI has rapidly expanded, from less than $3 billion in 2003 to $68 billion in 2011 and $77.22 billion in 2012 (including M & A and Greenfield project).[3] While the state-owned enterprises continue to be the largest investors—mainly in petroleum, construction, telecommunications, and shipping, many private companies also have started to invest abroad. Although the major part of China's ODI is directed toward Asia, but it is mainly related to Southeast Asia. But since 2003 China has increased its ODI towards South Asia. As for the reasons for strengthening economic ties with South Asia from that time, China, on the one hand, wanted to enhance its export-led growth strategies and expand trade routes; on the other hand, Indian prime minister Vajpayee's visit to China improved Sino-Indian relations, which created a good atmosphere for China to invest in South Asia, because in the past India was very concerned about China's close relations with its neighbours. In 2012, while China's ODI towards SAARC was about $400 million, with a growth rate of 39 per cent compared to that of 2011, South Asian countries' real investment in China was $500.2 million. At the end of 2012, the stock of China's ODI toward SAARC was about $4 billion, and the stock of South Asian countries in China was nearly $700 million.[4]

[3] Zhang Yuan'an(张远岸), 2013, "2012 Chinese ODI Reach at a New Record High (中国2012年海外投资额再创新高)", http://finance.caixin.com/2013-04-16/100514976.html

[4] "The Economic and Trade Cooperation between China and South Asian Countries Develop Fast (中国与南亚国家经贸合作发展迅速)", http://www.scio.gov.cn/ztk/xwfb/2013/14/5/Document/1320707/1320707.htm

Form 4
China's ODI Towards South Asia (in 10 Thousands US$)

Year	2003	2004	2005	2006	2007	2008	2009	2010
Total	3322222	4477726	5720562	7502555	11791050	18397071	24575538	31721059
Asia	2660346	3347955	4095431	4797804	7921793	13131697	18554720	22814597
S.A.	4567	6022	25526	22645	124880	173829	195092	263266
India	96	455	1462	2583	12014	22202	22127	47980
Pakistan	2748	3645	18881	14824	106819	132799	145809	182801
Bangladesh	845	866	3296	3966	4330	4814	6030	6758
Sri Lanka	654	679	1543	846	774	1678	1581	7274
Nepal	181	332	299	359	866	867	1413	1594
Maldives	-	-	-	-	-	-	-	-
Bhutan	-	-	-	-	-	-	-	-
Afghanistan	43	45	45	67	77	11469	18132	16859

(Data Source: 2010 Statistical Bulletin of China's Outward Foreign Direct Investment)

A sizable portion of Chinese ODI has come in the form of large construction projects, mainly in the sectors of agriculture, energy, and transportation. China's 2010 and 2011 annual investments were highest in Sri Lanka, where Chinese firms have completed or are in the process of completing a number of large-scale projects. These projects span multiple sectors, including investments in transportation, a 35,000-seat cricket stadium, a large convention center, a $209 million international airport, and a $1.5 billion deep seaport located on strategic sea-lanes.[5]

China has several ongoing large-scale projects in Bangladesh. These projects are similar to those in Sri Lanka and include deep seaports in Chittagong and Sonadia Island. China also has plans to build a road and rail link through Myanmar to connect the Chinese city of Kunming with Chittagong. Moreover, China has invested in Bangladesh's agricultural sector, providing $226 million for the Pagla Water Treatment Plant project and $559 million for a fertilizer factory in Shahjalal.[6]

Similar to the portfolio in Sri Lanka and Bangladesh, China has invested heavily in Nepalese energy and transportation, including a $1.6 billion hydropower plant and a $1.9 billion railroad project to connect Lhasa to Kathmandu. Other transportation projects include the Pokhara Regional International Airport, a number of roads, bridges, and container depots.[7]

China has also pledged to vastly increase its investment in Pakistan's economy and infrastructure. Among other things, China has been helping to develop Pakistan's infrastructure through the building of power plants, roads and communication nodes. China is the largest investor in Pakistan's Gwadar Deep Sea Port. Now Pak-China Economic corridor plan is in the making. This ambitious long term project approximately costing $18 billion would include building around 200 kilometers of tunnels. The Strategic Communication Organization of Pakistan and the Huawei Company will set up communication link between Pakistan and China, and a local home solar solution project will be built in Punjab.[8]

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[5] Shihar Aneez, "RPT-Sri Lanka Takes Next Step to Opening Strategic China-Built Port," *Reuters*, March 4, http://www.reuters.com/article/2013/03/05/srilanka-port-china- idUSL4N0BX1DU20130305.

[6] Emily Brunjes, Nicholas Levine, Miriam Palmer, and Addison Smith, "China's Increased Trade and Investment in South Asia," http://www.lafollette.wisc.edu/publications/workshops/2013/China.pdf

[7] Emily Brunjes, Nicholas Levine, Miriam Palmer, and Addison Smith, "China's Increased Trade and Investment in South Asia," http://www.lafollette.wisc.edu/publications/workshops/2013/China.pdf

[8] "Pakistan, China sign deal on economic corridor," http://www.dailytimes.com.pk/default.asp?page=2013%5C07%5C06%5Cstory_6-7-2013_pg1_6

With India, China also has a lot of cooperation projects. As India's power gear makers have struggled to compete on price, many Indian power companies have been ordering equipment from overseas, especially from China. Now China is a big supplier of power equipment and other infrastructure to India. The Power Construction Corporation of China has signed a $2.4 billion contract to build the second phase of a massive coal-fired power complex in southern India to help meet soaring local demand for electricity. The project will create more than 10,000 jobs in India.[9] Now India's ministry of Power and China's National Energy Administration have signed an agreement allowing power equipment makers from China to set up power equipment service centres (PESCs) in India to further strengthen and deepen cooperation in the energy sector under the India-China strategic economic dialogue mechanism. [10]

In Afghanistan, China also contributed a lot of money to transportation and other infrastructure.

Although the economic exchanges between China and SAARC developed very fast in the past ten years, the economic integration between China and SAARC is the lowest compared with other regional economic integration organizations around China, such as ASEAN and SCO. The bilateral trade between China and SAARC is only 2.5 per cent of China’s total foreign trade in 2012. And China’s ODI towards SAARC is less than 0.5 per cent of its total ODI.

Positive Implications of Sino-SAARC Economic Cooperation and Its Obstacles

China and South Asian countries are linked together with mountains and waters. The Himalayas cannot block the mutual economic attraction between China and SAARC. China has a very large market and the fastest growing economy, while South Asian countries have plenty of natural resources and human resources. The economic integration of China and SAARC will create a huge market with 2.8 billion people, which will bring new driving force for not only China and South Asian economic development but the whole world.

The economic integration of China and SAARC will push forward the

[9] “China power giant inks $2.4-bln India project,” http://in.reuters.com/article/2012/04/13/china-power-india-idINDEE83C05X20120413

[10] “India opens doors to Chinese power equipment makers news,” October 23, 2013, http://www.domain-b.com/industry/power/20131023_power_equipment.html

economic development of South Asian countries and China at least from three aspects:

1) Most of the SAARC countries are at a lower level of industrialization, and unemployment problems are very pressing for South Asian governments. China is now at the medium level of industrialization. Chinese capital will "go global". With the restructuring of Chinese economy, a lot of labour intensive industries in China will move to other countries. Although some Chinese economists take Africa as the best choice for these industries[11], South Asian countries enjoy better geographic advantages. It has a vital significance for South Asian countries to resolve the employment problem, raise the proportion of manufacturing sector in their economies, and improve their economic growth. At the same time, the further reform and opening-up of China will provide a huge market for South Asian countries.

2) China has been playing an active role in power project, transportation, and other infrastructure construction overseas, particularly in developing countries, taking advantage of state financing as well as experience and technology acquired through three decades of economic boom. Most SAARC countries are backward in infrastructure. If South Asian countries absorb Chinese financing and experience on infrastructure strongly, which will change the backward situation of South Asian countries' infrastructure, put forward the social and economic development, and create better conditions for absorbing further FDI. Last month, Indian Prime Minister Singh visited China, and signed an agreement with Chinese government on railway construction. This is an encouraging win-win achievement for both sides.

3) In the past three decades of economic reform and opening-up, China got a lot of experience beyond economic development and infrastructure construction. In this era of globalization, if a country wants to get economic development, first of all, it must have social stability and peaceful periphery. Political leaders and the whole society should have an open mind towards the outside world, especially concerning FDI; and political leaders should be willing to reform those unsuitable

[11] Lin Yifu (林毅夫), 2013, "Zhongguo chanye shengji yao shiru 'lanhai'" (中国产业升级要驶入'蓝海'，China's industrial upgrade should sail into 'Blue Ocean'), *Renmin Ribao* (人民日报*People's Daily*), August 21, 2013, A5.

rules, regulations and laws. China is very cautious in communicating with other developing countries about this experience since some Western countries condemn the so called "China model". But this experience is very helpful to South Asian countries along with China's economic and technological aid to South Asian countries and their people to people communications. These communications of experience will improve South Asian countries' social and economic development, hasten the integration of SAARC, and create better conditions for the resolving regional conflicts. Besides, Sino-SAARC cooperation on international financial issues will enhance South Asian countries' capability to respond to international financial crises, and benefit the reform of international financial system.

However, there are lots of obstacles facing Sino-SAARC cooperation. Firstly, economic obstacles. As I mentioned above in this article, there are trade imbalances and unbalanced trade structure between China and South Asian countries. This phenomenon is harmful for the establishment of China-SAARC free trade area. But China's trade surplus from bilateral trade with South Asian countries is not deliberate. China announced a Generalized System of Preferences to many developing countries, including most SAARC countries. Maybe China should do more for importing South Asian goods. The main reason of this trade deficit is the backwardness of South Asian manufacturing sectors. How to deal with this issue. The only way lies in opening-up and absorbing FDI, introducing advanced technologies and production, which will help increase the employment rates in these countries, improve their manufacturing, and boost their exports. Protectionism can play some role, but it cannot resolve the problem from the root. It seems that opening-up and protectionism are contradictory, but they are not in fact. Among SAARC countries, India is the biggest trade partner of China. India is also among the countries that take most serious anti-dumping and countervailing measures towards China. Before 2005, when India enjoyed trade surplus with China, India never initiated to sign free trade agreement with China. But since 2006, with its trade deficit growing, Indian government has faced a lot of opposition on this issue. During his recent visit to China, Prime Minister Manmohan Singh also raised the trade imbalance issue.

Secondly, as far as political and security obstacles are concerned, Sino-Indian relations are becoming better, but it's a relationship driven by top leaders and business circle. The basis of Sino-Indian bilateral relations is fragile, and there is a lack of mutual strategic trust. Indian strategic and security circle is concerned about China's activities in South Asian countries and the Indian Ocean. On the one hand, India has imposed many restrictions on Chinese companies and Chinese investment; on the other hand, India pays close attention to China's economic activities in other South Asian countries. She is afraid that China will encircle India; and at times India has interfered in other South Asian countries' economic agreements with China openly and covertly. Together with some Western countries' alienating manoeuvres this situation has created problems. Some western scholars created a "string of pearls" strategy for China (as shown in Map 1), and it is accepted by many Indian scholars. Actually, even western scholars don't believe this "string of pearls" strategy. Just as Emily Brunjes and his colleagues said, "China's economic engagement with South Asia … does not reveal activity inconsistent with normal economic interests. … that the "string of pearls" theory is plausible, but building ports and roads facilitates trade as much as it increases the ability to project power. …we caution against interpreting China's activity as threatening to regional stability or Indian security." The signing of the Border Defense Cooperation Agreement between China and India was hailed by Indian media as the most significant and enduring diplomatic achievement since the birth of the US India Civil Nuclear Agreement. We hope Prime Minister Singh's recent visit to Beijing will reset Sino-Indian good relations.

Map 1: the so-called "String of Pearls"

Thirdly, the social stability and security situation in some countries influenced the economic interactions between them and China. Terrorism became the biggest obstacle to these countries economic and social development. Not only Chinese private enterprises, but also state-owned enterprises would not choose these countries to conduct business. Even if they have invested in such countries, they will withdraw or stop when the situation worsens. As we know, China National Petroleum Corporation stopped its oil project in northern Afghanistan because of the disturbance created by the local warlord. Sri Lanka is a good example. After Sri Lanka government restored peace domestically, China increased a lot of ODI towards Sri Lanka, and their bilateral trade has grown very fast in recent years.

Lastly, the fragmentation of economic integration: Now SAARC is divided between the India-eastward camp and the Pakistan-westward camp.[12] Although the India-eastward camp is more integrated, India cannot

[12] Yang Xiaoping, "The Security Architecture of South Asia: Problems and Prospects," http://indiachinainstitute.org/wp-content/uploads/2010/03/Yang-Xiaoping-Security-Architecture-of-SA.pdf

play a leading role in their economic development. Among SAARC countries, transportation facilities are far from enough. Trade volume between India and other SAARC countries is much less than that with countries outside the region. The reason of is both economic and political. As for the whole SAARC, political factors play a more negative role than economic factors. As the most influential member in SAARC, India has too many contradictions with other members, which badly affects the construction and development of SAARC. Now SAARC needs outside dynamics to drive its integration. As a neighbouring country joined by common mountains and rivers, China is different from other SAARC observers. South Asian countries' peace, stability, and development are closely related to the stability and development of Southwest China. Furthermore, the security of energy and trade channel in the Indian Ocean is vital to China. China is like any other country of the region in this respect. However this makes some SAARC countries suspicious of the integration process dominated by India. If SAARC were to follow the example of ASEAN's "10+3" system, and include China as a formal member, its integration will be quickened with China and India as "dual drivers". It is said that China and Russia had supported India's membership of Shanghai Cooperation Organization,[13] so maybe India would reciprocate by supporting the formal membership issue of China in SAARC.

How and What Should China Do Next?

Since assumption of power by President Xi Jinping and Premier Li Keqing, China's foreign policy has shown some new trends and innovations. Among them, two aspects are closely related to Sino-SAARC relations:

The first is about "the Chinese dream." During his trips abroad or meetings with visiting foreign guests at home since the 18th Party Congress, President Xi has spoken at length to leaders and people of foreign countries on the importance of the Chinese dream, namely, to achieve the great renewal of the Chinese nation. The Chinese dream requires a peaceful and stable international and neighbouring environment, and China is committed to realizing the dream through peaceful development. Since the Chinese dream is closely linked with the dreams of other peoples around the world, China is committed to helping other countries, developing countries and neighbouring countries in particular, with their development while

[13] Pyotr Akopov, Vzglyad, "SCO membership precursor to Russia-India-China alliance," October 10, 2013, http://indrus.in/world/2013/10/10/sco_membership_precursor_to_russia-india-china_alliance_30051.html

achieving development of its own. China will share more development opportunities with other countries so as to facilitate their efforts to realize their dreams. China hopes to see win-win cooperation and common development with the rest of the world. While working to realize the Chinese dream, the people of China are desirous of realizing the world dream through concerted efforts with the people around the world.[14]

The second aspect is the right approach to upholding justice and seeking interests with a view to enhancing friendship and cooperation with neighbouring countries and developing countries. Inheriting the fine traditions of Chinese culture and the diplomacy of New China and keeping in mind the new tasks in the new period of China's relations with other developing countries and its neighbours, President Xi underscores the need to adopt the right approach to upholding justice and seeking interests in growing relations with these countries. Politically, China should uphold justice and fairness as a guiding principle. Economically, China should pursue mutual benefits and common development. In growing relations with our neighbours and other developing countries that have long been friendly towards China yet face daunting challenges in development, China will accommodate their interests rather than seeking benefits at their expense or creating troubles for them. China will follow the right approach to upholding justice and seeking interest in strengthening relations with its neighbours and other developing countries. During his visit to Africa, President Xi stressed China's commitment to cooperation with Africa with sincerity, real results, affinity and good faith. In particular, he emphasized the win-win nature of China-Africa cooperation. He reiterated that China will fully honour its commitment to Africa, attach no political strings to aid to Africa, help African countries translate their strength in natural resources into progress in development and achieve diverse, independent and sustainable development.[15] These principles also apply to South Asian countries.

As for China’s foreign policies related or directed to Sino-SAARC economic cooperation in practice, President Xi and Premier Li have put forward the Silk Road Economic Belt, BCIM economic corridor, and China-Pakistan economic corridor (CPEC) ideas (shown as Map2, 3, 4) respectively to Central Asian leaders, Indian and Pakistani leaders in addition to bilateral economic cooperation and people to people interaction

[14] Yang Jiechi, “Innovations in China's diplomatic theory and practice under new conditions,” *Qiushi* (*Seeking Truth*), http://english.peopledaily.com.cn/90883/8366861.html

[15] Yang Jiechi, “Innovations in China's diplomatic theory and practice under new conditions,” *Qiushi* (*Seeking Truth*), http://english.peopledaily.com.cn/90883/8366861.html

steps.. These policies coincide with “go west” strategy proposed by Professor Wang Jisi. Next, China will lay a lot of emphasis on Silk Road Economic Belt, BCIM economic corridor, and China-Pakistan economic corridor, improving inter-connectivity process, including policy, road, trade, currency and public thinking. Among them, the inter-connection of roads is the base for the building of these economic belts or corridors.

The Silk Road Economic Belt, BCIM economic corridor, and China-Pakistan economic corridor are complementary. The Silk Road Economic Belt will connect East Asia and EU, and improve the development speed of Central Asian natural resources. Much before the United States suggested a new Silk Road project to connect Central Asia with Afghanistan, Pakistan and India, China had already put forward its Silk Road plan. There’s no conflict between these two Silk Road plans. Now Afghanistan is very interested in China’s Silk Road Economic Belt plan. If Afghanistan’s situation becomes stable, these two Silk Road plans can combine. China-Pakistan economic corridor can also be connected with the Silk Road Economic Belt. Many CPEC projects will not only boost Sino-Pakistan bilateral relations, but also serve the larger regional interests including Central Asia, Afghanistan, the Gulf, and Iran. While BCIM is another interconnection between China and SAARC, the idea would also aid China's Silk Road diplomacy and trade. Maybe in the future, BCIM can be connected with Megon-Ganga Cooperation Initiative (MGCI). Thus the Silk Road, Southern Silk Road and Maritime Silk Road can be combined together.

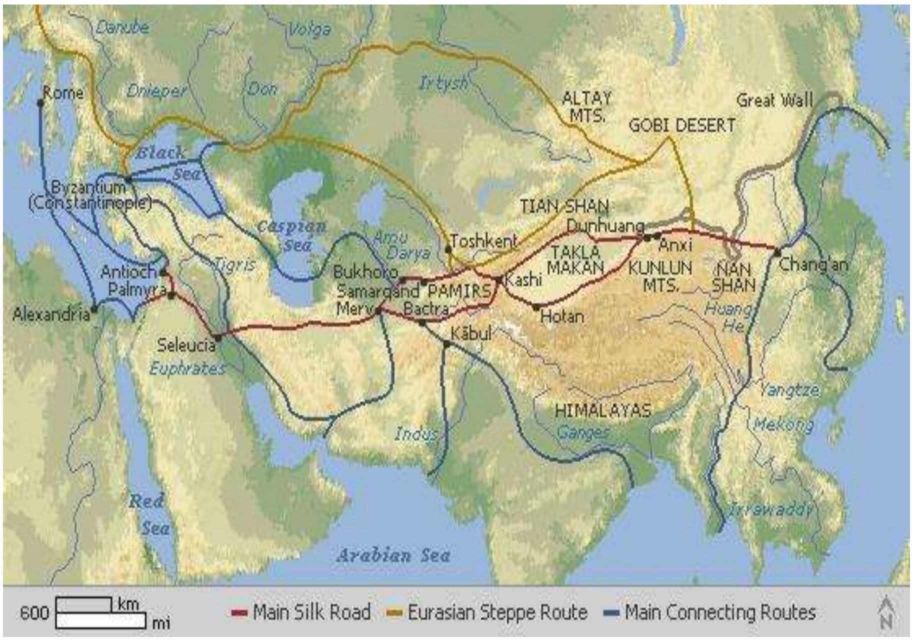
There are several preconditions to establish these economic belts or economic corridors. First of all is political and security stability in the region and in each country; the second is international relations among those countries along the economic belt or economic corridors must maintain smooth and improve strategic trust. A smooth Sino-Indian relationship will pave the way for close coordination for those projects among many stakeholders. Pakistan must see the development of Sino-Indian relations from this important perspective. The success of the China Pakistan Economic Corridor (CPEC) also greatly depends on the normalization and bolstering of ties between China and India.

Besides, political consensus must be reached. Take BCIM as an example. Indian top leaders are very positive on Premier Li’s proposal of BCIM. India has been suffering an economic slowdown in recent years. Singh did not get any substantial commitments from the US during his visit there last month, since Washington primarily intends to take advantage of its military force to contain China. As a result, cooperation with China to develop its economy has become a realistic choice for New Delhi. What's more, this corridor is pertinent to security and prosperity in north-eastern

India. However, there is still some opposition.

India's domestic concerns about the BCIM Economic Corridor mainly come from three aspects: Given the unsettled Sino-Indian border disputes, the opening-up of the north-eastern area may pose a threat to its defence security once conflicts take place; a number of rebel groups that share ethnic ties with people in both Myanmar and China have been causing turbulence in this part of the country, and regional frictions are likely to turn into international conflicts once the district is opened up; further, commodities from China and some Southeast Asian nations sell well in the Indian market, which, therefore, may be occupied by foreign products amid regional economic integration.

Such worries actually expose the fact that domestic vested interest groups in India are a strong obstructing force to its social development and international economic cooperation. The opening up of the borderlands will bring about redistribution of social and economic interests, and directly lead to the declining status of such interest groups. The signing of the border defence cooperation may help dispel India's worries on national security, since it ensures that the two sides will not resort to force to solve border controversies by law. And economic integration will not only inject vitality to the region, but also weaken popular support for the rebels. India has to overcome more domestic impediments than China.



(Map 2: Silk Road)

(Map 3: BCIM economic corridor)

Map 4: China-Pakistan Economic Corridor

Conclusion

Although the economic relations between China and SAARC have developed very fast in the past ten years, the economic integration between China and SAARC is the lowest compared to other regional economic integration organizations around China. Many scholars have proved that China's economic engagement with South Asia does not reveal any activity inconsistent with normal economic interests.

Now SAARC needs outside dynamics to realize its integration. As a neighbouring country joined by common mountains and rivers, China's prosperous economy is the best driving force for South Asian countries' development and SAARC integration. While the Chinese dream requires a peaceful and stable international and neighbouring environment, and China is committed to realizing the dream through peaceful development, China is also committed to helping other countries, developing countries and neighbouring countries in particular, with their development while achieving development of its own. China will share more development opportunities with other countries so as to facilitate their efforts to realize their dreams.

Chinese leaders have put forward plans of the Silk Road Economic Belt, BCIM economic corridor, and China-Pakistan economic corridor (CPEC) to enhance Sino-SAARC cooperation. Now the main obstacles are from SAARC and South Asian countries domestically. In order to realize economic and social development and SAARC integration, SAARC countries' political leaders must reach consensus on their own domestic reform and opening-up, achieve security stability in the region and in each country, and maintain smooth relations among all countries, also including Sino-Indian relations.■

CHAPTER 7

Fast Tracking Economic Collaboration in SAARC Countries

Dr. Pervez Tahir

Introduction

This paper focuses on the extent to which fast-tracking is possible in the areas of economic collaboration in the SAARC region. It also comments on the extra-regional incentives for regional cooperation.

Five years elapsed between the origin of the idea of SAARC in 1980 and the formal adoption of its Declaration in 1985 by the heads of state. Given the vicissitudes of history in the region, a cautious start was made. Only five areas of cooperation were selected. Under the rubric of the SAARC Integrated Programme of Action (SIPA), these included agriculture, rural development, telecommunication, meteorology and health & population. With predominantly agricultural economies and rural populations, poor tele-connectivity, climatic linkages and underinvested social sector, the choice of areas made sense. None of these linkages could be described as economic, though. Trade, the characteristic feature of regional economic blocs, was missing as an area of cooperation. It took another six years to mandate economic cooperation in 1991. The SIPA was reconstituted to add areas left out earlier. The total number of areas of cooperation rose to 15, listing agriculture & rural, biotechnology, culture, economic and trade, education, energy, environment, finance, funding mechanism, information, communication and media, people to people contacts, poverty alleviation, science and technology, security and social development and tourism.

Under the reconstituted SIPA, deliberations were initiated on the expansion of intraregional trade. A step by step approach was adopted. It was envisaged to go through the stages of trade preferences, free trade area, customs union, common market and eventually an economic union. As a first step, the agreement on the South Asian Preferential Trade Area (SAPTA) was signed in April 1993. Differential treatment was given to members categorized as least developed countries (LDCs) and non-LDC members. Special concessions were provided to LDCs — Bangladesh, Bhutan, Maldives and Nepal. Market access under SAPTA was limited.

Even this took four rounds of negotiations. It provided limited market access to member states.

The next important step was the establishment of the South Asian Free Trade Area (SAFTA). Discussions on SAFTA started in 1995. It took the next nine years to sign the SAFTA agreement on 6 January 2004 in Islamabad. Another two years were consumed by the ratification process. At long last, the agreement was enforced on January 1, 2006 (Appendix I). Trade liberalization started with effect from July 1, 2006. The process is steered by the SAFTA Ministerial Council (SMC) consisting of commerce ministers, which is mandated to meet at least once a year. Seven meetings have been held so far, the last one in Colombo on August 23, 2013.

In addition to tariff reductions to liberalize intraregional trade, trade facilitation measures are necessary in the form of improved connectivity through the development of linkages of rail, road and telecommunication networks. Energy has provided a strong impetus to collaboration in other regional economic groupings and free trade agreements. SAARC is, however, an energy deficient region, with limited potential for cooperation.

Gradualism in Regional Integration

Economists generally agree that regional economic collaboration is mutually gainful for the participating countries. The whole, in their view, is greater than the sum of the parts. Regional integration provides the best arrangement for increasing benefits from spill overs and externalities in an interdependent world. Distribution of gains is not necessarily equal, but the provision of safeguard clauses protects the weaker member countries. In spite of the theoretical consensus on benefits and empirical evidence of mutual gains for the late comers, nearly all regional groupings went through a gradualist or evolutionary process rather than rushing into full integration. This is true across the continents — EU in Europe, NAFTA in North America MERCOSUR in South America, ASEAN in Asia and the African Union. Even in cases of near absence of political conflict or historical enmities, caution, gradualism and evolution characterized the development of regional integration.

The SAARC region is no exception. In about three decades of its existence, it has moved from a preferential to a free trade area. On the ground, however, the movement is not beyond the preliminaries of a free trade area, which economists define as free or freer trade between members but without a common external tariff for third countries. At the same time, the SAPTA continued until 2008 for non-LDC member preferences for LDCs and 2012 for LDC members. The prolonged, dirigistic rounds of negotiations under SAPTA covered over 5000 items. Each Round contributed to an incremental trend in the product coverage and the deepening of tariff concessions over previous Rounds. The next stages of customs union, common market and economic union are distant dreams. All the trappings of a free trade area are there. Tariff reduction programme, rules of origin, safeguards, dispute resolution and an institutional mechanism are in place. Notifications to give effect to the SAFTA Trade Liberalization Programme are issued continually. Certificates of origin are regularly notified (Appendix II, Table 1). In addition, cooperation in standards is happening. The SAARC Agreement on Trade in Services has also been signed. Cooperation in avoidance of double taxation is taking place. SAARCSTAT has been set up to generate and disseminate data. SAARC trade fairs area regular feature. SAARC Chamber of Commerce and Industry is active to promote cooperation in the private sector.

This is an impressive institutional and policy architecture. But it has not led to the desired outcome of rapid expansion of intraregional trade. Despite SAFTA, access of SAARC members to the markets of third countries in Europe is much better than the access to each other’s market.

Are these free trade measures the building blocks or the stumbling blocks in the process of regional integration in South Asia? Before addressing this question, it is important to analyse the progress made so far in the field of intraregional trade.

Trends in Intraregional Trade

At present, SAFTA has a small share in world exports. In 2006, the first year of SAFTA, its member countries exported goods worth of $158.9 billion to the world or 1.3 per cent of the world exports. This share increased to 1.8 per cent in 2010. Within this small global share, exports of members to each other attributable to the emergence of SAFTA were just $ 0.69 million in 2006 or a fraction of their total exports. In 2010, the SAFTA-related exports were only 0.24 per cent of total exports. Even the absolute numbers are less than inspiring. The latest figure for 2012 shows exports at$ 822 million, still less than a billion dollars. This is an impressive growth, but insignificant relative to the total trade volumes. As a matter of fact, the cumulative intraregional trade between 2006 and 2013 is valued at $ 2.92 billion. Of this the largest share was not contributed by the largest country, India, but by Bangladesh, defined as an LDC. Bangladesh contributed $ 1.344 billion while India’s share stood at $ 1.328 billion. Information on Pakistan is not complete in the latest periods, but its availability is unlikely to alter the fact that she fares a poor third. Appendix II, Tables 1-2 may be seen for detailed information.

It is interesting to look at the pre-and-post-SAFTA shares of the member countries in their own international trade. The following table gives the information.

Share of SAARC Trade in Total Trade

Country	% of Total Exports		% of Total Imports	
	2005	2008	2005	2008
Afghanistan	42.8	39.1	43.1	42.2
Bangladesh	2.6	3.6	16.5	17.4
India	5.3	5.8	0.9	0.6
Maldives	16.6	15.9	17.4	12.6
Nepal	66.0	59.2	66.5	48.2
Pakistan	11.2	13.2	3.0	5.9
Sri Lanka	10.3	8.0	22.4	22.9
SAARC	6.6	6.8	4.6	4.1

Before SAFTA, Bangladesh, India and Pakistan gained in exports and the rest experienced decline. The impact on overall SAARC exports was a marginal increase from 6.6 per cent to 6.8 per cent. On the import side, there was an increase in the case of Bangladesh, Pakistan and Sri Lanka. The overall SAARC imports declined from 4.6 per cent to 4.1 per cent. Only Bangladesh and Pakistan increased their exports as well as imports. Pakistan's gains are largely due to the entry of Afghanistan, its third largest export market, in SAARC.

The Stumbling Blocks

A number of stumbling blocks have slow-tracked the expansion of intraregional trade. Sensitive Lists are the most important. These Lists allow what are called items in the declared Sensitive Lists exceptions to the agreement. Often these Lists contain items that have a greater potential to contribute to the expansion of intraregional trade than those included in the Trade Liberalization Programme. In the case of India and Pakistan, there was some progress recently. In 2012, Pakistan abandoned its elaborate Positive List and replaced it with a smaller Negative List. This smaller list still has 1,209 tariff lines. According to Pasha, et al (2012b), the importables from India increased from 27 per cent to 82 per cent. It was also promised that a much shorter Sensitive List will be issued after the granting of full MFN status to India. Reciprocally, India scaled down its

Sensitive List by 30 per cent. By April 2013, India promised to limit the Sensitive List to 100 items. It also declared that the import duty will be reduced to 5 per cent by that date.

April 2013 has come and gone. Neither Pakistan has granted India the MFN status, nor has the promised liberalization by India materialized.

The analysis by Pasha, et al (2012b) reveals that the actual benefit of the measures announced by India are in fact far less. First, the quantification of the Indian Sensitive List on the basis of the 8-digit level of HS Code, India's tariff lines outnumber that of Pakistan. Second, Pakistan's preferential tariff lines cover 94 per cent of its exports, while Indian preferential treatment covers 65 per cent of Pakistan's exports. Third, Pakistan has a comparative advantage in agricultural products. India's Sensitive List is, however, biased towards agricultural products. Duties between 30-100 per cent are reinforced by 5.2 per cent GDP spent on subsidizing agriculture. The subsidy bill in Pakistan is one per cent of GDP and tariffs are low, ranging from 0-10 per cent. Fourthly, Pakistan's comparative advantage in textiles is also affected. "India's import duty is the higher of the rate of 10% or a specific duty. For several products the ad valorem equivalent of the specific duties exceeds 100%. As opposed to this tariff structure the maximum duty, excluding automobiles, in Pakistan is 30%." Finally, there are concerns that a much smaller Indian Sensitve List vis-à-vis Bangladesh can cause outflow of investment from Pakistan.

Non-Tariff Barriers (NTBs) have been another stumbling block. Any measure other than tariffs imposed or sponsored by the government is defined as an NTB. These measures thwart the impact of reduced tariffs and provide protection to a domestic activity by another name.

India has a long list of NTBs: Sanitary and phytosanitary regulations and rules, especially on foodstuffs; the complexities in licensing, permit and tariff regimes; quantitative controls applied as safeguards; duties and charges in addition to customs tariffs; reference prices with bimonthly revisions in response to changing world prices; and restrictions about the port of entry. There are also security related restrictions, as the SAFTA agreement permits members to take any measure considered important for national security.

Pakistan has its own set of NTBs for reasons of national security, health, environment and religion. Federal Board of Revenue has issued a number of SROs restricting imports. In terms of the World Bank's Overall Trade Restrictiveness Index, India is more restrictive than Pakistan.

Energy

If the interregional trade is not moving fast because of the slow pace of tariff reductions, Sensitive Lists and prevalence of NTBs, can economic collaboration be put on a fast track in other areas of cooperation.
Energy is sometimes mentioned as one such area. In the SAARC, energy sector was paid attention in 2000. A Technical Committee on Energy was set up. Subsequently, a specialized Working Group was also set up in 2004. In 2005, SAARC Energy Ministers formed an Expert Group which prepared a road map for energy conservation and efficiency. After the thirteenth SAARC Summit, SAARC Energy Centre was set up in Islamabad. It had an elaborate mandate going well beyond energy conservation and efficiency. It included development of energy including hydropower, renewable and alternative energy resources. Regional energy trade would also be promoted. The concept of Energy Ring was advanced. A common template on technical and commercial aspects of electricity grid interconnection is ready. Asian Development Bank has carried out the SAARC Energy Trade Study (SRETS), which identified four trade options. Another study was commissioned to explore the development of a regional power market. Concept papers on the Road Map for developing SAARC Market for Electricity and SAARC Inter-Governmental Framework Agreement for Regional Energy Cooperation have been taken up.

A lot of paper work has been done. However, South Asia is an energy deficient region. No member is endowed with surpluses of fossil fuels. Power outages are common. Demand outstrips supply and the gap is expected to widen in the coming years. Fast tracking any regional imitative in the energy sector is a difficult proposition. Two extra-regional initiatives have promise, but any breakthrough in near future is unlikely. The first is Iran-Pakistan-India gas pipeline. India has already pulled out and Pakistan has neither the money nor the hope that the United States would exempt it from sanctions. Similarly, the fate of the Turkmenistan-Afghanistan-Pakistan-India gas pipeline depends on the normalization in Afghanistan. There are also issues of the exact quantity of gas available and pricing.

Connectivity

Trade is hampered by poor regional connectivity. Road, rail, air and telecommunication links need to be improved. In a number of cases, it is cheaper to export to third countries than to the region. In terms of the logistic performance, India fares better than Pakistan. But this need not hide the fact that quality of infrastructure is unsatisfactory. A lot can be fast-tracked here. A Regional Railways Agreement is under consideration.

Establishment of a cargo corridor can bring about considerable reductions in the cost of doing business. A demonstration run of a container train has been proposed to link Bangladesh, Nepal and India. The India-Sri Lanka Ferry Service is to be regularized. In 2011, the seventeenth SAARC Summit called for “effective linkages and connectivity for greater movement of people, enhanced investment and trade in the region”. As it provides East-West connectivity, grand designs for a wider Indian Ocean Cargo and Passenger Ferry Service have been mentioned.

It must be remembered that the British had established an elaborate rail and road network linking what is now Pakistan with East India for the movement of food and troops. These links fell into disuse after the independence in 1947. They can be restored on a fast track basis without the high costs involved in initiating mega projects. Let the Bengals and the Punjabs, for instance, trade overland with each other.

Economic Union in Politics, not Economics

India and Pakistan in SAARC are the France and Germany of European Union. In the past six decades, peace broke out in Europe. Unlike Europe, India and Pakistan have found the legacy of revenge and conflict hard to overcome. The Nobel Peace Prize 2012 was awarded to European Union (EU) "for over six decades contributed to the advancement of peace and reconciliation, democracy and human rights in Europe." In his Nobel Lecture, Herman Van Rompuy, President of the European Council maintained that mere symbolism does not work for peace. What worked was the European Union's "secret weapon" which he described as “an unrivalled way of binding our interests so tightly that war becomes materially impossible.” The foundations of this peace were laid on 9 May 1950, when the French Foreign Minister Robert Schuman began his peace project by bringing the erstwhile enemies together in producing coal and steel, the very materials of war, to make peace. In his words: "The solidarity in production thus established will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible".

The global financial crisis shook the foundations of EU. It has survived the crisis, not because of any economic initiative, but because of its political framework which is based on the principle of collective responsibility. The stronger economies are required to support the economies in crisis. As the afore-mentioned Nobel Lecture put it: “Without this European cooperation, the result might easily have been new protectionism, new nationalism, with the risk that the ground gained would be lost." In sharp contrast, a single incidence can roll back years of work on peace between India and Pakistan and economic cooperation in SAARC.

From committees to summits, discussions of bilateral issues are avoided in the deliberations of SAARC. These fora, however, do provide an opportunity to the leaders to engage in a political dialogue. The Kashmir dispute between India and Pakistan has cast the longest shadow over the economic cooperation in South Asia. There is no agreement on Kashmir. This is, however, not to say that agreements are implemented. Despite agreement, the issues of Sir Creek and Siachin remain a bone of contention. Even the settled issues such as the Indus Water Treaty are in danger of being reopened. The issue of the rights of co-riparians of Ganges and Brahmaputra basins is no less important.

In recent years, terrorism has done more damage to the peace process than any other issue. The only time the SAARC looked at a political and security issue with bilateral implications was during the twelfth and the thirteenth SAARC summits. Fight against terrorism was on the agenda and regional cooperation was agreed. There is nothing concrete to show in this regard.

Regional Cooperation is the subject of central governments of the member states. Even when these governments have the desire to move ahead in key areas, they are unable to develop national consensus in the enormously diverse populations. Prime Minister Nawaz Sharif made peace with India an elections issue. However, developments on the Line of Control undermined his position and that of Prime Minister Manmohan Singh. Instead of regional cooperation to fight terror, the two Prime Ministers were taking positions at the United Nations which have been frozen in time. In case of Sri Lanka, India takes a position on terrorism which is the opposite of the position vis-à-vis Pakistan.

Conclusion

Most regional economic integration arrangements went through a step by step process. There are no quick fixes. This is especially so when the region has a history of conflict. The important thing is to keep engaged. SAARC has not made any significant progress in extending regional economic collaboration. The objective of a South Asian Economic Union by 2020 is unlikely to be achieved. Nor can it be fast-tracked by extra-regional incentives. Slow but steady progress in intraregional trade, facilitated by improved regional connectivity for ideas, people and goods, is the way forward. Increasing intraregional strength opens up greater possibilities of integration with the globalized world. If Germany and France could forget the past and lead the way towards sixty year of peace and progress in

Europe, India and Pakistan can also do it through political will exercised on behalf of democratically elected Parliaments. In the last elections in Pakistan, friendship with India was a campaign slogan. The route to economic progress in the region goes through politics. The great advantage of SAARC is that even when India and Pakistan are not talking bilaterally, it provides opportunities on the sideline of summits to keep the two mistrusting nations engaged. Economic fast tracking in SAARC is directly proportional to the accumulation of trust capital between India and Pakistan.■

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Appendix I

Key Articles of the SAFTA Agreement

Article - 8
Additional Measures

1. Contracting States agree to the following schedule of tariff reductions:

a) The tariff reduction by the Non-Least Developed Contracting States from existing tariff rates to 20% shall be done within a time frame of 2 years, from the date of coming into force of the Agreement. Contracting States are encouraged to adopt reductions in equal annual instalments. If actual tariff rates after the coming into force of the Agreement are below 20%, there shall be an annual reduction on a Margin of Preference basis of 10% on actual tariff rates for each of the two years.

b) The tariff reduction by the Least Developed Contracting States from existing tariff rates will be to 30% within the time frame of 2 years from the date of coming into force of the Agreement. If actual tariff rates on the date of coming into force of the Agreement are below 30%, there will be an annual reduction on a Margin of Preference basis of 5 % on actual tariff rates for each of the two years.

c) The subsequent tariff reduction by Non-Least Developed Contracting States from 20% or below to 0-5% shall be done within a second time frame of 5 years, beginning from the third year from the date of coming into force of the Agreement. However, the period of subsequent tariff reduction by Sri Lanka shall be six years. Contracting States are encouraged to adopt reductions in equal annual instalments, but not less than 15% annually.

d) The subsequent tariff reduction by the Least Developed Contracting States from 30% or below to 0-5% shall be done within a second time frame of 8 years beginning from the third year from the date of coming into force of the Agreement. The Least Developed Contracting States are encouraged to adopt reductions in equal annual instalments, not less than 10% annually.

2. The above schedules of tariff reductions will not prevent Contracting States from immediately reducing their tariffs to 0-5% or from following an accelerated schedule of tariff reduction.

3. a) Contracting States may not apply the Trade Liberalisation Programme as in paragraph 1 above, to the tariff lines included in the Sensitive Lists which shall be negotiated by the Contracting States (for LDCs and Non - LDCs) and incorporated in this Agreement as an integral part. The number

of products in the Sensitive Lists shall be subject to maximum ceiling to be mutually agreed among the Contracting States with flexibility to Least Developed Contracting States to seek derogation in respect of the products of their export interest; and

b) The Sensitive List shall be reviewed after every four years or earlier as may be decided by SAFTA Ministerial Council (SMC), established under Article 10, with a view to reducing the number of items in the Sensitive List.

4. The Contracting States shall notify the SAARC Secretariat all non-tariff and para-tariff measures to their trade on an annual basis. The notified measures shall be reviewed by the Committee of Experts, established under Article 10, in its regular meetings to examine their compatibility with relevant WTO provisions. The Committee of Experts shall recommend the elimination or implementation of the measure in the least trade restrictive manner in order to facilitate intra SAARC trade1

5. Contracting Parties shall eliminate all quantitative restrictions, except otherwise permitted under GATT 1994, in respect of products included in the Trade Liberalisation Programme.

6. Notwithstanding the provisions contained in paragraph 1 of this Article, the Non-Least Developed Contracting States shall reduce their tariff to 0-5% for the products of Least Developed Contracting States within a timeframe of three years beginning from the date of coming into force of the Agreement.

Article - 9

Extension of Negotiated Concessions

Article - 10

Institutional Arrangements

Contracting States agree to consider, in addition to the measures set out in Article 7, the adoption of trade facilitation and other measures to support and complement SAFTA for mutual benefit.

These may include, among others: -

a) harmonization of standards, reciprocal recognition of tests and accreditation of testing laboratories of Contracting States and certification of products;
b) simplification and harmonization of customs clearance procedure;
c) harmonization of national customs classification based on HS coding system;
d) Customs cooperation to resolve dispute at customs entry points;
e) simplification and harmonization of import licensing and registration procedures;

f) simplification of banking procedures for import financing;
g) transit facilities for efficient intra-SAARC trade, especially for the land-locked Contracting States;
h) removal of barriers to intra-SAARC investments;
i) macroeconomic consultations;
j) rules for fair competition and the promotion of venture capital;
k) development of communication systems and transport infrastructure;
l) making exceptions to their foreign exchange restrictions, if any, relating to payments for products under the SAFTA scheme, as well as repatriation of such payments without prejudice to their rights under Article XVIII of the General Agreement on Tariffs and Trade (GATT) and the relevant provisions of Articles of Treaty of the International Monetary Fund (IMF); and
m) Simplification of procedures for business visas

Article - 14
General Exceptions

Article - 15
Balance of Payments Measures
Notwithstanding the measures as set out in this Agreement its provisions shall not apply in relation to preferences already granted or to be granted by any Contracting State to other Contracting States outside the framework of this Agreement, and to third countries through bilateral, plurilateral and multilateral trade agreements and similar arrangements.

Appendix II

Table 1
Number of SAFTA Certificates of Origins Issued by the Member States

Period	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total Number
July-2006 – Dec 2006	0	0	0	0	3	0	4	0	7
Jan-2007 – June 2007	0	346	0	0	0	0	9	0	355
July-2007 – Dec 2007	0	545	0	75	0	0	12	1	633
Jan-2008 – June 2008	0	2298	0	55	0	0	258	2	2613
July 2008 – Dec 2008	0	1953	0	156	0	0	2727	4	4840
Jan 2009 – June 2009	0	2858	0	457	0	0	1521	39	4875
July 2009 - Dec 2009	0	4007	0	582	0	0	2298	103	6990
January 2010 - June 2010	0	3302	0	844	0	0	1266	8	5420
July 2010 - December 2010	0	4049	0	432	0	0	2069	8	6558
January 2011- June 2011	0	5220		946	0		1288	12	7466
July 2011 - December 2011	773			922	0		1640	4	3339
Jan 2012 – August 2012	1993	10937		1708				8	14646
July 2012 - December 2012		10344						12	10356
Jan 2013 – June 2013		7364						32	7396
Total	2766	53223	0	6177	3	0	13092	233	75494

Source: SAARC Secretariat

CHAPTER 8

Towards an Asian Century: Future of Economic Cooperation in SAARC Countries: A View from FPCCI

Mr. Muhammad Ali

He said that SAARC states are the one of the least in connected states in regional trade in the globe. Despite this region have many resources to progress in future. If we compare it to other states then it is the least connected region with regional least trade of 5% of the total trade. Question arises that what are the hurdles in its progress. He said, the presence of the non-tariff measures (NTM) is the reason by which trade is low. NTM includes all the measures include besides tariffs. NTMs are usually unforced to reinforce the market restrictions imposed by a tariff that's why NTMs are more important than tariffs. He highlighted the common NTMs which have been identified by The United Nations Conference on Trade and Development (UNCTAD) is the following:

- Price control measures
- Quantity control measures
- Para-tariff measures
- Finance measures
- Anti-competitive measures
- Export-related investment measures
- Distribution restrictions
- Restriction on post-sales services
- Subsidies
- Government procurement restrictions
- Intellectual property
- Rules of origin
- Arbitrary, inconsistent and discriminatory behaviour favouring specific producers or suppliers
- Inefficiency
- Procedural barriers including obstruction, non-transparent practices, legal obstacles and unusually high fees or charges

Moreover, while discussing NTMs he said that the most common NTMs in SAARC which are following:

- Sanitary and phyto-sanitary measures through a number of laws
- A strong focus on food security and self-sufficiency
- Complexities and variations in licensing, permits and tariffs according to product or user
- Safeguard measures (including anti dumping duties and quantitative restrictions)
- Duties and charges, over and above tariffs
- Reference prices for some products, which are revised to align with international market prices
- Import of some specific products through specified ports only
- Transportation restrictions
- Import only by state trading agencies (particularly in agriculture)
- Stringent visa requirements for a country
- Import prohibitions and licensing for health, safety, security, religious and environmental reasons

He further mentioned that the most NTMs in SAARC region as a survey conducted by LUMS that the following reasons were found to be most important when a survey was held:

- Problems in land transportation (61 %)
- Problems in getting visas and harassment during visits (more than 50 %);
- Problems in handling at ports and dealings of Customs, etc (20 to 60 %)
- Problems in certification requirements (21 to 37 %)
- Problems at the port of entry (30 %)
- Problems in banking transactions (23 %)

According to the said survey, SAARC states have weak transportation linkages and we often spent on transport the goods. South Asian enterprises pay 35% of the additional cost due to trading with the third country and 10% times more confinements then those to the direct trade. Most of the SAARC countries do not share common borders like Pakistan and Bangladesh, Bangladesh and Afghanistan, and Pakistan and Nepal so hurdles are present for the land trade. For this we have to gather and discuss each other regarding sound road linkages across the regional states borders with free charges. Only Bhutan and Nepal have the transit facility from India to trade with Bangladesh.

SAARC states can easily multiply their trade. According to the Asian Development Bank, SAARC multi model transport has identify many cross roads within region, like Afghanistan-Pakistan, Afghanistan-Pakistan-India-Nepal, Bangladesh-India-Nepal, which need to be established for the future growth of the SAARC region. Further complex rules of the origin makes it difficult for the SAFTA due its preferences. Many times exporters face duties regarding costs and compliances.

He raised the question that, Why we need to liberalize the trade in SAARC region? Answering this question, he said one fourth of the world population lives in the SAARC countries. But we are producing 2 per cent of the total GDP due to political conflicts. We are in a category of least developing states accept India and Pakistan. India accounts 80 per cent of the total regional GDP, Pakistan is falling 10 per cent and Bangladesh 7 per cent. The establishments are not only failed to open trade and investments opportunities but also did not bring prosperity by integrating smaller economies into the large economic space. The ultimate result of the trade is not only limited to the current account or balance of the payment, but active utilization of the resources can minimize the economic measures, by controlling inflation and providing more employment opportunities.

Discussing another question that how we can move forward? He replied and said that we need expansion of regional production. For that we have to extend the production expansion network in the global economy, FDIs, removing the investment barriers, so with this we have to prove the transport for logistic barriers. Trade between India and Pakistan has made some progress but it is limited because of trade barriers and insufficient regional cooperation. It is a need for tremendous improvements and we should also look beyond our neighbourhood. India has good relationship with the SAARC countries but we need to look forward to gather all the states together even who do not share the land borders.

He added that we need efforts of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI) to increase infra SAARC trade. Over the past two years private sector of Pakistan led by FPCCI has been engaged in an effort to improve trade and investment relations with India. With time we are in reading in exchange of delegations each year. We are also organizing the round table conference for normalizing India Pakistan trade. The FPCCI is also tolerating other South Asian states, an attempt to further increase in regional trade within SAARC, as Afghanistan is a Pakistan's biggest export market. We are also active in sending the delegations to Nepal with Sri Lanka. We are trying to see how we can make existing FTA more useful for the business communities of the both countries Bhutan and Nepal but there are hurdles.

In concluding remarks he focused on futuristic scenario of intra SAARC trade. He said that the progress of the SAARC trade rely on gradual improvements and normalization of the Indo-Pak trade relationship. If these relationships improve then we can expect that Pakistan's relationship with Nepal, Bangladesh, Bhutan and Sri Lanka will grow rapidly. Private sectors of the SAARC countries should take the leading role in trade promotion activities. Private sector should interact more with each other to visits and delegations that held in each country. Apart of this there is a vast potential of tourism in SAARC region but poor connectivity makes this area largely under develop. There is a strong need of connections and communication links is needed but political issues kept the process behind.

Adding some recommendations, he said, South Asia trade and investment goes hand to hand. It is a time that policy makers should review the existing SAFTA agreement into a comprehensive cooperation agreement that cover not only trade and goods but the services with Trans border investments as well. This area needs attention for the rationalization of the trade documentation.

Lastly, it is the collective responsibility of the regional governments, political parties, media and business communities that create such areas, where regional cooperation could take place to celebrate economic growth, social progress and cultural development.■

CHAPTER 9

Economic Cooperation among SARRC Countries: Political Constraints

Dr. Rashid Ahmad Khan

This paper discusses the political constraints on the trade relations and economic cooperation among the SAARC countries at bilateral as well as at multi-lateral levels, identifying their origins and impact on the process of regional cooperation in South Asia. The main argument underlining the paper is: although bilateral connectivity, trade and economic relations among the SAARC countries have shown encouraging signs of growth during the last about one decade, they are still hostage to political constraints; and unless efforts are made to mitigate them, the goal of regional integration in the South Asian region will remain elusive.

The paper is divided into three parts. Part one describes the distinctive features of the region such as its insular geographical location with India holding central position, asymmetrical economic development, colonial legacy and persistence of strategic discord between India and her neighbours. In part two the origin of political constraints with their implications for bilateral economic relations and the process of regional cooperation would be discussed. Part three of the paper comprises the conclusion.

Introduction

In December 2015, the South Asian Association for Regional Cooperation (SAARC), grouping Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka would complete its 30 years of life. It was created to serve as a platform for promoting regional cooperation and trade among its members; but its performance in this direction has been abysmally low. According to latest data, intra-regional trade is less than five per cent despite the presence of strong imperatives, both domestic and regional, for accelerating the process of regional cooperation to address problems of socio-economic development. The region is inhabited by more than one and half billion people or 23 per cent of world’s total population; but its share in global Gross Domestic Product (GDP) is less than two and half per cent. A prominent feature of the region is stark diversity in the level of economic development. By regional standards, Pakistan and India, which also happen to be the most populous nations of South Asia, have the largest economies in terms of regional GDP. These two countries have attained this status largely as a result of economic reforms introduced in 1990s. For about two decades Indian GDP has grown at double digit level annually. The annual growth rate has shown a downward trend during UPA II; however, India still stands out as a dominant economy in the region with 78.8 per cent of the region's GDP, 40.3 per cent of its trade and 75.8 per cent of incoming foreign direct investment (FDI). Geographically, India occupies a dominant position in the whole region, including the Indian Ocean area. Together with the insular position of the region with almost impassable Himalayas in the north, Karakoram and Hindukush mountain ranges in the north west and the Malaysian Peninsula and East Africa constituting the two walls of the Indian Ocean on the east and west, the vast area, large population, strong economy and powerful military bestow on India a unique role in the region, which can lead to both positive and negative consequences for efforts aimed at promoting regional cooperation in South Asia.

Positive in the sense that four out of eight member countries of SAARC, namely Pakistan, Nepal, Bhutan and Bangladesh have common borders with India. Sri Lanka and Maldives also enjoy geographical proximity with their big neighbour as they are separated from the Indian peninsula only by the waters of the Indian Ocean-a very narrow waterway in case of Sri Lanka. The countries of South Asian region have had from times immemorial strong economic, trade and cultural ties. Two of the three ancient trade routes which connected East with the West through Persian Gulf and the Middle East on to the Mediterranean passed through India via Sindh and Arabian Sea along the Mekran coast. The areas now constituting Pakistan served as catchment areas of famous Silk Route adding Indian merchandize of spices, ivory, honey, cotton and precious metals to the goods from China and Central Asia carried by the trade caravans heading towards the ports located on the eastern coasts of the Mediterranean. All these three trade routes converged on the eastern coast of the Mediterranean dotted with busy sea ports from areas south of Turkey to Palestine and the Nile Delta. From these ports the goods were transported to Europe through ships and boats. This pattern of flourishing trade continued to exist till the establishment of Ottoman naval supremacy over the Mediterranean in the fifteenth century. The arrival of Vasco da Gama on the western coast of India in 1498 marked a new era in the history of the South Asian region as the seaborne trade began to replace land based trade relations, which had not only knit various sub-regions of South Asia together economically and culturally but also connected South Asia with China, Central Asia and Southwest Asia. The dawn of European era in South Asia led to the reorientation of trade and interaction between India and Europe through the sea. The triumph of the British over other European powers in the struggle for control over India in the nineteenth century further strengthened this trend. The onset of rivalry, also known as Great Game, between Russia and Britain sparked by the former's moves into Central Asia in late nineteenth century-a development perceived by Britain as a threat to its imperial interests in India-provided final touches to the closures of routes through which commercial and cultural interaction used to take place between India on the one hand, and Central Asia and West Asia on the other.[16] The British colonial rule, however, brought about a fair amount of economic integration in the region. This is why the partition of India into two separate and independent dominions of Pakistan and India was called more a political act than an economic one. After independence, India for a couple of years was not only Pakistan's most important trading partner "accounting for half of Pakistan's exports (agriculture produce and minerals) and 32 per cent of imports (mainly manufactured goods),"[17], the two countries were also bound together in a sort of customs union as Pakistan was allowed to export its jute without export duty through Kolkata (then Calcutta) and India enjoyed the facility of importing free of duty petrol and kerosene oil from the Middle East and the Persian Gulf through the Pakistani port of Karachi.[18] India took a unilateral decision to bring this arrangement to an abrupt end in 1949, apparently as retaliation against Pakistan's refusal to devalue its currency to match similar decision by India; but the real reason behind the Indian decision was the rising tension with Pakistan over Kashmir. Thus trade and economic relations between Pakistan and India had been influenced by political disputes between them right from the beginning. Being the two largest economies in the region, their bilateral disputes held back the process of regional cooperation under SAARC; but Pakistan-India discord on political and strategic issues was not the only restraining factor on the process of regional integration in South Asia, economic cooperation among the SAARC countries has also been influenced by political differences India has had with other countries of the region or these countries have had among them. There are four sources of political constraints on the economic relations among the SAARC

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16 Ejaz Nabi, "Lifting up the Indo-Pak trade game," *Hindu* (Delhi), March 28, 2012, Selections From Regional Press (hereafter referred to as SFRP) , Institute of Regional Studies, Islamabad, vol. 31, no. 6, March, 16-31, (2012), p. 1.

17 Ibid.

18 Rashid Ahmad Khan, "Pakistan-India Trade Relations," *Regional Studies*, Institute of Regional Studies, Islamabad, vol. XIII, no. I, 1995. See also Rashid Ahmad Khan, "Pakistan-India Trade: Route to Inter-regional and Intra-regional Connectivity," *IPRI Journal*, Islamabad Policy Research Institute, Islamabad.

countries, namely strategic discord emanating from divergent perceptions of India and its neighbours on the issues of peace and security in the region, lingering bilateral disputes, especially between Pakistan and India, domestic political compulsions arising out of pressures from pressure groups, and the influence of extra-regional powers pursuing their economic and strategic interests in the region.

Strategic Discord

One of the main reasons for slow pace of regional cooperation in South Asia is the persistence of strategic discord between India on the one hand and most of the South Asian countries on the other. This strategic discord is reflected in divergent stands of India and some other countries in the region on the issues of peace and security in the region. Although all the members in the Dhaka Declaration of (first summit) SAARC acknowledged that they "could effectively pursue their individual and collective objectives and improve the quality of life of their people only in an atmosphere of peace and security," the track record of the past six decades of the South Asian countries reveal sharp divergences in their foreign policy postures. During the Cold War era, Pakistan opted to become a close ally of the United States through bilateral security agreements with the United States and membership of US sponsored anti-communist military treaties such as Baghdad Pact (later CENTO) and SEATO; whereas India went for neutrality and non-alignment. Prime Minister, Jawahar Lal Nehru sharply reacted against Pakistan's aligning with the United States, claiming that it had brought the Cold War to India's doorstep. Although signs of strain in relations between Pakistan and India had surfaced in 1948 over the latter's entry into Kashmir, the formal joining of Cold War alliance system by Pakistan as the US ally, pushed the relations between the two countries further down on the road to deterioration. India's negative reaction to Pakistan's alliance with the United States in 1950s was motivated by the former's firmly held view that South Asian region should remain free from the political and military influence of extra-regional powers. Two of India's early post-independence strategic thinkers-Jawaharlal Nehru and K M Panikkar-a historian, diplomat and one time Indian Ambassador to People's Republic of China- had propounded the exclusivist doctrine on the future of the region and India's role in it. Nehru had even proposed a *Monroe Doctrine* for South Asia and Panikkar had suggested as early as 1941 a dominant role for India in the Indian Ocean stretching from the Arabian Sea and Bay of Bengal because of its insular position.[19] Guided by this doctrine, India has always sought to limit the foreign policy options of the smaller countries of South Asia. India not only opposed Pakistan's alliance with the United States, it also expressed concerns at the Nepalese efforts, under Ranas, to cultivate close relations with the United States. Indian refusal to endorse Nepali call for declaring Nepal as Zone of Peace and opposition to Sri Lankan bid to seek extra-regional help to fight Tamil insurgency could also be explained in the light of India's self-image of its role in the South Asian region. Indian opposition to foreign military bases in the Indian Ocean and call for its designation as Zone of Peace was also driven by the same doctrine. The divergent paths in the foreign policy realm and conflicting views on the issues of peace and security in the South Asian region, reflect lack of strategic accord and deep mistrust between India and the peripheral countries of South Asia.

Mutual Mistrust

The mutual mistrust is also reflected in the respective responses of South Asian countries to the various ideas and initiatives for regional integration in the region. For example, just on the eve of independence, Nehru proposed to link Nepal and Sri Lanka with India in a confederation on the basis of not only geographical proximity but also common historical experience, cultural links and economic imperatives. But the suggestion produced a sharp reaction in Sri Lanka and Nepal and all the political parties, although most of them were inspired by the Indian nationalist movement under the leadership of Congress, rejected the idea as a move to establish Indian hegemony in the region by undermining their sovereignty. Following independence, India convened first Asian Relations Conference in New Delhi. Pakistan refused to attend it, perceiving it as an Indian attempt to establish its hegemony in the region. Mistrust between India and her neighbours also stems from the former's allusions to its past glory as a dominant power in the Indian Ocean area and the latter's fear of being re-absorbed in the much bigger and powerful state. "From the first century of Christian era," writes Nehru in *Discovery of India*, "wave after wave of Indian colonies spread east and southeast, reaching Ceylon (modern Sri Lanka), Burma, Malaya, Java, Sumatra, Borneo, Siam (modern Thailand), Cambodia and Indo-China. Some of them managed to reach Formosa (modern Taiwan), the Philippine Islands and Celebes."[20] Statements such as

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[19] K M Panikkar, *India and the Indian Ocean: An Essay on the Influence of Sea Power on the Indian History*, (Mysore, Mysore Publishing House, Second Impression, 1962), pp. 61,62

[20] J. L Nehru, *Discovery of India*, (New Delhi, Penguin Books, 1981 edition), p.213

these have reinforced the perception among the smaller countries of South Asia that regional integration under Indian hegemony would undermine their sovereignty and independence, limiting their freedom of action in the area of foreign policy. The same mistrust has also been responsible for perception in India that regional cooperation is a mere euphemism for its neighbours to "gang up" against India and not recognizing its claims to be the pre-eminent regional power.[21] This perception is thought to be behind the reported Indian insistence on inserting a provision in the SAARC Charter excluding contentious bilateral issues from the SAARC preview and taking decisions on the basis of consensus. However, there are signs that this perception is changing as India finds promotion of economic and trade relations with its neighbours more beneficial economically as well as politically. However fears still exit in the smaller countries of the region that free trade with India would not only lead to their markets being swamped by goods from a large and powerful economic and industrial power but could also enable it to influence public opinion and enhance its political influence in these countries through a strengthened economic clout.

Bilateral Disputes

With the exception of Bhutan, all other geographically contiguous countries of the region, namely Pakistan, Nepal, Bangladesh and Sri Lanka have bilateral disputes with India. However, Pakistan-India bilateral disputes, chiefly the dispute over Kashmir have been the biggest political constraint on the forward movement of the process of regional cooperation in South Asia. For a long time, Pakistan continued to maintain its position that trade normalization with India could take place only after the dispute over Kashmir was settled in accordance with the wishes of the Kashmiri people as pledged in the relevant UN Security Council resolutions. As late as 2004, Pakistan maintained that the issue of granting MFN (Most Favoured Nation) status to India was linked with Kashmir issue.[22] Economic compulsions, however, forced the country to moderate its position with the assertion that lifting of official restrictions on free trade could be considered if there was a "tangible progress" in Pakistan-India bilateral dialogue towards the settlement of Kashmir dispute. The peace process and Composite Dialogue process initiated in 2004 between Pakistan and India

[21] Rajiv Kumar, *SAARC: Changing Realities, Opportunities and Challenges*,(Bonn, German Development Institute 2009), p.3.

[22] Statement by Prime Minister of Pakistan, Shaukat Aziz in New Delhi during his visit to India as SAARC chairman in November, 2004. "MFN status hinges on Kashmir issue-Aziz," *Hindu (*New Delhi*)*, November 24, 2004.

has helped promote bilateral trade between the two countries to a significant level. In fact the enhancement of bilateral trade is being called as the biggest achievement of Pakistan-India peace process, although it has suffered occasional interruptions as in the wake of Mumbai terrorist attacks in 2008 and again by incidents of ceasefire violations on the Line of Control in Kashmir in January and August this year. But despite these setbacks, there has been considerable expansion of bilateral trade between the two countries. Trance-LoC trade was not suspended during the post-Mumbai interruption period. It remained suspended for a month in September last due to tensions on the LoC; but was quickly restored on the demand of the trading and business communities from both sides of dividing line in Kashmir. In November 2011, Pakistan announced its decision to begin the process of granting MFN status to India by switching over from Positive List to Negative List of trade items and reducing the number of items on the Negative List progressively with the goal of ultimately abolishing it completely by December 2012 for complete trade normalization with India.[23] The process of trade normalization was accelerated following the resumption of stalled peace process as a result of a meeting between Prime Minister of Pakistan, Syed Yousaf Raza Gilani and his Indian counter-part, Dr, Mamohan Singh on the sidelines of SAARC Summit in Thimpu, the capital of Bhutan in April, 2010. By December 2012, the trade and economic ties between Pakistan and India had received such a big boost that they were being called as the biggest achievement of the dialogue process.[24] The announcement to normalize bilateral relations and start the process of granting India MFN status by the end of 2012 was preceded by an agreement between Pakistan and India as a result of a meeting between Pakistan's Commerce Minister Amin Faheem and his Indian counterpart, Anand Sharma in New Delhi in September 2011 to boost their bilateral trade to $6 billion, more than double the current level of $2.7 billion during the next three years. On the road to further liberalizing their bilateral trade, the two countries also agreed on a move to open a second customs point on their international border at Wagha and implement new business visa regime by November 2011. According to media reports these measures were being taken by the leadership of the two countries in the belief that increased trade and economic interaction would enhance the trust level

[23] "Pakistan and India agree to 'normalize' Trade Ties*," Daily Times (*Islamabad), November 16, 2011, SFRP, vol. XXX, no. 22, November 16-30, 2011, (Institute of Regional Studies, Islamabad), p.12.

[24] Sandeep Dikshit, "Indo-Pak trade, silver lining in dark cloud," *Hindu* (New Delhi), December, 19, 2012, SFRP, vol. XXXI, no. 24, December 16-31, 2012, (Institute of Regional Studies, Islamabad), p. 3.

between them and become a helpful instrument for the resolution of bigger and more complex issues like Kashmir.[25]

Pakistan's announcement to grant MFN status to India in November 2011 was, however, met with protests by 'hundreds' of people in Lahore and Muzaffarabad. The participants in these protests, according to media reports, were largely the members of right-wing political parties and extremist groups such as Jamaat-i-Islami (JI), Jamaatud Daawa (JuD), Lashkar e Taiba (LeT) and Jaish-e-Mohammad JM). JI had been in the forefront of organizing country-wide protests against the plans of PPP-led coalition government in Pakistan (2008-2013) to normalize trade relations with India for quite some time, but the participation of banned jihadi groups or groups associated with banned outfits did raise the question about the timing of these protests and who instigated them.[26] The PPP Government of Pakistan, however, could not fulfill its pledge to grant MFN status to India by January 2013 due to a sudden rise of tension between the two countries over incidents such as hanging of an alleged Kashmiri militant, Afzal Guru and acts of repression by the Indian security forces in the Kashmir valley. The clashes on the LoC in early 2013 resulting in the suspension of planned meetings under the revived dialogue process further dimmed the prospects of granting of MFN status to India. Prime Minister Mohammad Nawaz Sharif spoke about his ardent desire to promote regional peace and security through improvement of Pakistan's relations with India and Afghanistan. He specifically called for expanding trade and economic ties with India. His statements brightened the prospects of Pakistan's granting of MFN status to India. But the eruption of new clashes between the border security forces of the two countries on LoC in August this year dampened the chances of Pakistan implementing the decision by the newly elected government of Nawaz Sharif. In view of the continuing firing across LoC, Pakistan felt constrained to postpone the decision on MFN status to India. On August 12, 2013 Finance Minister Ishaq Dar announced that the issue was no longer under the consideration of the Government of Pakistan as, he said, there was need to first normalize relations between the two countries.[27]

Nepal, Bangladesh and Sri Lanka have also bilateral disputes with India. In case of Bangladesh, the major dispute is over the sharing of

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[25] "Pakistan, "India agree to boost bilateral trade to $6 billion," *Daily Times* (Islamabad), September 29, 2011, *SFRP*, vol. .XXX, no. 18, (Institute of Regional Studies, Islamabad), p. 8,9.

[26] "MFN protests," *Dawn* (Islamabad), November 3, 2011, SFRP, vol. XXX, no. 22, November 16-30, 2011, p.13.

[27] "MFN Status for India not under Consideration-Pak," *The Tribune* (Chandigarh), August 13, 2013, *SFRP*, (Institute of Regional Studies, Islamabad), vol. XXXII, no.15, August 1-15, 2013, p.9.

Ganges River waters. The two countries signed an agreement in 1996 when Hasina Wajid of Awami League was head of the government as Prime Minister in Bangladesh. The agreement established a thirty year water sharing arrangement between India and Bangladesh. But Awami League's bitter opponent, BNP's Khalida Zia, has continued to oppose the agreement as unjust and terming it contrary to the interests of the country. Consequently, the issue still remains as a subject of conflict and a source for anti-India campaign by the right wing political parties and extremist groups. Moreover, the agreement on sharing the waters of the Ganges represents only one instance of the ability of India and Bangladesh to resolve a critical water issue. The two countries share 54 rivers. The failure to sign a deal on the Teesta River during Prime Minister Manmohan Singh's visit to Bangladesh in September 2011 shows the power of domestic political compulsions to influence bilateral relations in the region. The Chief Minister of West Bengal Mamata Bannerjee of Trinamool Congress refused to accept the proposed deal to gain the support of regionalist lobby in the state. Unlike the chief ministers of Tripura, Assam, Meghalaya and Mizoram, who accompanied Prime Minister Sigh on his visit to Bangladesh, Mamta declined to join the delegation. As a result the deal, which had been worked out in a series of meetings between the Indian and Bangladeshi teams of experts, fell through. Seeking to allay the apprehensions of Bangladesh, the Government of Prime Minster Sigh assured Dhaka that his government was trying to build domestic political consensus to implement the deal on the Teesta River.

However, during his visit in 2011, Prime Minster Singh announced a number of concessions to redress Bangladeshi grievances in the areas of trade and demarcation of more than 4000km long and highly porous land boundary. Ten agreements/Protocols/MoUs were signed by the two sides, including a framework Agreement on Cooperation for Development and Protocol to the Agreement concerning the demarcation of Land Boundary. With the objective of correcting gross imbalance in Indo-Bangladesh bilateral trade, the visiting Indian Prime Minister announced the decision to import 48 textile items from Bangladesh duty free. In a later move India extended this facility to all items except 25. It should be noted that the balance of Indo-Bangladesh bilateral trade is heavily in favour of India. In Financial year 2011-12, the volume of bilateral trade between India and Bangladesh amounted to $5.42 billion. Out of this, Indian exports to Bangladesh were worth $4.73 billion; whereas its imports from Bangladesh were of less than $498 million.

Domestic Political Compulsions

Almost in all member countries of the SAARC, domestic political compulsions act as serious constraints on improvement of bilateral relations arresting the process of regional cooperation. We have already seen how these compulsions have worked in case of a move by the previous PPP-led government in Pakistan to grant MFN status to India. Defence of Pakistan Council (DPC) — a conglomerate of about 40 extremist and right wing political parties and groups, launched a nation-wide campaign against the decision of the previous government to grant MFN status to India. Although Federal Minister for Information and Broadcasting, Ms. Firdous Ashiq Awan, while announcing in 2011 the decision of the federal cabinet to grant MFN status to India had claimed that the army was on board, reports in a section of the media revealed that the security establishment had cautioned the PPP-led government against taking hasty steps in promoting trade with India. The decision by the present government of Prime Minister Nawaz Sharif to defer the issue is solely motivated by the domestic political compulsions as Finance Minister Ishaq Dar, while declaring on August 12, 2013 that the Government of Pakistan had no immediate plan to grant MFN status to India had also acknowledged that increased trade between Pakistan and India was beneficial for both as it will lead to increase in per capita income (in both countries), decrease in poverty and growth in GDP.[28]

The history of Indo-Nepal relations since 1948 presents another example of how domestic political compulsions play their part in determining the course of bilateral cooperation despite historical links and geographical proximity, close cultural and social relations and ethnic ties. Speaking on the unique nature of Indo-Nepal relations, the Prime Minister of the Himalayan state, Baburam Bhattarai had once said: “Nepal and India share a very unique relationship. Nepal is sandwiched between two states of India and China; but we are virtually India-locked as we have borders on three sides. Most of our socio-economic interactions take place with India. Two thirds of our annual trade is with India, while only ten per cent with China. Given the historic tilt towards India, our bilateral relationship is unique. When you have more interaction, you have more problems and more friction. At times there are misgivings and misunderstandings on various issues-some are genuine, while others are borne (sic) out of skepticism.”[29]

These misgivings and misunderstandings stem from the perception in Nepal that India has sought to expand its political influence in the

[28] Ibid.

[29] Baburam Bhattarai, “A vision for Nepal-India relations,” *Hindu* (Delhi), October 19, 2011.

landlocked country through unequal and unjust bilateral treaties concluded in 1950s at the cost of Nepali sovereignty. The treaties relate to friendly and peaceful relations (Treaty of Peace and Friendship-TPF), bilateral trade treaty (Treaty of Trade-TT) and transit facilities granted by India to Nepal. India regards these treaties as bedrock of Indo-Nepal relationship, whereas the dynamics of Indo-Nepal relationship changes with every change of government in Nepal. These treaties are considered as troublesome for Indo-Nepal relationship. Every regime in Nepal-from kings to Maoists-have sought revision of these treaties as governments in Nepal have had difficulty in accommodating the genuine interests and concerns of India. These interests and concerns relate to politics and security as Nepal forms a buffer zone between India and China. Any Nepali bid to cultivate close relationship with China such as the purchase of Chinese arms during the reign of King Mahindra was viewed with concern by India leading to a strained relationship between the two countries.

It is interesting to note that in addition to the robust bilateral trade — mostly comprising Indian exports of fuel, food, manufactured goods and consumer items to Nepal, India and Nepal have also taken notable steps to enhance bilateral connectivity through recently signed Rail Services Agreement (RSA) and Air Services Agreement (ASA). But the mistrust arising out of political considerations has prevented any move for tapping the vast hydro potential of Nepal. Nepal is estimated to have hydro power potential of 43000 MW, which is technically feasible and economically viable. However, as a statement by the Indian Ministry of External Affairs (MEA) says," major projects have not taken off due to considerations outside the realm of economics."[30] Instead of attaining self-sufficiency in power, Nepal is a net importer of electricity from India.

Apart from India's relations with Pakistan, Bangladesh and Nepal, Indo-Sri Lanka relations are also affected by domestic political compulsions. In this case the issue of Tamils inhabiting the northern part of Sri Lanka has played a most prominent role. On the basis of ethnic affinity, the treatment meted out to the Tamils in Sri Lanka has always been an emotional issue in the southern Indian state of Tamil Nadu where protests and demonstrations have been held against the alleged human rights violations against the Tamil community by the Sri Lankan government of President Mahinda Rajapaksa, following the elimination of LTTE in army operation in May 2009. Under pressure from the state government and violent public protests in Tamil Nadu, Prime Minister Manmohan Singh decided not to go to Colombo to attend the Commonwealth Heads of

[30] A statement by Ministry of External Affairs of India, www.mea.gov,in/Portal/Foreign Relations/Nepal-February 2012.pdf

Government Meeting (CHOGM) in mid-November and, instead, sent Foreign Minister Salman Khursheed to represent India. On the other hand, Sri Lanka has on a number of occasions in the past about six decades accused India of resorting to interference in its internal affairs on the Tamil issue. Tamil insurgents in Sri Lanka had for long known to have received help from sympathetic elements in Tamil Nadu and set up training and recruitment bases in the state, which helped sustain the Tamil insurgency in Sri Lanka. During the regime of Rajiv Gandhi, India opposed Sri Lankan government's bids to seek extra-regional assistance for overcoming the Tamil insurgency, and pressurized President J. Jayaverdene to accept Indian Peace Keeping Force (IKP) to quell the insurgency in 1987.

It is interesting to note that India is the largest trading partner of Sri Lanka and the two countries have a flourishing Free Trade Agreement (FTA), which, signed in 1996 raised the volume of their bilateral trade from \$500 million in 2000 to \$5 billion in 2012. In June this year, the two countries decided to double this volume of trade to \$10 billion in the next three years. However, observers are of the opinion that political controversies with India are driving Sri Lanka to promote its strategic relationship with extra-regional powers such as China. Sri Lanka defeated LTTE with Chinese arms and in return Colombo has allowed the Chinese to acquire substantial amount of economic, trade and investment interests in Sri Lanka. The Chinese have got \$ 4 billion worth of infrastructure investment in the country. What worries India is that most of the Chinese investment goes into the building of strategic infrastructure in strategically important Sri Lanka, which includes port terminals, airports and highways. A Chinese company owns 85 per cent shares in a \$500 million investment in a Container Terminal in Colombo. There were 42 Chinese companies among 83 participating in the trade exhibition "Reflections of Sri Lanka", held on the sidelines of the November 2013 Commonwealth leader's summit in Colombo. Against this only 21 Indian companies participated in the exhibition.

External influence

Sri Lanka has enjoyed strategic significance by virtue of being situated right in the middle of the Indian Ocean since the dawn of the European era in this part of the world towards the end of 15^{th} century. Every major power has thus been keen to get a foothold in this island state for the furtherance and protection of its strategic interests in the whole region comprising the Indian Ocean area, East Africa, Horn of Africa and Persian Gulf. Before the Second World War, the British enjoyed complete dominance over the Indian Ocean through a chain of military bases from Suez to Malacca

Straits, turning it into a ‘British Lake.’ As a rising economic power, China is keen to establish its influence in this area to gain access to the markets and sources of energy and raw materials in Africa and the Middle East. The Chinese endeavours for promoting economic and trade relations with the countries of South Asia are part of this strategy. Apart from China, the US, Germany, EU, Russia and Japan are also keen to establish commercial and economic ties with the countries of South Asia. The United States enjoys a relationship of strategic partnership with India since 2006. There is a strategic dialogue process between Pakistan and the United States under which the two countries are cooperating with each other in various areas such as counter terrorism. The convergence of major powers on South Asia to benefit from its burgeoning consumer market and other economic opportunities resulting from GDP growth, as is evident from a bee line of states seeking Observer Status at SAARC summits, provide strong incentives for South Asian countries to shift their focus for trade and economic relations to other regions. Indian Look East policy and Pakistan’s all out efforts to further expand its already deep defence, economic and investment ties with China can be understood in this context.

Conclusion

The trends towards growth in the volume of bilateral trade and agreements to promote bilateral as well as regional connectivity among the countries of South Asia in the last decade, reflect, on the one hand, a reduced ability of political consideration to block economic interaction among the South Asian countries; on the other, Pakistan’s hesitation in implementing its decision on MFN status to India and no to India’s request to use the land route across its (Pakistan’s) territory for trade with Afghanistan and countries of West and Central Asia, shows that economic relations among the SAARC countries still face serious political constraints. The countries of South Asia recognize the merits of economic cooperation and enhanced trade for not only alleviating poverty and raise the level of socio-economic development but also as an important instrument for removing the trust deficit among them. To a degree these steps have proved to be productive as increase in bilateral trade and opening up of new routes for travel have been welcomed by an overwhelming majority of people in these countries. But the movement towards regional cooperation under SAARC still remains slow-paced. An incident on the border, however insignificant it may be, is enough to cause sentiments to flare up on both sides of the border into calls for strong punitive action or even war. Even an event, which falls strictly within the domain of internal affairs of a country, can develop into a serious issue straining bilateral relations. It only means that the mistrust among the countries of the region is much deep rooted. The nations of South Asia need to make concerted efforts to build mutual trust so that the process of regional cooperation can move forward.■

CHAPTER 10

Implications of Bilateral and Sub-regional Trade Agreements on Economic Cooperation:
A Case Study of SAARC in South Asia

Syed Akhter Hussain Shah and Syed Tariq Shah

Abstract

The paper analyses the impact of bilateral and multilateral agreements amongst SAARC countries on their agreements with the developed countries. Multilateral agreements for economic development contribute to socio-economic development of individual states and enhance regional cooperation. Bilateral agreements for economic development may contribute to regional cooperation in the long but in the short run negatively affect a country which is less competitive, less informed, has a weak marketing system. In the long run most states may increase their capacity, strengthen marketing networks, improve competitiveness and improve trade by linking with comparative advantage, which may raise overall production, reduce inefficiencies and increase total trade thereby enhancing income levels, interdependence and regional harmony amongst member states.

Introduction

With the increasing acceptability of the concept of globalization, the trend of developing relations at inter-state, intra-regional and inter-region levels has gained ground. States now belong to different regional, economic or military blocs.. This engagement is made through formal, informal understanding, memorandums of understanding, pacts and agreements etc. Understanding is reached on common interests and smaller interests are compromised for the sake of greater interests in line with their priorities. Locational and situational advantage of a state helps to improve her bargaining power. Internal and external factors such as the strength of congovernment based on popular support, financial stability, foreign policy, diplomatic relations, harmony in domestic and foreign policies, and degree of engagement with neighbouring countries. External environment defined by presence of strong influential powers in the area of concern, the prevailing political and diplomatic culture and, global trends affect the foreign policy choices of a state.

For economic development most of the states are making alliances, forming regional and sub-regional groups. These groups devise common policies through agreements. At the global level economic agendas are pursued through the World Trade Organization (WTO). Many of the countries make their local, sub-regional and regional economic groups through separate agreements. Many states enter into bilateral agreements. Regional or bilateral trading agreements (BTAs) have now become the dominant mode of international commerce, and their importance continues to grow (Bhagwati 2008).[1]

Ample literature is available on the topic, however, limited work has been done on comparison of agreements of developed with developing countries in respect of opportunity cost to the states in their trade relationships with developed countries over and above that with developing countries. Some time it may substitute and at other complement. In order to understand opportunity cost comparison of FTA with developing countries is necessary. Developing countries after entering into agreement with developed states often abandon opportunities of trade agreements with their developing partners. This will be discussed here in the context of SAARC countries.

The paper is organized in the following manner: section one covers the main features of FTA with developed countries, section two and three contain an overview of SAARC, the comparitive advantage of SAARC countries, effects of FTA investment., Section four and five discuss Sub-regional and Bilateral Trading Relations and agreements. Sections six and seven discuss the opportunity cost of Intra-SAARC trade and issues and management of trade relationships of SAARC countries. Section eight discusses management of trade potential followed by the Conclusion.

Main Features of FTAs between Developing and Developed Countries

Trade relationships amongst developed and developing countries are more complex and multifaceted. The trade agreements are more than just trade and trade related matters. Haque (2009) states that after failure in a multilateral setting, industrialized countries became interested in developing regional and bilateral relations to further their agenda. He points out two advantages for developed countries: one, it may help to divide and weaken

[1] For details see Bhagwati, J. (2008). *Termites in the Trading System*. A Council of Foreign Relations Book, Oxford University Press, New York.

developing countries as a group within the WTO negotiations; and, two, individual countries could pursue and promote commercial relations driven more obviously by their national interests. Besides an industrial country (typically, the bigger, more powerful partner) may reward or punish countries on a selective basis. The developed countries by utilizing their better bargaining position add indirect and non-trade elements in the agreements. Regarding overt and covert aspects of trade relations between developing and developed countries *Khor* (2008) states that developed countries including US, EU and Japan attempt to achieve what is left in WTO etc., specially, market access in goo s, services in general, specific services sectors like financial and telecommunications, intellectual property rights; rules on the “Singapore issues” or “non-trade issues” pertaining to investment, government procurement, competition policy, labour standards, environment and food. He further states that [2] most of bilateral FTAs with developed countries (for example, the US, EU and Japan) now include investment chapters, which can incorporate the elements and “standards” preferred by the developed countries.

Scope and Definition

The scope and definition of investment is broadened. “In US FTAs, the definition of foreign investment covers foreign direct investment (FDI), portfolio investments, credit, intellectual property rights (IPRs) and practically all sectors except security and defence”. He quotes the example of US-Singapore FTA in which; “investment means every asset owned or controlled, directly or indirectly, by an investor, that has the characteristics of an investment. Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) futures, options, and other derivatives;(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licences, authorisations, permits, and similar rights conferred pursuant to applicable domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.”[3]….Which “means that all these forms of investments (and the investors) will be subject to the rules on pre-establishment rights, market

[2] For details may see, KhorMartin (2008), Bilateral And Regional Free Trade Agreements: Some Critical Elements And Development Implications. Third World Network.

[3] Ibid.

access and national treatment, as well as funds transfer, expropriation and investor-to-state dispute."

Non-discrimination and National Treatment Principles

National treatment and MFN status would be given to foreign investors and investments. National treatment means that the foreign investor would be given rights to be treated no less favourably than local investors (thus, the foreign investor can be given treatment better than or equal to but not less than the treatment accorded to the local investor). Any measures or preferential treatment to local investors over foreign investors leading to discrimination would be discouraged.[4]

Ban on Performance Requirements

Under this provision, the host state of investor would be prohibited from imposing performance requirements on the foreign investor or investment. For example, regulation on limits and conditions on equity, obligations for technology transfer, measures for using local materials and for increasing exports or limiting imports would be prohibited or disciplined.[5]

Rights of Funds Transfer

Under this system the states are obliged to allow investor's funds mobility freely into and out of signatory country.

Protection of Investors' Rights against Expropriation

There are also strict standards of protection for foreign investors' rights, especially in relation to "expropriation" of property. Expropriation is widely defined in the US FTA model as both direct and "indirect expropriation". An "indirect expropriation" includes the loss of goodwill and future revenue/profits of a company or an investor as a result of a government measure or policy. If there is such an expropriation, the host state is liable to compensate the investor for such losses.[6] Instances of such type of compensation payments made to investors in Pakistan.

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[4] Ibid.
[5] Ibid.
[6] Ibid.

Dispute Settlement

Under this system investors may be enabled to bring cases against the host state in the designated international courts, including the International Centre for Settlement of Investment Disputes. "Granting pre-establishment rights to foreign investors and companies would be a radical departure from existing policy for many developing countries. Foreign investors will have 'national treatment', i.e. the right to be treated as well as or better than local investors. This prevents governments from having positive policies that favour local investors and firms".[7]

Effects of the FTA Investment and their Management

The possible effects of FTA pertaining to investment and their management have been described by Khor (2008) as the following:

a) May contribute to financial fragility due to the movement of funds into and out of the country, and to some types of financially distorting activities; may impact on the balance of payments (for instance increased imports and outflow of investment income, which have to be balanced by export earnings and new capital inflows; if the balance is not attained systematically, then alternate options are limited).
b) Instances have been observed that in a quarter, the financial outflows remained higher than the inflows.
c) May affect the competitiveness and viability of local enterprises.
d) May affect the balance between local and foreign ownership and participation in the economy; and possibly affect the balance of ownership and participation among local communities.

On the other hand foreign investment can make positive contributions, such as:

(a) Use of modern technology and technological spillovers to industry of host country and local firms.
(b) Global marketing network may be established.
(c) Contribution to capital funds and export earnings may be made.
(d) Increased employment of local people and national human resource.

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[7] Ibid.

For implementation of agreements' obligations, the host country may have to undertake a number of reforms and introduce new procedures.

Recognizing the significance of the role of government procurement in socio-economic development and national policy, Khor (2008) is of the view that FTA would erode the positive role.

South Asian Association for Regional Cooperation (SAARC)

Member countries of the South Asian Association for Regional Cooperation (SAARC) have entered into agreements for cooperation in economic development, trade, social, and cultural fields.

Regional cooperation is affected by a number of factors including partner states' trade, culture and perception of the masses, commitment of leadership, institutional support and harmony. The role of external countries may affect the relationship of two partner countries with respect to the nature of their agreements, whether complementary or substitute. The complementary agreements increase trade relationship between external, internal and partner states. If complementary agreements are signed then these would contribute to convergence in regional cooperation. If these agreements are of the nature of substitutes then that may lead to divergence in regional cooperation.

Any threats, to the agreements' prospects may affect the degree of convergence on or divergence from regional cooperation. Lag factors, opaqueness and multi-stages in the final outcome may also affect the reaction and perception of the states. Economic agreements give rise to immediate expectations, The mindset change for entering into agreements is also a significant factor. Sustainability of these agreements is also dependent on any change in the mindset. Historical relationships, perceptions, socio-cultural relationships also affect the prospects of reaching an agreement. Social capital may be an important factor for convergence of efforts and agreements for economic cooperation among different states in a region.

An Overview of SAARC Trade

Regarding comparative performance of SAARC countries, Jain and Singh (2009) state that trade flows within the SAARC region are not much significant, which is perhaps on account of the disparities in the market size of SAARC economies unlike other regional groupings. They quoted the example of Bhutan and Nepal which cannot be the major export destinations for India or Pakistan. In their view one cannot expect intra-

SAARC trade, particularly of big SAARC countries with small SAARC economies, to be anything but modest. Haque (2009) states that [8] despite some progress made in recent years, economic integration and trade relations within South Asia are still weaker. He is of the view that exports to Bangladesh, India, and Sri Lanka are modest, with small improvement over the past few years. Taking the SAARC countries together, the sub region's importance for Pakistan has increased considerably, with around 10 per cent share in exports. Intra-SAARC countries trade is around 5 per cent whereas intra- ASEAN trade is about 25 per cent and intra- NAFTA trade is 43 per cent; the highest is intra-EU trade at 66 per cent (Hartwick 2008). Intermittent political tensions between India and Pakistan are also a retarding factor in intra-regional trade development. For example SAFTA was adopted after two years of its constitution at the 2004 summit of SAARC.[9]

Analysing SAARC countries' exports based on six digit commodity data aggregated to 99 broad industry groups, Jain and Singh (2009) found that all SAARC countries have more or less a similar export basket which partly explains the low intra-SAARC trade as member countries tend to specialize in similar items for exports. However, the export and import composition of SAARC countries also shows that India and Pakistan's exports are notably complementary to the imports of some South Asian economies, specially of Bangladesh and Sri Lanka. Besides, other economies, demonstrate efficiency in only a small number of export areas, most of which are not complementary to India's imports (or those of any other country)[10].

Comparative Advantage of SAARC Countries in Trade

SAARC countries have trade potential based on their comparative advantage, which may be analysed by taking into account different parametres and variables. Besides, the member states are also taking different measures to reform and restructure their economies at individual levels. As far as comparative advantage of SAARC countries is concerned, Jain and Singh (2009) state that in 1995, SAARC countries, as a whole, had

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[8] Irfan ul Haque , "The Rise of Bilateralism in Trade and its Implications for Pakistan," *The Lahore Journal of Economics* 14: SE (September 2009): pp. 111-133

[9] Ibid.

[10] For more details look at Jain Rajeev and J. B. Singh(2009), Trade Pattern in SAARC Countries: Emerging Trends and Issues, Reserve Bank of India Occasional Papers vol. 30,no.3, Winter.

comparative advantage only in a few Standard International Trade Classification (SITC) broad industry groups. In 1995, India had comparative advantage in five trade sectors. However, India has developed comparative advantage in 10 sectors over the years. In contrast, Pakistan and Bangladesh have lost their comparative advantage in some sectors over the same period. Out of 12 broad (SITC) Groups as classified by UNCTAD (though not mutually exclusive), India has comparative advantage in the highest number of sectors while Pakistan, Sri Lanka and Bangladesh have only 4, 3 and 7 sectors, respectively. [11] The study found that Pakistan and Bangladesh had revealed comparative advantage (RCA) index of more than one in agricultural raw material and food items respectively in 1995 but both witnessed a decline in RCA below one in 2006. Nepal has developed comparative advantage in a number of sectors such as food items, ores and metals, nonferrous metals, chemical products and iron and steel as the respective RCA indices were more than one in 2006. Jain and Singh (2009) found that None of the countries have comparative advantage in capital intensive and high value added products. For instance, no SAARC country has RCA greater than one in machinery and transport equipment. In contrast, all SAARC countries, except Maldives, have strong comparative advantage in the industry group of textile fibres, yarn, fabrics and clothing. In the overall manufactured goods sector, Bangladesh and Pakistan have comparative advantage with RCA index of 1.29 and 1.14, respectively, followed by Nepal and Sri Lanka with RCA index of 1.01 each. They state that India is behind in comparative advantage in the manufactured goods sector. India has improved its comparative advantage substantially in ‘iron and steel’, ‘chemical products’, ‘non-ferrous metals’, ‘ores and metal’ and ‘agriculture raw material’.

The analysis of competitiveness indicators carried out by Jain and Singh (2009) based on the index of relative trade advantages (RTA) representing the difference between the index of relative export advantages (RXA) and the index of relative import advantages (RMP) shows that out of 12 broad industry groups, India enjoys relative trade advantage in 9 industry groups while

[11] Ibid.

Table 1: Revealed Comparative Advantage of Major SAARC Countries : 2006

Source: Rajeev Jain and J. B. Singh (2009)

Broad SITC Groups /Countries	BD	IND	MALD	NEP	PAK	SRL
1	2	3	4	5	6	7
Primary commodities, including fuels (SITC 0+1+2+3+4+68)	0.29	1.34	3.94	1.09	0.74	1.07
All food items (SITC 0+1+22+4)	0.84	1.36	15.69	3.20	1.88	3.42
Agricultural raw materials (SITC 2 - 22 - 27 - 28)	0.86	1.30	0.00	0.76	0.80	1.38
Ores and metal (SITC 27 + 28 + 68)	0.06	1.97	0.23	1.46	0.13	0.80
Non-ferrous metals (SITC 68)	0.02	1.31	0.00	1.07	0.03	1.08
Fuels (SITC 3)	0.03	1.13	2.08	0.00	0.38	0.01
Manufactured goods (SITC 5 to 8 less 68)	1.29	0.91	0.01	1.01	1.14	1.01
Chemical products (SITC 5)	0.12	1.09	0.00	1.44	0.24	0.12
Machinery and transport equipment (SITC 7)	0.03	0.29	0.01	0.05	0.05	0.14
Other manufactured goods (SITC 6 + 8 less 68)	4.20	1.98	0.00	2.57	3.58	3.05
Iron and steel (SITC 67)	0.08	1.78	0.00	2.10	0.09	0.02
Textile fibres, yarn, fabrics and clothing (SITC 26 + 65 + 84)	17.84	3.25	0.00	7.52	13.96	10.60

| Textile fibres, yarn, fabrics and clothing (SITC 26 + 65 + 84) | 17.84 | 3.25 | 0.00 | 7.52 | 13.96 | 10.60 |

Bangladesh enjoys only in textile items and manufactured goods (which are not entirely mutually exclusive). Pakistan has relative trade advantage in textile, food items, manufactured goods and other manufactured goods. The study found that SAARC countries seem to compete with each other in textile sector as most of them have relative trade advantage in this sector.

Sub Regional Agreement

Sub-regional agreements are made among the states to get closer to each other in a specific group. A sub regional agreement signed among some SAARC countries is BIMSTEC.

Bay of Bengal Initiatives on Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)

This sub regional group was initiated by Thailand in 1994 with the participation of Bangladesh- India-Thailand-Sri Lanka involving contiguous countries of South and South East Asia surrounding the Bay of Bengal. Raihan Selim and M. A. Razzaque (2007) state that it was formally launched as BIST-EC (Bangladesh India Sri Lanka Thailand Economic Cooperation) in June 1997 in Bangkok with the adoption of the Bangkok declaration. In a special ministerial meeting held in Bangkok on 22 December 1997 Myanmar was accorded full membership of the group and renamed as BIMST-EC (Bangladesh India Myanmar Sri Lanka Thailand Economic Cooperation). At the ministerial meeting held in February 2004, Bhutan and Nepal were welcomed as new members. Subsequently, the Grouping was renamed as “Bay of Bengal Initiatives on Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)[12].

The Economic ministers adopted a negative list approach for free trade area in the Region and established a Group of Experts for drafting the Framework Agreement of the BIMSTEC FTA in Colombo. This Framework Agreement on BIMSTEC FTA was adopted at the First BIMSTEC Summit in February 2004 and came into force on June 30, 2004. It provided an economic forum to reduce tariff, improve trade, economic growth, technological exchange and deal with other economic aspects among member states. Unlike SAFTA, this Agreement covers trade in service and investment in addition to trade in goods. However, the volume of trade is still smaller than envisaged.

Bilateral Trading Relations and Agreements

SAARC countries have also entered into bilateral trade relations parallel to regional and global trading agreements with other individual states within and out of the region. Pakistan has entered into trade relations with Sri Lanka, Afghanistan, India etc. Through these trade relations a number of goods and commodities are traded amongst these neighbouring states. However, the degree of existing trade arrangements is below its potential level, which can be improved through advanced arrangements. Through improved trade relations of India-Pakistan both the countries can increase their total volume of trade, reduce the cost of trading and make available a variety of goods to consumers of both the countries at relatively low prices. Technological transfers, labour mobility, skill transfers, input supply and outputs trade can also be increased.

The FTA between Pakistan and Afghanistan helps in trading a number of goods. Being a landlocked country Afghanistan also uses the

[12] Selim Raihan and M. A. Razzaque (2007); Welfare Effects of South Asian Free Trade Area (SAFTA), Regional Trading Arrangements (RTAs) in South Asia: Implications for the Bangladesh Economy. Paper prepared for the UNDP Regional Centre Colombo, January.

Pakistani route for trade with other countries. The trade agreement generates employment in transport, trading and commerce sectors, increases choices of consumers' goods etc. This relationship may be used for capitalization of regional energy trade with other states of the region, thereby increasing global competitiveness of the regional countries. However, this trade relationship also creates market distortions when thro imported goods are smuggled back to Pakistan and dumped in its numerous Bara markets.

Issues in Trade Relationships of SAARC Countries

A number of trade and non-trade related issues are hampering the performance of intra SAARC trade keeping it below its potential level. Jain and Singh (2009) describe among reasons the vast disparity in the size of the economies, while the World Bank points to protectionist trade regimes that discriminate against trade among larger neighbours; the continued conflict between India and Pakistan; and transport and trade facilitation constraints. Chaturvedi (2007) pointed out that the intra-regional trade has remained far below the potential in the absence of sufficient trade facilitation measures. A cause of low performance of trade agreements is stated by Baysan, Panagariya and Pitigala (2006) relating to bilateral Free Trade Agreement (FTAs) and the SAFTA exclusion of major sectors in which countries have comparative advantage and imposing tariff quotas on many other sectors. Similarly, strict 'rules of origin' further handicap the potential expansion of intra-regional trade on preferential basis in products that had large potential of trade. The follow-up agreements on concessions, dispute settlement, negotiation of a Rules of Origin Agreement would be important factors in determining whether the SAFTA is a trade creating or a trade diverting RTA[13].

Opportunity Cost of Low Intra-SAARC Trade

This low performance of intra SAARC trade has huge opportunity costs, which directly and indirectly affect individual states, the region and individuals living in these states. The SAARC Secretary General puts the cost of opportunity lost due to non-cooperation among the South Asian nations at US$ 8 billion a year.[14] A World Bank Study by Wilson and Otsuki (2006) suggests that by raising the capacity halfway of countries of

[13] Jain Rajeev and J. B. Singh (2009), "Trade Pattern in SAARC Countries: Emerging Trends and Issues," Reserve Bank of India Occasional Papers, vol. 30, no.3, winter.

[14] Ibid.

South Asia to East Asia's average, the intra-SAARC trade would rise by an estimated US$ 2.6 billion, approximately 60 per cent of the total intraregional trade in South Asia. Upgradation of the Services sector infrastructure, efficiency in air and maritime ports would significantly improve intra-regional trade gains. South Asia also has a stake in the success of efforts to promote capacity building outside its borders. Similarly, if South Asia and the rest of the world raised their levels of trade facilitation halfway to the East Asian average, the gains to the region would be an estimated US$ 36 billion. Out of these gains, about 87 per cent of the total gains to South Asia would be generated from South Asia's own efforts (leaving the rest of the world unchanged)[15].

Management of Intra-SAARC Countries Bilateral and Multilateral Trade Potentials

Intra SAARC countries trade agreements may enable the member states to get various direct and indirect returns through economic cooperation, social capital accumulation, labour mobility, technological and skill sharing. Member states may cooperate at different levels through bilateral and multilateral agreements. A number of trade and non-trade issues need solution through mutual recognition and cooperation.

The states have to target capacity building in trade facilitation, reducing barriers to foreign direct investment (FDI), lowering tariff rates of protection, strengthening co-ordination, and elimination of other non-tariff barriers reducing productivity and private sector growth. Macroeconomic policy stability of the region is also an important factor for the region's trade with the rest of the world, Jain and Singh (2009). Settlement of pending disputes concerning SAARC countries at the WTO through SAFTA would also help in taking collective stand on WTO related issues. Jain and Singh (2009) suggested addressing of economic and political issues for making SAFTA more fruitful to the region. The study viewed that as SAARC economies grow and economic complementarities begin to develop, all the countries of South Asia, specially the larger ones, would make significant progress.

Reduction in the cost of trading across borders in South Asia is necessary as it is one of the highest in the world due to higher level of protection within the region than with the rest of the world. Jain and Singh 2009) supplemented findings of Baysan, Panagariya and Pitigala (2006) which suggested that the region should avoid substituting intra-regional trade liberalisation for extra-regional liberalization. They think that if

[15]Ibid.

countries in the region bring down the customs duties to five per cent, the impact of trade diversion will be considerably reduced. Procedural formalities in the region are still relatively cumbersome. It takes on average more than 33 days to export from South Asia compared to 12 days from OECD countries; and more than 46 days to import into South Asia compared to 14 days for OECD. The study informed of numerous opportunities in the region for intra-SAARC trade growth through appropriate agreement for capitalization of potential of roads, rail, air, and shipping enabling seamless movement. Besides, South Asian region countries being net energy importers, may meet the growing energy requirements through energy trade between these countries, which is currently limited to cross-border energy trade amongst Bhutan, India and Nepal. Dhungel (2008) suggests utilization of the potential for energy trade between India, Pakistan and Bangladesh for integration of regional economies. Similarly, by devising an effective mechanism for facilitation of exporters, increased and frequent supply of inputs at a low price and better quality from one state to the other, would enhance competitiveness of these states, and thereby of SAARC at global level.

Inter-state labour mobility, skill transfers, small scale and large scale technology transfers may be increased and consequently, global competitiveness of the region and of individual states may be raised.

These agreements may have other implications on the states also: they may bring these states closer to each other, help reduction in tension, provide a forum to discuss issues of mutual interests and suggest appeasement policies for settlement of conflicts and promote socio cultural gains through grass root level interaction and accelerate building up of a social capital accumulation base etc.

Conclusion

Multilateral agreements relating to economic development contribute to socio-economic development of individual states, thereby promoting regional cooperation. Bilateral Agreements relating to economic development may contribute to regional cooperation in the long run but harm the less developed economies in the short term. In long run most of the states may increase their capacity, strengthen marketing networks, improve competitiveness and improve trade by linking with comparative advantage, which may raise overall production, reduce inefficiencies and increase total trade thereby enhancing income level, interdependence and regional harmony amongst the member states.

Multilateral and bilateral trade agreements with developed countries should not be treated as substitute to trade agreements amongst SAARC countries, however efforts should be made to converge on developing complementarity by diversifying trading baskets in respect of both inputs and outputs for enhancement of global competitiveness.

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Chapter 11

Implementation of SAFTA: Bottlenecks

Barkat-e-Khuda and Selim Raihan

Abstract

To strengthen economic integration within South Asia, the South Asian leaders in 2004 agreed to the setting up of the South Asian Free Trade Area (SAFTA) with the primary objective of eliminating barriers to trade, and thereby facilitating cross-border movement of goods among the member countries.

The volume of trade among the South Asian countries has remained quite low, indicating that the SAFTA has not been able to bring in the desired results. This is due to various barriers: (i) issue of long sensitive lists, (ii) lack of connectivity and transit crisis,(iii) institutional constraints, (iv) proliferation of bi-lateral free trade agreements, (v) trading blocs with countries outside of the region, (vi) non-tariff and para-tariff barriers, (vii) exclusive focus on "trade-in-goods", (viii) identical comparative advantage, (ix) fear of revenue loss, and (x) lack of trust.

In order to remove the bottlenecks in the implementation of SAFTA, it is necessary that the following strategies are vigorously pursued. These include: (i) reducing the number of items in the sensitive list; (ii) eliminating tariff, para-tariff and non-tariff barriers; (iii) expanding market access; (iv) improving physical infrastructure; (v) trade liberalization; (vi) promoting joint ventures and foreign direct investment; (vii) promoting intra-industry trade; (viii) promoting trade in intermediate goods; (ix)involving private sector representatives in the negotiations; and (x) accelerating implementation of all SAFTA Agreements.

Background

Since the concept of regional trade agreements (RTAs) was perceived during the Uruguay Round, several countries have created regional trading blocs to expand trade and investment among themselves. The growth of RTAs and Bilateral Trade Agreements (BTAs) has been quite phenomenal and unprecedented. The large majority of the WTO Members are party to one or more RTAs. Thus, along with liberalization of trade on MFN basis, countries are moving towards a faster pace of liberalization within the regional and bilateral trading agreements. The RTAs are WTO-compatible as long as they promote deeper (compared to MFN) liberalization (CPD 2006).

RTAs facilitate a friendly trading environment among a limited number of countries located geographically close to each other. Regional trade blocs have been established all over the world at an increasing trend, especially during the last two decades, partly due to failures of multilateral negotiations, especially at various ministerial meetings of the World Trade Organization (WTO). The economic reasons behind RTAs are to allow their regional members to benefit from economic cooperation and comparative advantages, to achieve economies of scale, and to become less dependent on necessary imports from more distant countries. To achieve such an economic integration within South Asia, Bangladesh proposed a regional cooperative body of South Asian leaders in 1980, leading to the establishment of the South Asian Association for Regional Cooperation (SAARC) in 1985, the adoption of the SAARC Preferential Trading Arrangement (SAPTA) in 1993, and the agreement on the South Asian Free Trade Area (SAFTA) in 2004 (Abdin 2009)[1]. SAFTA includes all countries of South Asia — Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

SAFTA is more ambitious than SAPTA, with the provisions of its Trade Liberalization Programme scheduled to be fully implemented by 2016. SAFTA has six core elements: trade liberalization programme, sensitive lists, rules of origin, non-tariff & para-tariff barriers, revenue compensation mechanism, and technical assistance for LDCs. Also, the Agreement allows for safeguard measures, and allows partial or full withdrawal of preference. The objectives of SAFTA are to: (i) eliminate barriers to trade, and facilitate cross-border movement of goods; (ii) promote conditions of fair competition and ensure equitable benefits, taking into account their respective levels and patterns of economic development; (iii) create effective mechanisms for the implementation and application of the agreement and the resolution of disputes; and (iv) establish a framework for further regional cooperation to expand and enhance mutual benefits (Jalil 2011).

As per the Trade Liberalization Plan (TLP) of SAFTA, Pakistan and India will bring down their tariff to the level of 0-5 per cent by 2012, and Sri Lanka by 2013.The four South Asian LDCs, namely, Bangladesh, Bhutan, Maldives and Nepal, will reduce their tariffs to 0-5 per cent by 2015. SAFTA is to eventually graduate into a full-fledged South Asian Economic Union (CPD 2006).

[1] Raihan 2008; Jalil 2011.

Trade

Intra-regional Trade in South Asia

Since the primary objective of SAFTA is to encourage trade among the member countries, it would be useful to briefly review change in trading among the member countries, following the setting up of SAFTA.

Intra-regional trade between South Asian countries has been low for decades. Before 1951, its share of the region's total trade was in double digits. By 1967, however, as South Asia became progressively more closed to the world market and political rivalry between India and Pakistan intensified, intra-regional trade dropped to a meagre 2 per cent of the total. It increased through the 1990s and by 2002 it had increased to over 4 per cent (Baysan et.al. 2006). It peaked at 6 per cent in 2004, and then, declined to 4 per cent in 2010, though this decline in intensity is attributable more to South Asia's increased trade with the rest of the world than to intra-regional declines. The region's outward trade may look healthy; however, its internal activity, compared to other regions such as NAFTA, ASEAN and EU, is quite low.

In South Asia, the distribution of intra-regional trade is highly imbalanced. India is the largest exporter in South Asia, accounting for 65 per cent of the intra-regional export, while Bangladesh is the largest importer in South Asia, accounting for 26 per cent of total intraregional import in 2008 (Raihan 2011).

All other South Asian countries, except Bhutan and Nepal, have their major export destinations outside of South Asia. Regional export constitutes less than 5 per cent of total exports from Bangladesh. The corresponding figure for India is just over 5 per cent. India is the major export destination for Nepal and Bhutan, with Bhutan's and Nepal's exports to India comprising almost 100 per cent and 71 per cent respectively of its total exports. Among the South Asian countries, trade is unequally distributed. Bangladesh trades very little with Bhutan, Nepal and Sri Lanka. India is the dominant source of imports for Bhutan and Nepal, and India is also one of the major sources of imports for Bangladesh. However, trade with India is largely one-sided, with the volumes of imports from India to Bangladesh and Nepal being considerably large, although the volumes of exports from these countries to India are quite low (Raihan 2011).

An important aspect of the South Asian intra-regional trade is substantial informal border trade, which, in itself, is a barrier to boosting formal trade among the member countries. Some studies on the informal border trade among the South Asian countries pointed out that the informal and illegal trade between India and Bangladesh, between India and Nepal, and between India and Sri Lanka could be as high as the recorded trade (Pohit and Taneja 2003; Taneja et.al. 2004;Das and Pohit 2006; World Bank 2006).

Growth in the Services Sector

Over the past three decades, Bangladesh, India and Nepal have experienced a persistent rise in the growth of the services sector, while Bhutan, Pakistan and Sri Lanka experienced a rather fluctuating trend in the growth of their services sector. Compared to the 1980s, the average growth rate in services sectors increased by 78 per cent in Nepal during the 2000s. The corresponding growth rates for Bangladesh, India and Sri Lanka are 64 per cent, 41 per cent and 23 per cent respectively. However, growth rates declined for Bhutan and Pakistan during the same period by 13 and 23 per cent respectively (Raihan 2013).

Bangladesh, India, Maldives and Sri Lanka experienced consistent rises in the growth rates of services exports and imports over the last three decades, while some fluctuating growth rates were recorded in Nepal and Pakistan The impressive growth of services exports helped India achieve healthy surpluses in the services trade during the 2000s compared to deficits during 1980s and 1990s. High growth in services exports during the 2000s also helped Maldives to widen trade surpluses. However, Bangladesh, Nepal, Pakistan and Sri Lanka experienced deterioration in balance of trade and services during 2000s (Raihan 2013).

In terms of the contribution of the services trade to the total trade, South Asian countries had mixed experiences. Bangladesh, Nepal and Pakistan recorded declines in the share of services exports in their total exports during the 2000s compared to the 1980s. For Bangladesh and Pakistan, this has been largely due to much better export performances of the manufacturing sectors. In Nepal, the growth rate in services exports declined during the 2000s. India and Maldives experienced remarkable growth in their share of services exports in total exports during the 2000s due to their impressive growth performance of services exports during that period. In the case of share of services imports in total imports, Bangladesh, Maldives and Nepal experienced declines, while India, Pakistan and Sri Lanka recorded positive growth during the 2000s (Raihan 2013).[2]

[2] Raihan and Angkur (2012) argued that deeper regional integration in services trade would provide huge welfare gains for the South Asian countries, since almost all of them were net importers of services.

Barriers

Ever since the SAFTA was launched nine years ago, there has not been any marked change in trade flows among the member countries. South Asia still remains the least integrated among the global regions. Here, the various barriers affecting increasing trade among the member countries are being briefly discussed.

Historically, the member countries pursued import substituting development strategy with tariff and non-tariff barriers to imports. Gradual trade liberalization has, however, led to reduction in tariffs and elimination of non-tariff barriers in some cases. Nevertheless, the remaining tariff and non-tariff barriers especially, the non-tariff barriers, continue to be major impediments to trade. As a result of various trade restrictions, trade has not increased to the desired level among its members, because some tariff rates within SAFTA are higher than in any other RTAs and because of many non-tariff barriers (NTBs) as discussed below[3].

The issue of Long Sensitive Lists

Under the SAFTA arrangement, every member country preserves its right to protect its industry by imposing restrictions to imports of goods from other countries by including specified goods in their sensitive lists or negative lists. For example, major goods of Bangladesh that fall into the sensitive lists of other SAARC countries are woven garments, knitwear, leather goods and foot wear, ceramic products, jute and jute goods, tea, handicrafts, bicycles, pharmaceutical products, meat, vegetables, and ships. The serious implications these negative lists have on intra-SAARC trade is especially true in the case of South Asia’s textile industries.

According to Article 7(3) (a) of SAFTA, the tariff liberalization programme would not apply to the tariff lines included in the sensitive lists; and therefore, the benefits from the regional trade agreement have been restricted, especially for the least developed countries (LDCs) of the region.

It is estimated that over half of the total import trade in SAARC countries has been subject to the negative lists of the respective countries, thereby seriously inhibiting intra-regional trade. Out of Bangladesh’s top 50 export items, 31 items are in India’s sensitive list for SAFTA LDCs (Jalil 2011). In January 2012, the member countries submitted their revised sensitive lists. India appears to have cut down its sensitive list drastically for the LDCs, paving the way for greater potentials of market access for the LDCs’ exports in her market. However, concerns still remain on a number

[3] Raihan 2008, 2011, 2013; De, Raihan and Kathuria 2012; Abdin 2009; Jalil 2011.

of non-tariff barriers, related to SPS and TBT, which can significantly restrict the realization of such potentials.

Poor Connectivity and Transit Crisis

Land connectivity makes transportation of goods easier, quicker and cheaper. However, after over two decades of SAARC's establishment, it has not been able to create land connectivity in the region, thereby not being able to make efficient business transaction among the member countries. The condition of land ports is not up to the desired level. In addition, ports are plagued by labour problems, poor management, and lack of equipment.

Regrettably, the SAARC countries are still not giving sufficient transit to each other. For example, India is giving only two hours transit to Bangladesh and Nepal through Bangla Banda land port, which is quite inadequate to meet the transportation demands between Bangladesh and Nepal. If, however, this was raised to at least eight hours, Bangladesh's export to Nepal can be increased three-fold compared to its present level.

Due to poor connectivity and transit crisis in South Asia, costs of trading increases[4]. For example, transaction costs at the India-Bangladesh border are quite high due largely to infrastructure bottlenecks, both at the borders as well as within the countries. The lack of benefits of cheaper transportation would not encourage trade between and among the member countries.

Poor trade logistics in South Asia, including Bangladesh, affect the cost of export and import very significantly (De, Raihan and Kathuria 2012). The quality and performance of logistics services differ considerably between India and Bangladesh and also across their trading partners, because of differences in the quality and cost of infrastructure services and also because of differences in policies, procedures, and institutions. All these have significant effect on compliance costs, trade competitiveness and market access.

Institutional Constraints

Institutional constraints impede the prospects of gain from SAFTA. Such institutional constraints include procedural red tape, inadequate enforcement of contracts, complicated and inefficient visa system, poor definition and enforcement of rules of engagement, asymmetry in standards, delays in Customs clearance, delays at ports and border crossings, pilferage during transit, corruption, and highly restrictive protocols on the movement

[4] See also Ahmed and Ghani 2010.

of cargo. According to the World Bank (2012), the domestic logistics chain, including collection of products from producers, road haulage to the warehouse, containerization, haulage to the port, and customs at port, remains quite underdeveloped.

There is strong evidence that improving the efficiency of Customs and administrative procedures and simplification of trade related documentation can facilitate trade between and among the countries. However, despite the improvements, trade facilitation indicators in South Asia remain substantially poorer than those achieved in other regions of the world (Raihan 2011).

Bi-lateral Free Trade Agreements (FTAs)

The existence of bilateral Free Trade Agreements (FTAs) raises questions whether the member countries really want to make SAFTA effective. Several member states (India and Sri Lanka, Sri Lanka and Pakistan, and India and Nepal) are doing business with each other under their separate FTAs.

Moreover, SAFTA is silent about how it will integrate the bilateral and multilateral trade arrangements, which currently exist between some SAARC countries and between SAARC countries with countries outside the region. There are concerns that if the pace of tariff reduction is not accelerated, SAFTA may become irrelevant in light of other competing agreements. Also, with respect to ROO, there are discrepancies while comparing the SAFTA treaty with the India-Sri Lanka bilateral FTA agreement and also with the BIMSTEC Agreement (Raihan 2008).

Trading Blocs with Countries Outside of the Region

Most SAARC countries are now members of more than one RTA, including those which exclude some of the SAARC countries, as in the case of Pakistan in BIMSTEC. As a result, the excluded members in such RTAs experience competition from the non-SAFTA countries such as Thailand and Myanmar. This could lead to loss of preference in trading with some member countries (Razzaque 2008).

Non-tariff and Para-tariff Barriers

Non-Tariff Barriers (NTBs) mostly have to do with standards, testing and certification procedures, licensing, classification of goods, custom valuation, countervailing duties. Also, the lack of trade facilitation is acting as an NTB (Raihan 2012).

India is by far the biggest source of imports for Bangladesh. Nevertheless, despite a growing huge and sustained trade deficit and despite the fact that India has provided a duty free market access to all LDCs under her Duty Free Trade Preference (DFTP) policies, non-tariff and para-tariff barriers far outweigh the benefits of tariff concessions.

There are various products (plastic and melamine products, chemical products, toiletries, copper wire, betel nuts, raw jute, jute products and fertilizer which have significant export potential in the Indian market under SAFTA. However, a number of such products, i.e., plastic products, toiletries and betel nuts are included in the Indian SAFTA sensitive list, thereby making it almost impossible to expand exports of these products in the Indian market. Also, Bangladeshi exporters face a number of non-tariff and para-tariff barriers in the Indian market; however, SAFTA is silent on the removal of para-tariffs and NTBs (Raihan 2008).

While tariff concessions have been offered by India to Bangladesh under SAFTA, greater benefit can be achieved by addressing non-tariff and para-tariff barriers in both countries (De, Raihan and Kathuria 2012).For example, the Indian Food Adulteration (Prevention) Act 1954 requires that the shelf life of processed foods from Bangladesh should be not less than 60 percent of the original shelf life at the time of import. While this objective is fine, the process of determining shelf life is often arbitrary and non-transparent. Also, to export textile and textile products to India, exporters must obtain a pre-shipment inspection certificate from a textile testing laboratory accredited to the National Accreditation Agency of the country of origin. Non-availability of the certificate requires testing from the notified agencies in India for each and every consignment. In some cases, even certificates issued by EU-accredited laboratories have been rejected by Indian customs authorities and such consignments are subject to repeat tests in India. Bangladesh also imposes several NTBs and supplementary duties on Indian exports. For example, Bangladesh has imposed over 60 per cent supplementary duty on import of plastics from India. Also, Bangladesh still maintains 225 items in its sensitive list in terms of trade with India, covering machinery, pharmaceuticals, textiles, etc.

Exclusive Focus on “Trade in Goods”

The existing SAFTA Treaty is predominantly centred on “trade in goods”. Under such an approach, Bangladesh cannot enhance its growth opportunities much by merely promoting exports of goods to the regional market. Bangladesh's exports to the South Asian region are quite small, and even a quadrupling of its intra-regional exports will not lead to any significant expansion in its total exports (Raihan 2012).

A major limitation of SAFTA is that it leaves out trade in services, thereby depriving member countries from benefitting from the services sector in the region. Recognizing the importance of the services sector, the South Asian Agreement on Trade in Services (SATIS) was signed at the 16th SAARC Summit in Thimpu in April 2010 with the objectives of promoting and enhancing trade in services among the Contracting States in a mutually beneficial and equitable manner by establishing a framework for liberalizing and promoting trade in services within the region in accordance with Article V of GATS. However, the member countries are yet to schedule their specific liberalization commitments under SATIS.

Identical Comparative Advantage

The member countries enjoy comparative advantage in similar products and in a narrow range of products (Hossain 2002; Hussain 2009). These countries import capital-intensive products and technology from the developed countries, and export a narrow range of labour-intensive products to such countries. Incidentally, exports from the member countries receive favourable treatment in developed countries in the form of GSP facilities or quota allocations. Hence, it becomes more attractive for the member countries to trade with the developed countries. In fact, some of the major export items of these countries directly compete with each other in developed country markets. For example, Bangladesh, Pakistan and Sri Lanka all export RMG. Likewise, Bangladesh and Sri Lanka export tea. The issue of comparative advantage largely explains the small volume of intra-regional trade in South Asia (Hossain and Rahman2002).

Fear of Loss of Revenue

Intra-regional trade liberalization involves potential loss of revenue, which can discourage governments to liberalize. Since importing countries lose tariff revenue, it is argued that exporting countries should compensate the importing countries for the loss of revenue. This logic for compensation is, however, contested because loss of revenue resulting from trade liberalization under WTO is also not being compensated for. In the case of SAFTA, there is preferential treatment of imports from member countries, while in the case of WTO imports are treated on MFN basis. The case for compensation is stronger if trade involves trade diversion, which involves revenue redistribution benefitting the exporting countries. However, fear of potential revenue loss should not deter a country from liberalization. Each country should be able to find alternative sources of revenue other than customs revenue to recover the lost revenue such as from VAT and supplementary duty (Hossain and Rahman2002).

Lack of Trust

The governments and businessmen in the SAARC region suffer from lack of trust. The lack of trust is largely due to: (i) the long period of British colonization which has divided sub-continental people in many aspects; (ii) animosity between the two large member states, India and Pakistan; and (iii) the way India is behaving like a "big brother" and projecting its superiority complex at the negotiation table. The lack of trust, especially among the political leaderships in the member countries is a major deterrent in the way of boosting trade among the SAARC countries.

Conclusion and Recommendations

The volume of trade among the SAARC countries is quite low, with the major trading partners of the individual South Asian countries located in the West. Also, due to limited complementarities in the region, there would not be considerable expansion of intra-regional trade, even under the SAFTA. In addition, SAFTA may lead to substantial trade diversion than trade creation for some of the member countries. Furthermore, SAFTA may work as a stumbling block to multilateral trade liberalization (Raihan 2012). However, given the 2008 global financial crisis and the challenges being faced by the developed countries, which resulted in a downward trend in exports from the developed countries in the context of a strong trade flow of developing countries, it can be expected that the South-South trade may be one of the best ways to avoid a more serious trade slump. Countries in the South will continue to have higher trade with South-South region. In this regard, India and Pakistan from South Asia and China from East Asia have added responsibilities to drive this momentum.

The following strategies should be vigorously pursued to remove the barriers in implementation of SAFTA, and thereby, help boost trade among the member countries.

Reduce the Number of Items in the Sensitive List

Some of the major exportable products of South Asian countries are formally excluded from trade among the member countries due to long negative lists. If the goal is to have a free trade area within South Asia, every country should shorten its negative list as soon as possible, especially regarding those products which are of export interest to the SAARC member countries for trade within South Asia (Jalil 2011). Also, the shortening of the negative lists would reduce the cross-border smuggling of goods and the resultant loss of revenue for the governments in the region.

The SAFTA working group proposed reduction of tariffs on a number of products under the initial lists of sensitive goods during the second phase of tariff reduction from January 1, 2012. Except for Bhutan, all other countries have reduced the number of products on their sensitive lists. A concern, however, is that there is no format in the SAFTA Treaty for phasing out of the negative list over the years (Raihan 2008). Therefore, there is an urgent need to address this concern.

Eliminate Tariff, Para-tariff and Non-tariff Barriers

If SAARC countries want an effective regional free trade area, all tariffs and trade barriers should be identified and appropriate actions taken to remove them before the end of 2015.

High tariff rates among the SAARC countries, indeed, higher than in any other region, are one of the major reasons behind the low intra-regional trade in the region. Thus, reduction in the tariff barriers among the member countries is likely to have important implications in terms of improved market access of these countries in their neighbouring countries (Raihan 2011).

Non-tariff barriers can easily reduce the potential gains from tariff liberalization. Unless these barriers are removed simultaneously with the reduction of tariffs, the full gains from various phases of tariff reduction will not be achieved; and as a result, the objective of preferential tariffs will not be fully realized.

NTBs in India and in some other South Asian countries are holding back the export potentials from those countries, including Bangladesh. This calls for mutual recognition agreements among respective organizations of the member countries, including Bangladesh, and its trading partners in the region, particularly India. Also, there is a need for harmonization of TBT and SPS measures. In addition, non-tariff measures and para-tariff measures not notified in WTO should be prohibited (Raihan 2011). Therefore, each SAARC Summit should set a target to address particular NTBs, which the member countries must report on in the subsequent Summit.

Expand Market Access

The ESAS countries (Bangladesh, India, Nepal and Bhutan) could benefit considerably from facilitating new market accesses, if SAFTA would be more effective. If SAFTA is implemented properly, India would be bound to offer transit to the other member countries, resulting in considerable increase in Bangladeshi exports to Nepal and Bhutan. Also, the Pakistani and Afghan markets would be more easily accessible for Bangladeshi products. Furthermore, by establishing a deep seaport in Bangladesh, the country would earn considerable amount of revenue by providing transit to the regions and countries which are land-locked to the eastern and northern parts of Bangladesh (Abdin 2009).

There is a need for economic corridor among the ESAS countries in the region. Reduction in tariffs, together with elimination of sensitive lists and improved trade facilitation, will enhance the market access of these countries (Raihan 2011).

The ESAS countries may not be able to gain much within the existing ‘trade in goods’ based agreement. The possibility of a large trade diversion for Bangladesh, under the full implementation of existing SAFTA Agreement, is high. Bangladesh will have to considerably raise her export share into the regional market to derive gains through positive terms of trade effect. Export diversification in this regard is quite important. Also, Bangladesh should try to expand its export outlets outside the region such as the BIMSTEC, D-8, and the IOR-ARC, of which Bangladesh is a member; and seek to improve its trading relations with the ASEAN (Raihan 2008).

The Treaty should go beyond the mere Agreement in ‘trade in goods’; and include regional co-operation mechanism in the areas of investment, finance, services trade, trade facilitation and technology transfer. This will help create an enabling environment to promote intra-regional investment by setting up a SAARC Investment Area through an intra-SAARC investment agreement (Raihan 2008). Also, it will raise prospects of LDCs, including Bangladesh, for getting larger investment inflows from the more developed member countries in the region to improve their export supply capabilities and boost exports, both inside and outside of the region, to derive the desired benefits from SAFTA. In addition, the Agreement should assign adequate importance in promoting services trade in the region.

Improve Physical Infrastructure

Improved infrastructure and growth through improved connectivity would allow South Asia to share its benefits more widely. The state of physical infrastructure in South Asia needs to be improved. There are two dimensions of poor infrastructure which need to be duly addressed: i) unavailability of a certain service or utility (e.g. telephone, water, electricity, roads and highways, etc.), and ii) unreliability of the services provided.

Road, railway, river and sea transport need to be improved to facilitate the flow of goods in the region. For successful free trade agreement with any member country, developing infrastructure and transit facilities for the region as a whole makes more sense. Provision of transit facilities through different countries linking different trade points is quite important. Transit through India linking Nepal and Bangladesh, transit through India linking Nepal and Pakistan, and transit through Bangladesh linking Eastern India with other parts of India and allowing Nepal and Eastern India access to Bangladesh's ports can facilitate trade in the region. There are clear economic gains from transit; however, political sensitivities act as deterrent to allow it. The problem can be redressed, if the political leadership in the member countries are made fully aware of the extent of economic gain by providing such transit facilities, without compromising security interests of the respective countries.

Trade Liberalization

The gains from trade facilitation in South Asia are much higher than the gains from mere reduction in tariff. Therefore, to make SAFTA effective, trade liberalization is a necessary condition, but not a sufficient one. A very high priority should be given to developing trade infrastructure facilities (hardware) and trade facilitation (software), including the necessary reforms in custom clearance. In addition, intra-regional investment flow has a strong role for deepening the regional integration. Further, inflow of foreign investment has a favorable impact on exports and imports as well (Raihan 2012).

Promote Joint Ventures and Foreign Direct Investment

Even if Eastern and Southern African (ESA) countries get free access to the regional market and all non-tariff barriers are removed, it is doubtful how far such countries would be able to penetrate the regional market without some other complementary policies. Until adequate and appropriate production capacity is developed, the ESAS countries cannot make much headway in the regional export market. This necessitates the flow of FDI and establishment of joint ventures whose products will be targeted to the regional market.

The South Asian countries have opened most areas of the economy for foreign investment with a small list of reserve areas in each country. To attract FDI, the countries also offer an attractive package of incentives in the form of tax holidays, lower interest rates, repatriation of profits and dividends, concessionary rate of taxes on expatriates, income duty exemptions on capital goods imports, etc. Also, the countries provide protection of foreign investments through various agreements. Despite such incentives, FDI is quite low in South Asia due to less than expected economic returns, infrastructural deficits, and political stability. Therefore, the governments in the South Asian countries should attach high priority to address the impediments to low FDI in South Asian countries.

Promote Intra-industry Trade

When countries possess similar comparative advantage as do other countries, there is not much scope for expanding export to the member countries through inter-industry specialization. However, a member country can expect to make headway through production of commodities with competitive advantage. There are two types of competitive advantage which firms can gain, (lower average costs and product differentiation). With competitive advantage, a member country can engage in intra-industry trade with other member countries, which is quite low at present (Hossain and Rahman2002).

Promote Trade in Intermediate Goods

A substantial part of international trade involves trade in intermediate goods. Trade in intermediate goods is based on both comparative and absolute advantage. The South Asian countries can engage in vertical specialization through production sharing arrangements. For example, in the textiles sector, cotton can be produced in one country, yarn and fabrics in another country, and garments in yet another country. Viewed from this perspective, the trade flows (both exports and imports) will be looked at more positively; and South Asia can bargain with the outside world as one entity because they all have stakes in the particular activity (Hossain and Rahman2002).

Involve Private Sector Representatives in the Negotiations

At present, all types of trade negotiations are taking place at the governmental level, both in the case of the WTO and the SAFTA. Business communities, the actual actors, are, by and large, left out. To be able to identify the problems more clearly and to solve them efficiently, business communities and private sector representatives, including apex business bodies (e.g. the Federation of SAARC, SAFTA Customs Union, Bangladesh Chambers of Commerce and Industry, and the Federation of Indian Chambers of Commerce and Industry), should be included in all trade negotiations.

Accelerate Implementation of all SAFTA Agreements

While the treaty has come into force on January 1, 2006, there are various elements which are supposed to be fully implemented only by December 31, 2015. Therefore, it is important that all SAFTA agreements are implemented within the stipulated time.■

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Chapter 12

Economic Cooperation among SAARC Countries: An EU Perspective

Wolfgang-Peter Zingel

Abstract:

The initiative to form a regional cooperation in South Asia was very much welcomed in Europe right from its beginnings in the early 1980s. It was actively supported by European governments and especially by the European Commission. Europeans as well as non-Europeans saw the European Communities (Coal and Steel, Economic, Atomic Energy) as a role model to overcome national rivalries and hostilities. Not to forget: Germany and France had fought three wars between 1870 and 1945; there had been territorial disputes since the 9th century. So we were tempted to see parallels in South Asian and European histories and hoped, if not expected, that economic cooperation would yield less political tension in the region as well as economic and social uplift in all member states. As success lies in the eyes of the beholder, both co-operations, in Europe as well as in South Asia, are seen as great achievements, but also blamed for their shortcomings. The author had the opportunity to discuss regional cooperation in Kathmandu (SAARC), Singapore (ASEAN), Teheran (ECO) and Brussels (EU). As an economist he asks whether regional cooperation brings out economic development or economic development leads to regional cooperation. Economic cooperation is also more than free trade, and — not to forget — has considerable security aspects that certainly played a role in the case of the European Community/Union. The question therefore also is, whether regional economic co-operations thrive best if backed by a strategic alliance.

Introduction

This conference is on "Towards an Asian Century". So then, what does Asian Century mean? Continents, like so many other territories, got their names by outsiders: The Greek called what is today western and central Turkey Mikra Asia, Asia minor in Latin. What lay beyond was Makra Asia, Asia major. Nobody knew how big Asia was. Beyond Asia was India, basically all lands beyond the Sindhu (Indus). For Americans today Asia is East Asia, maybe including Southeast Asia. In the Gulf countries Asia refers to the lands east of Iran. When we talk of competition from Asia, we usually mean China and sometimes also India, the largest emerging economies. But they are not attaining a new role in world economics. It is China and India that have been the leading economic powers in the world over most of the last 2,000 years, as Angus MADDISON (2006), the economic historian found out. According to his findings, most of the last twenty centuries have been Asian centuries, indeed.

It is the role that the economic cooperation among South Asian states, the SAARC countries, play in, or rather on the way towards a new Asian century will play, that is in the focus of our international conference, organized by the Islamabad Policy Research Institute (IPRI) in collaboration with Hanns Seidel Foundation (HSF).

This paper has been prepared as a contribution to the panel dedicated to the impediments to economic cooperation in South Asia. After the panel discussed the political constraints, bilateral and sub-regional agreements, and SAFTA's bottlenecks, it is to give a EU perspective. However, since the European Union is still working on their SAARC policy, the author will also look into the role of regional co-operations and their economic, political and security aspects.

What Telephone Number Does South Asia Have?

Henry Kissinger, the former US foreign policy advisor and secretary of state, famously asked: 'What telephone number does Europe have?' What he meant was that there was nobody to speak for Europe. Still there is discussion what mandate Lady Ashton, the foreign spokesperson for the European Union, really has. (LARIVÉ 2011). Since her mandate obviously is very limited, the powerful leaders around the world still would talk to national political heavyweights rather than to European bureaucrats.

A similar question can be asked for South Asia: Is there anyone who can speak for the South Asian countries? The General Secretary of the South Asian Association for Regional Development (SAARC) in

Kathmandu obviously has very limited powers. Article VIII of the Charter of the South Asian Association for Regional Cooperation of 1985 simply states: ‘There shall be a secretariat of the Association’. Supreme body is the heads of state or government (article III). A Council of Ministers consisting of the foreign minister of the member states (article IV) formulate the policies, review the progress, decide on new areas of cooperation, establish additional mechanisms and decide on ‘other matters of general interest’. At the same time the foreign ministers form a Standing Committee (article V) to monitor and coordinate programmes, approve projects and programmes, determine inter-sectoral priorities, mobilize resources, and identify new areas of cooperation. They are assisted by Technical Committees (article VI). There is an Action Committee (article VII) ‘comprising member states concerned with implementation of projects involving more but two but not all member states’. The major caveats are the General Provisions (article X): ‘1. Decisions at all levels shall be taken on the basis of unanimity.’ and: ‘2. Bilateral and contentious issues shall be excluded from the deliberations.’ (SAARC 2013).

The author had the opportunity to meet and talk to former general secretaries and staff at SAARC headquarters and outside. He found enthusiastic diplomats and specialists, but much less of an organizational infrastructure than expected. Besides the General Secretary there were one director and another senior diplomat from each member country plus some administrative and support staff, housed in a mid-sized bungalow that also contained a small library. In that respect it resembled very much the Economic Cooperation for Development (ECO) headquarters in Teheran that the author had visited earlier. SAARC does not have any representations inside or outside the member states; but there is a dozen or so of SAARC institutes set up in fields of common interest, like agriculture and forestry, spread over all member countries and acting to some extent as information centres on SAARC. Their main activities are training and exchange of knowledge in the various fields, hampered by the fact that the costs of the participants have to be borne to quite an extent by their home countries. Travel is eased by ‘SAARC visas’ that allow a small group of specialists unrestricted travel within SAARC countries.

Compared to the European Union, SAARC is a very modest venture, if one only thinks of the EU budget of Euro 134 billion planned for 2014. That is almost as much as Pakistan’s gross national income (GNI) of one year.

So how much attention has SAARC found by the European Union? Since 2005, SAARC welcomes outside observers. At present there are nine: Australia, China, European Union, Iran, Japan, Republic of Korea, Mauritius, Myanmar, and the US. The EU became an observer in 2006. The relations are cordial, but not very active. The official website of the EU dedicated to SAARC relations is only a few lines long ending with the message of 2006 ‘EU obtains SAARC Observer Status’ (EC 2013).

The EU Regional Programming for Asia 2007-2013 mentions SAARC briefly: ‘The EC will concentrate its assistance to the SAARC countries on regional capacity-building with a particular focus on three areas,’ namely SAFTA trade development, sectoral dialogue facility and civil aviation. ‘The envisaged EU-SAARC cooperation will strengthen institutional capacity and mechanisms for implementation of the SAFTA agreement and apply relevant EU experience to help demonstrate the potential benefits of progress under SAFTA (MDG 8, target 12).’ (EC 2007: 14).

SAARC so far has not been a partner for trade negotiations that are conducted by the individual South Asian governments. A new EU ‘free’ trade agreement with India, for example has been discussed extensively since 2007 and might be concluded in 2014. It has aroused suspicion and resistance in the EU and India as well, mainly among civil society, but also among groups with vested interests like the farm lobby on both sides.

The Asian Development Bank runs a web-page on ‘Pakistan-European Union Free Trade Agreement’, but actually only refers to some press reports. (ADB 2013). In April 2013, the EU Ambassador designate reported that Pakistan would get the Generalized Scheme of Preferences (GSP) plus by the end of the year.[1]It would give Pakistan a better access to the markets of the EU, its largest trading partner with an annual trade volume of Euro 10 billion. (EC 2012).

Bangladesh as a Least Developed Country (LDC) enjoys ‘the most favourable regime available under EU’s Generalized Scheme of Preferences (GSP), namely the Everything But Arms (EBA) arrangement. EBA grants ... duty free quota, free access to the EU for exports of all products, except arms and ammunition.’ (ECDGT 2013).

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1. For the European Union GSP nomenclature: ‘There are three main variants (arrangements) of the scheme: the standard GSP scheme, which offers generous tariff reductions to developing countries. Practically, this means partial or entire removal of tariffs on two thirds of all product categories. The "GSP+" enhanced preferences means full removal of tariffs on essentially the same product categories as those covered by the general arrangement. These are granted to countries which ratify and implement international conventions relating to human and labour rights, environment and good governance; "Everything but Arms" (EBA) scheme for least developed countries (LDCs), which grants duty-free quota-free access to all products, except for arms and ammunitions.’ (EU 2013)

As can be seen, the all-important trade agreements are concluded bilaterally between the European Union and South Asian governments, but not with SAARC. In the light of these obvious limitations, SAARC so far has not been more than a platform for multilateral dialogue among the member countries. It is not, at least for the time being, a partner for trade negotiations between Europe and South Asia. However, there is hope in the member countries of SAARC and in Brussels that SAARC one day would have the mandate to negotiate trade and other agreements on behalf of the member countries. The next section, therefore, is dedicated to the economics of regional trade agreements, usually the first step towards regional economic cooperation.

On the Economics of Regional Trade Agreements

Regional trade agreements are a typical second best solution of international trade. The economics of trade, or the 'gains from trade' as they are called in economic text books, are threefold:

1. Lower production costs,
2. A greater variety of products and
3. Better quality of products.

Lower production costs are the result of scale effects: The larger the quantity of (identical) goods produced, the lower the average production costs, as fixed costs can be spread over a larger number of products. This effect is commonly known as economies of scale. Such economies are not unlimited, because there are also diseconomies of scale, since the costs of information and control are usually low in small firms, but can be substantial in large ones. Reaction time is also shorter in small ones. Hence, the success of highly specialized, medium sized and family-owned undertakings in Germany, known as *Mittelstand*. Smaller countries opening their borders benefit more from economies of scale than larger ones. The success of the first Asian 'tiger' economies would not have been possible if they had not been granted access to captive international markets, especially in the US. The rise of computer firms like Acer and Asus from Taiwan would have been much slower, if rising at all, without having access to the US market.

Lowering of trade barriers creates larger markets, which allow a greater variety of products: For example, Germany exports cars to France, and France exports cars to Germany; they might be similar, but they are not identical and obviously people are ready to pay a premium for products of their liking and choice. Most of global trade is among the industrialized countries and they exchange a lot of similar goods. Medium and larger economies benefit most from this effect. If we look again at the automobile industry, we find that medium sized markets provide economies of scale, but only for a limited range of products. This could be observed in the former 'socialist' countries. Once their borders were opened, people decided for imported goods, because of their greater variety, even at higher costs.

The limitation of production to a small range of products creates monopolies that are prone to inefficiencies, irrespective of whether the monopoly is enjoyed by a public or a private enterprise. In the case of a public enterprise we would talk of state failure, and in the case of a private enterprise of market failure. Typical inefficiencies of the first type are inflated production costs due to overstaffing and corruption, and of the second type due to artificial scarcity (smaller quantities) and monopolistic (higher) price settings. In both cases quality can be compromised. It is competition that usually not only results in lower prices, but also in better quality. Once alternatives are available, producers are forced to improve quality, if they do not want to lose their customers.

In principle, thus, free trade and international competition should be a win-win game. Then, why has there been so much resistance to opening up the markets? A first argument would be the dynamic effects: Economies have developed under a highly complex system of trade restrictions and it would be impossible to change this set up overnight. A second and third argument would be politics and poor economics. As BHAGWATI and PANAGARIYA (2001) have found out, trade is most restricted between poor (economically less developed) neighbouring countries in South Asia and Africa. Politics forbids trade concessions that are seen as undue favours to a disliked neighbour, while the perception of the global economy as a zero-sum game is hurting the own country, may be even more, than the neighbouring trading partner. The present set-up of tariff and non-tariff trade restrictions, unfortunately, cannot easily be undone. There simply is no reset button for trade regulation. Changing a system also creates winners and losers. A simple example from South Asia, i.e. that of the onion prices, will illustrate the problem,

The Tale of the Onion Price and the Housewife

From time to time consumers in India and Pakistan complain about a sudden rise in the price of onions and demand a ban on the export of this commodity. This happens, if export of onions is allowed and the world market price of onions suddenly rises. In a typical open 'small' economy, that is in an economy with open borders and an inconsiderable (small) share of the world market, prices are determined by the world market: If the world market price rises, so does the domestic price, since there would be no incentive to sell at a lower price at home, if a higher price can be realized abroad. For the housewife, who does the shopping and cooking, a rise in the price of onions means a reduction of her real income. It also restricts her ability to cook a tasteful meal, since onions are a less expensive and affordable way to give simple food some taste. If the price of an item rises, the normal reaction would be to substitute it, at least partly, with a cheaper item. In the case of onions, however, there is no such cheaper substitute, economists would say: inferior substitute and the housewife will be hit by the full force of the onion price increase. Hence, with her sound understanding of economics, she will ask for a ban on export of onions. If onions no longer could be exported, demand would be restricted to the domestic demand. Fewer onions altogether would be in demand on the domestic market and as a result, the onion price would fall to its original level.

A student of economics, however, might be tempted to argue otherwise: He has learnt that international trade is a win-win game: Onions would only be exported, if the benefits of foreign exchange earnings from the export of onions would he higher than the (social) loss from the reduced availability of onions for cooking. Economists call this an increase in welfare: With the benefits from onion export larger than the costs (i.e. of not having them anymore) total income (GNI) and the income per head would increase. Unfortunately, the housewife is the one that does not benefit, at least not directly, from a larger national welfare, while the producers, traders and exporters of onions, and may be also the state (via an export tax), do. Theoretically, the state could plough back some of the gains to the housewife in the form of income subsidy or employment, but usually she would have nothing of it, especially not immediately. In other words: The state could compensate the consumer for the loss of the exported onions with part of the gains from trade. Such compensation would be necessary, because adjustment of the economy that works so well in economic textbooks, does work less well in reality, as adjustment and restructuring of the economy takes time. In the longer run, more onions would be grown, while their production costs would sink (because of the economies of scale). But that does not solve the problem of the housewife.

Unfortunately, it is much easier to destroy an industry than to (re-)build it. Therefore, the resistance in any country against trade liberalization. Surprisingly, in industrial countries it is especially strong in the agricultural sector; the United States, Japan and France are examples. The major exception is Britain that as a colonial power decided to let in cheap food in order to keep costs of living and industrial wages low and, thus, enhance Britain's competitiveness. This played an important role when the United Kingdom joined the European Economic Community, because it meant that the import of food items from the Commonwealth became liable to the intricate system of European import tariffs. It also explains why Britain was partly exempted from paying for the Common Agricultural Policy. Without going into detail, it is important to see, that free — or freer — trade is not so much a matter of principle and conviction, but of balancing the interests of the various stakeholders, especially if these are politically influential (like the farm lobby in the US Congress).

Summing up: The housewife and the student are both right: She is losing real income and therefore asks for a ban on exports, while the student only sees the gains from trade. But gains from trade for the economy do not automatically mean gains for everybody. There are winners and losers in the process of liberalizing exports and imports, and usually the potential losers are better organized (because smaller in number with higher individual effects) than the potential winners (the rest of the populace with often marginal individual effects). In a democracy consumers are the electorate and any democratic government is well advised not to infuriate their housewives, and there are cases, where governments were toppled over the question of onion prices. (*The Hindu* 2010). In Pakistan, I observed a number of cases, where even the export of items like eggs had been banned from being 'exported' (transported) from one district to another in order to keep prices down. Interestingly, the legal basis for similar actions still is section 144 of the Code of Criminal Procedure of 1898 that certainly was not passed into law to limit trade between districts. (*Express Tribune* 2011).

The classical textbook case of the devastating effect of preferring free trade over consumers' interests would be the Great Irish Potato Famine of the 1840s, when a ban on export of food grains from Ireland would have helped to lower the price of food there and save many Irish lives. Free trade between Ireland and England, then, was upheld in order 'not to disturb the markets'. In the 1940s, it was just the opposite: The decision of the Indian surplus provinces to restrict the export of food grains to the deficit provinces added to the food problems of Bengal and led to the Great Famine of 1943.

What does this mean for SAARC? SAARC is unusual in that the Association comprises economies of very different sizes: The largest, India, has four thousand times as many inhabitants than the smallest, i.e. the Maldives. The size of the economies of the smaller seven members put together would be only a fraction of that of India. Until Afghanistan joined the SAARC, no member shared a border with another member, except India. In any case, the size of the smaller trading partners determines the volume of trade. We therefore have to be careful discussing indexes of openness (usually simply the sum of exports and imports in relation to GDP): Large countries appear to be surprisingly less open.[2] The USA and Japan would be good examples.

The South Asian countries, however, all rank at the bottom of the Open Markets Index (OMI)[3] of 2011, with India at position 66 of 75, Pakistan at 70, Sri Lanka at 72 and Bangladesh at 75. (ICC 2011: 17). This compound index, put together by the international Chamber of Commerce, reflects openness well. It is evident, that South Asian countries have been protecting their markets to quite an extent, albeit in different ways.

The gains of liberalizing the South Asian market are not easy to make out: India would have the least to fear, because her domestic market is big enough to realize considerable economies of scale for most products. An even larger market would, of course, allow even further cost reductions and, thus, would be very welcome, indeed. Pakistan as the second biggest economy would have to fear more, since some of the existing industries would have difficulties to withstand Indian competition. Small economies for very practical reasons tend to be open, and have less reason to fear the lifting of trade restrictions.

In Europe, Luxemburg, the smallest of the original six members of the European Economic Community (EEC), is by far the richest one (per head), thanks to its leading role in financial services. The same holds true for South Asia, where the smaller countries are also the richer ones, with the Maldives, Bhutan and Sri Lanka reporting the highest GNI per capita. It is the same in Southeast Asia, where Brunei, Singapore and Malaysia are the richest ones.[4]

Regional Collaboration - A Quick Overview

World-wide there have been more than 200 regional cooperations, but most of them never became too active. They all have their own distinct historical background and other peculiarities. I shall briefly discuss some of the better known ones. Until the recent problems of the Euro zone, the European

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[2] It is a statistical effect: Globally the sum of exports equals the sum of imports. The share of trade then is smaller in proportion to the GDP of big economies as compared to small ones.

[3] The Open Market Index has been constructed on the basis of 14 indicators in four different areas: openness to trade (4), trade policy (4), international capital flows (4), infrastructure for trade (2). Scores ranging from 1 to 6 were derived on the basis of statistics and expert opinion. For details sees. Open Markets Index 2011.(ICC 2011).

[4] The other two small countries, i.e. Cambodia and Laos do not enjoy that position, but they were held back by political reasons and joined ASEAN only late.

Union (EU) was regarded as an outright success. The Association of South East Asian Nations (ASEAN) and the North American Free Trade Area (NAFTA) also earned much praise. Closer to home is the Economic Cooperation Organization (ECO): Like Afghanistan, Pakistan is a member of ECO as well as of SAARC. As long as the Soviet Union existed, there was also the Council for Mutual Economic Assistance (COMECON), a kind of common market for the Soviet Bloc.

The EU, COMECON, ECO and ASEAN came up during and because, although not exclusively, of the Cold War. After World War II the United States came out as the only super power. In 1949, their hegemony was broken by the Soviet Union, when it successfully tested its first nuclear bomb. By that time, the Soviet Union had already established their reign in Eastern Europe, had tried to establish themselves in Iran and threatened to dominate Southeast Asia. In March 1947 the US President told US Congress: ‘It must be the policy of the United States to support free people who are resisting attempted subjugation by armed minorities or by outside pressures.’ (Truman Doctrine 2003: 194). The Truman Doctrine, as it became known, is commonly taken as the beginning of the Cold War. It was also the beginning of the battle of the systems, i.e. the western, capitalist, democratic one in the West *versus* the eastern, centrally planned socialist/communist one in the East. After the War, Germany had been divided into four zones under military administration of the four powers (USA, Soviet Union, United Kingdom, France). Fearing social unrest and political radicalization, the western powers decided to end economic discrimination in their three zones in Germany; in 1948 the German Mark was devalued and substituted by a new Deutsche Mark (DM), bound to the US-Dollar. In 1949 the Federal Republic was founded, albeit still under the control of the Western powers. In 1955, the Federal Republic became independent and in 1957 it signed the Treaty of Rome. The European Economic Community came to life in January 1958. The final aim was a customs union and the creation of a single, common market.

Trade Regulation and the Burden of History

A customs union in principle means unhindered trade among the member countries and a uniform system of trade protection at the outer borders. European governments had been interfering in their national markets on a large scale since the 19^{th} century (e.g. the British Corn Laws of 1815, repealed in 1846) and even more in reaction to World War I (1914-1918), the Great Depression (1930s) and World War II (1939-1945). Their various policies had to be ‘harmonized’. This especially applied to their agricultural policies. Peasants in all the six original member countries of the EEC enjoyed a wide variety of direct and indirect subsidies and other incentives in order to stimulate production and to support agricultural incomes. Not to forget that, all Europe suffered a shortage of food during and after the World Wars; food was rationed in some countries well into the 1950s. (Rationing 2013)[5] A considerable segment of the population worked in agriculture and lived in rural areas; their income support had been part of the policies to ease their income problems during the Great Depression. Since many of them were part time farmers, support came in the form of price as well as income support. In order to create a level playing field for trade in agricultural commodities and agro-based processed goods, such incentives had to be brought to a uniform level. Because of the considerable voting power of the 'green front', i.e. the rural/agricultural voters, especially in France, it was agreed to fix the common agricultural prices on the basis of the highest national, i.e. German, level of support for all European Community. For the next half century, agriculture absorbed more than half of all funds of the European Community, in the beginning even more. French farmers became the main beneficiaries of the Common Agricultural Policy, and German industry of the Common Market. This is just one example to show, how far reaching consequences can be, if a common market is to be created. It certainly is more than just having a uniform customs tariff.

When the Berlin Wall came down, the prospect of a united Germany was not welcome everywhere. The European Community by that time had been extended in a series of enlargements; the most important was the North Enlargement of 1972 that included the United Kingdom. Great Britain had been invited earlier, but declined to become a member, and as we know, there are still reservations in the United Kingdom against an EU membership. In order to prevent Germany from becoming too powerful and independent, it was tied in by creating the European Union and the Euro as a common currency (although Britain, Denmark, Sweden and some new members stayed outside the European Monetary Union). Most Germans would have preferred to retain their strong Mark, but there was no serious resistance to the introduction of the Euro. The Euro, therefore has been primarily a political, not an economic project.

The Military Past

There is a discussion whether the European Community was a civilian outcrop of NATO, a military alliance.

[5] Cheese and meats came off rations in Britain only in 1954. (Rationing 2013)

The North Atlantic Treaty Organization (NATO) was founded in 1949 with headquarter in Washington, D.C. It was moved to Paris in 1952 and to Brussels in 1967 after France had demanded the removal of NATO troops from the French soil in order to underline French sovereignty. The movement for a united Europe, however, was older than NATO. Indeed, there had been initiatives for a better French-German understanding already in the 1920s (Aristide Brian, Gustav Stresemann and others). However, given the fact that Germany came out of World War II as the pariah of Europe, it is hard to imagine that Germany would have been welcome as a full member of a European Community so soon after the war, without the East-West confrontation. Not to forget that the Communist parties in France and in Italy were quite strong and there were fears of a 'domino effect' in Europe as well in the late 1940s and early 1950.

There had been various attempts at setting up a European defence cooperation: The Brussels Treaty of 1948 was an agreement signed by Britain, France, Belgium, the Netherlands, and Luxembourg, creating a collective defence alliance. (EB-BT 2013). It led to the formation of NATO and the Western European Union (WEU). The European Defence Community (EDC) was 'an abortive attempt by western European powers, with United States' support, to counterbalance the overwhelming conventional military ascendancy of the Soviet Union in Europe by the formation of a supranational European army and, in the process, to subsume West German forces into a European force, avoiding the tendentious problem of West German rearmament. The idea was originally mooted at the Hague Conference of 1948.' (EB-EDC 2013). A treaty was concluded in Paris in 1952, but not sanctioned by the French parliament. 'For the first time the divergent interests, especially in French politics, became evident, who want to see Germany tied in supranational structures and at the same time not want to have cut down their own sovereignty.'[6] In its place arose the Western European Unity Treaty, setting up the Western European Union (1955-2011) of ten countries (including France, Germany and the United Kingdom). It 'operated as a forum for the coordination of matters of European security and defence.' (EB-WEU 2013).

The concept of 'containment' required a ring of regional alliances around the Eastern Bloc. NATO extended into Southwest Asia when Turkey joined NATO in 1952. In 1955 the Kingdom of Iraq, the Republic of Turkey, the United Kingdom, the Dominion of Pakistan, and the Kingdom of Iran entered into a military alliance that became known as the Baghdad Pact, renamed Central Treaty Organisation (CENTO) after Iraq pulled out of the pact in 1959. As KECHICHIAN observed, CENTO 'failed to

[6]. Own translation from the German original (EVG 2013).

meet the real security needs of its members. In September 1965, for example, Pakistan invoked the treaty in connection with its war with India. Persia and Turkey gave verbal support, whereas Britain and the United States opted for neutrality ... Because of such failures, CENTO turned its attention more to economic development and technical cooperation issues.' (KECHICHIAN 2011). In 1964, the Regional Cooperation for Development (RCD) had been founded by Turkey, Iran and Pakistan. There were ambitious plans (like a RCD highway), but not much to show. Once Iran had left CENTO and RCD after the Islamic Revolution of 1979, both organizations were dissolved in the same year.

RCD re-emerged as Economic Cooperation Organization (ECO), 'an intergovernmental regional organization established in 1985 by Iran, Pakistan and Turkey for the purpose of promoting economic, technical and cultural cooperation among the Member States.' (ECO 2013). After the break-up of the Soviet Union the newly independent former Soviet republics Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan along with Afghanistan sought the membership of ECO and were admitted into the organization in 1992. Contrary to RCD, ECO was not backed by any military alliance. What they have in common is their location in Central or West Asia and their religion, as they are all inhabited predominantly by Muslims. Politically and militarily they follow their own courses. When the author visited the modest headquarter in Teheran, it turned out that ECO provides a forum for regional talks, but there was no signature project that would not have been possible otherwise. There had been a trial run of a train from Almaty via Tashkent and Tehran to Istanbul in 2002. Due to different gauges and train lengths through trains turned out to be impossible; however, there is a weekly container service that requires trans-shipments at the border(s). (TSR 2013).

In South Asia, there always had been a gap in the ring of containment. Neither Afghanistan nor India or Myanmar were ready to join any of the western defence alliances. South Asia, or India as it was called then, had been united by the British and was partitioned when the colonial power went in 1947. Relations of the successor states, the Republic of India and the Islamic Republic of Pakistan, have been strained ever since. In 1971 the former eastern 'wing' East Pakistan gained independence as Bangladesh. This explains why the South Asian countries at times thought of joining any of the other regional associations in southern Asia like RCD and ECO in the west and ASEAN in the east.

Since progress in Indo-Pakistan relations was not to be expected, BIMSTEC was founded in 1997, basically a SAARC minus Pakistan and plus Myanmar and Thailand: 'BIMSTEC originally stood for Bangladesh, India, Sri Lanka and Thailand Technical and Economic Cooperation. After

Myanmar joined the group later in 1997, and Bhutan and Nepal in 2004, the name was changed to the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation.' (Bhaskar 2006).

Other than South Asia that was ruled by just one colonial power, Southeast Asia comprised British, French and Dutch colonies and independent Siam (now: Thailand). When the Japanese conquered Southeast Asia, they were first welcome as liberators in most countries. It soon turned out that the new masters were not better than the old ones. The former colonial powers made all kinds of promises to the people of Southeast Asia in order to get their support to drive out the Japanese. When the colonial powers tried to take repossession of their lost colonies after the War, they were met by independent movements, some of them left leaning, with insurgencies especially in Vietnam, Laos, Burma and Malaya. The USA came to the aid of the French in Indochina and led a brutal undeclared war in Laos and Cambodia. After the 'loss' of China in 1949 and the defeat of the French at Dien Bien Phu in 1954, President Eisenhower had expressed his concerns that countries might fall following the 'domino principle'. (EISENHOWER 1954). By 1958, when Lederer and Burdick's 'The Ugly American' was published, it was clear, that the US had failed to read Southeast Asian minds. Over the next one-and-a-half decade the Vietnam war developed, with Thailand and Singapore becoming the rear bases for logistics and recreation. In the 1960s, Malaysia had become independent, only to cede Singapore in 1962 as an independent state. In 1965 a military coup d'etat brought down Sukarno in Indonesia, ending his nationalist claim on all Malay territories (i.e. Malaysia and Singapore) that would have made an earlier regional cooperation impossible.

The Southeast Asian Treaty Organisation (SEATO) was founded in September 1954 in Manila (hence: Manila Pact) after the Geneva Indochina Conference earlier that year, where the retreat of France from Indochina and the partition of Vietnam were agreed on. US Vice President Richard Nixon had advocated an Asian equivalent of NATO upon returning from his late-1953 Asia trip. Different from NATO, SEATO had no joint commands with standing forces. Founding members were the USA, the United Kingdom, France, Australia, New Zealand, the Philippines, Thailand and Pakistan. Vietnam, Cambodia and Laos could not become members because of the Geneva Accord, but came under the protection of SEATO. Burma was suffering from communist insurgencies, while the Kuomintang, remnants of the Chinese nationalist army, was fighting along the Chinese border. Burma, thus decided for a course of non-alignment and did not join SEATO. The Federation of Malaya, Singapore, Sarawak, Brunei and North Borneo were under British rule; Indonesia pursued its policy of non-alignment. In April 1955 representatives of 25 independent African and

Asian states met in Bandung, including, however, a number of states like Pakistan that already had aligned themselves, indeed. SEATO failed in becoming a Southeast Asian NATO (Sim 2011): The alliance had out-of-region members like the USA, UK, France, Australia, New Zealand and Pakistan, and only two Southeast Asian members (Philippines and Thailand). Malaysia, Singapore and Brunei did not join after independence. Suggestions to include the Republic of China (Taiwan) and the Republic of (South) Korea were not taken up. (TAH 1969). SEATO members supported the USA in the Vietnam war, but the alliance hardly lived up to US expectations. After the USA pulled out of Vietnam in 1973, SEATO became superfluous and was dissolved in 1977.

In 1967, i.e. in the crucial phase of the Vietnam War, the Association of South East Asian Nations, ASEAN was founded by Indonesia, Malaysia, the Philippines, Singapore and Thailand. Brunei (1984), Vietnam (1995), Myanmar, Laos (both 1997) and Cambodia (1999) joined later. Papua New Guinea and Timor Leste have an observer status. The aims and purposes of ASEAN are laid down in the Bangkok Declaration of 1967: (BD 1969).

1. To accelerate the economic growth, social progress and cultural development in the region ...
2. To promote regional peace and stability through abiding respect for justice and the rule of law ...
3. To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields;
4. To provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres;
5. To collaborate more effectively for the greater utilization of their agriculture and industries, the expansion of their trade, including the study of the problems of international commodity trade, the improvement of their transportation and communications facilities and the raising of the living standards of their peoples;
6. To promote South-East Asian studies;
7. To maintain close and beneficial cooperation with existing international and regional organizations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves.'

Although the original members clearly followed an anti-communist course, the agenda is mainly restricted to the economy. The Treaty of Amity and Cooperation in Southeast Asia of 1976 created the opportunity for outside countries to join ASEAN. China and India were the first ones (2003) to sign the treaty, followed by Japan and Pakistan (2004), Bangladesh and Sri Lanka (2007). The USA signed in 2009, France in 2006 and the EU in 2012 after the treaty was amended to allow for the accession of non-states. (EU-TACS 2012). Trade among members is more in ASEAN than in SAARC, but by far not as intensive as in the EU. At a closer look one can see that much of intra-ASEAN trade is actually transit trade through Singapore, which has developed into Southeast Asia's transport hub.

WTO and After

The Uruguay Round, named because it had been started in Punta del Este in Uruguay, lasted for over a decade and ended with the creation of the World Trade Organization (WTO) in January 1995. A similar organization, the International Trade Organization (ITO), had been planned already in the 1940s as a third pillar of the new world economic order, besides the International Monetary Fund (IMF) and the World Bank. The plan failed, because the United States was not ready to join it. What was established instead was the General Agreement on Tariffs and Trade (GATT) with two marked omissions, i.e. agriculture and textiles. The WTO was to include them, albeit with generous exceptions for ten years. The USA, which once had resisted the ITO, was instrumental in bringing about the WTO. The idea behind it was that the reduction, if not abolishing of trade restrictions, would be a win-win game for all participants, as already explained. The communist regimes of the Soviet Bloc were gone. The Asian tigers, old and new, had shown how beneficial trade could be as a growth engine. Resistance came especially from developing countries. What was the reason? The United States insisted to vote over WTO as a package, comprising not only merchandise goods, but also services (GATS), intellectual property rights (TRIPS) and investment (TRIM). The developing countries wanted an opening of the labour markets, an old demand that Nobel prize winner W. Arthur LEWIS (1954) already had raised in the early days of development economics.

The agenda was controversial under the terms of liberalization and globalization. India was sitting — so to say — on both sides of the fence: It wanted to save its agricultural markets from international competition, did not want to open its financial sector or admit large scale foreign investment and strongly resisted most of the new intellectual property rights, especially the patenting of living organisms. On the other hand, the export boom in IT-based services had started; India was on its way to become a world market leader in the production and export of pharmaceutical products, especially for the treatment of children's and communicable diseases and generic drugs.

India and Pakistan became founder members of the WTO. International trade almost exploded. India already had started opening her borders in 1991; Bangladesh became the biggest surprise and developed into the second biggest readymade textiles exporter, overtaking Pakistan in export earnings and home remittances.

After the industrial countries managed to get more concessions out of the developing countries in the so called Singapore Round, the developing countries demanded some compensation. That has not come. The Doha Round started in 2001 with great expectations, but has been getting nowhere so far.

What could be the reason? By the time WTO finally had been agreed on, the USA had lost interest in global arrangements, and started new rounds of regional and bilateral trade negotiations, creating a 'spaghetti bowl' of overlapping agreements. The USA always had close relations with its northern neighbour Canada; the North American Free Trade Agreement (NAFTA) also included Mexico. It is strictly a trade agreement. What has become one of the greatest achievements of the EU, i.e. the freedom to move within the Union and to settle everywhere, is out of the question for NAFTA. It is not much better in the case of trade in services: Mexican truckers have only a very limited access to the US market.

The Russian Federation had established a Commonwealth of Independent States (CIS) that allows close collaboration of the former Soviet republics with the exception of the Baltic states (Estonia, Latvia and Lithuania). China started the Shanghai Cooperation Organization (SHO) in 1998 together with four of the former Soviet republics (Kazakhstan, Kyrgyzstan, Tajikistan) and Russia; Uzbekistan joined in 2001. India, Pakistan, Afghanistan and Iran have observer status; ASEAN is a dialogue partner.

On the initiative of Australia, Japan and the United States the Asia Pacific Economic Cooperation (APEC) had been started in 1989. It is more of a discussion forum.

Conclusion

The paper started with the question, whether regional economic cooperation would yield less tension as well as social uplift. Seeing the quick recovery after the War and the high quality of life in Western Europe (despite the recent setback in southern Europe), we have reason to claim that the creation of a common market has been instrumental in Europe's recovery and development.

The second question was, whether economic development leads to more regional cooperation. This question is less easy to answer. Rich and poor countries have benefited from opening their borders, but there can be winners and losers in each country, as the example of the onion price has shown. The recent problems in Europe are less one of economic cooperation in the EU, but one of sharing a currency in the (smaller) Euro area, as a common currency means that an individual country no longer can raise its international competitiveness by devaluing its currency. Rich countries fear, as the case of Mexican immigrants in the USA shows, that they would be flooded by foreigners who would take away their jobs, undercut their wages and unduly claim social benefits.

The third question was, whether regional co-operations thrive best if backed by a strategic alliance. This obviously has been the case for the European Community/Union and for ASEAN. RCD was much less successful, reflecting the fact that Baghdad Pact and CENTO were of little military use. In any case it would be difficult, if not impossible, to single out just one factor and to establish simple causalities. Most probably it is a problem of co-linearity, i.e. underlying common causes: In Europe it was the political will of the people and governments of the member states not to repeat the mistake of revenge and retribution committed after World War I, but to come together and embark on a policy of cooperation. This policy was greatly helped, if not forced upon Western Europe, by the fear of socialism and Soviet expansionism, but also by American money in the form of Marshall Plan assistance. The approach failed in Southwest Asia, where RCD countries neither had the common traumatic experience of the World War II, only partly had the fear of being run over by the Soviets, and US assistance did not reach Marshal Plan proportions. Furthermore, Europe had to be rebuilt, whereas developing economies had to be built up from the ground. The ASEAN experience has been different to the extent that all countries (more or less) had their experience of socialist aggression; the original members more or less benefited, however indirectly, from the Vietnam war: All countries received substantial US assistance, rest and recreation for US troops were the beginning of Thailand's tourism industry: Singapore became the regional hub.

The conclusion for South Asia would be, that each and every regional cooperation has to cope with its own prospects and limitations, not only political, but also economical. Especially in South Asia, where governments have a tradition of state enterprises, market and price intervention and detailed restrictions of commerce, economic cooperation requires to look especially into the many non-tariff restrictions. Studying the process of integration of other regional cooperations, especially the EU, ASEAN and NAFTA, would be worthwhile.

The EU certainly could be helpful.[7] Already in the early 1980s when the idea of a South Asian Cooperation gained momentum, the author had discussed it at the Marga Institute in Colombo. It was only after the outbreak of the civil war in Sri Lanka that it was decided to set up SAARC headquarters in Kathmandu. Already then there was considerable interest in Europe in the concept of South Asian Cooperation on the lines of the European Community.

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[7]. See for example the report of the Export Group on Euro-Asian Transport Linkages (UNECE 2012) that refers to Afghanistan, Pakistan and India, but not to SAARC.

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Chapter 13

Implementing SAFTA and Role of Competitiveness

Dr. Salman Shah

Introduction

It is indeed a great privilege for me to have been given the opportunity to participate in this conference. I must compliment Ambassador Amin, IPRI and the Hanns Seidel Foundation for organizing discussion on such an important and contemporary topic which has very far reaching consequences for Pakistan. The questions raised are critical for policy makers in Pakistan to chart a clear course for Pakistan. Failure to be part of the Asian century will condemn us to the dust bin of history.

First of all we must understand that the 2011 report on Asian century projects average per capita in Asia to cross USD 42000 by 2050. But within the average there are winners and losers and not all Asian countries will achieve the average, in fact the report projects that Pakistan will cross US$ 7900 and India will cross $42000 by 2050. This asymmetric performance by the two neighbours is based on existing trends and the current state of domestic management of the economy in each country. The projected result will be highly destabilizing for South Asia and India-Pakistan relationship. It is in the interest of the region that all countries of South Asia put their own respective house in order and to be winners in the Asian Century. How this can be done is also part of the recommendations of the report on realizing the "New Asian Century". It has at least nine takeaways for us:

1. The ability of countries to realize the promise of the Asian Century will depend on success in three dimensions: national, regional, and global
2. Countries must push for access and opportunity for all citizens, employment generation and provision of protection to the vulnerable.
3. Growth will require harnessing of the full potential of technology, innovation and entrepreneurship.
4. Cities will be the centres of higher education, innovation, and technological development. The quality and efficiency of urban

areas would determine competitiveness and social and political stability.

5. Financial sector will need to become more open to institutional innovation, and support inclusive finance.
6. Radical energy efficiency and switching from fossil fuels to renewable energy will ensure future competitiveness.
7. Building more compact and eco-friendly cities; relying on mass transit for urban dwellers and railways for long-distance transport.
8. Eradicating corruption is critical for social and political stability and legitimacy. This will require effective governance, both at central and local levels with institutions that are transparent, accountable and predictable.
9. A market-driven and pragmatic approach supported by an evolving institutional framework that facilitates free domestic and regional trade , investment flows and some labour mobility throughout Asia.

The report clearly spells out that overall national success would depend on the adaptability, flexibility and capacity to respond to the changing global and domestic economic events; this will need far-sighted and enlightened leadership, willing and able to adopt a pragmatic rather than ideological approach to policy formulation and to keep focused on results. Building greater regional cooperation will be essential. Modernizing governance and retooling institutions, while enhancing transparency and accountability is a pre-requisite. In all the above factors Pakistan can definitely achieve success. It is blessed with unlimited potential of a young hard working population, dynamic entrepreneurs, unlimited renewable hydel power potential, natural resources to produce food and commodities, rapid urbanization, strategic geographic location, vibrant media and a free judiciary.

While we are concentrating on the theme of the conference that addresses many issues that are highly pertinent for Pakistan and our regional cooperation, we must remember that apart from fostering regional cooperation, each country has to reform its own domestic economy to achieve success. Furthermore regional economic cooperation can only be fully exploited if each economy in SAARC ensures adoption of the housekeeping principles embodied in the ADB report and is able to compete in the region on an equal footing.

Over the last day and a half we have been discussing many possibilities

- Will Asian century also encompass South Asia, central Asia and the Pacific islands?
- Is SAARC the way forward for South Asia?
- Can it be successful as EU and ASEAN?
- How hurdles can be removed to make SAARC a success?

The papers cover diverse and relevant topics such as Regional trade, Regional Investment, Regional energy Trade, Regional Transport and communication infrastructure, Regional energy corridors from West, Central Asia to south Asia, the New silk road initiative, China's cooperation with south Asia, SAARC as engine of economic cooperation. The topics also cover economic cooperation and political constraints, bilateral and sub-regional arrangements vs SAARC, SAFTA bottlenecks, EU perspective on SAARC and what can be learnt from the EU experience, hurdles in implementing SAFTA and JVs, replacing conflict with peace, dispute resolution mechanisms between India and Pakistan. This will generate a treasure trove of research and guidelines for moving forward on south Asian cooperation.

While we are focused on South Asian cooperation in general, there is no doubt that the future of this cooperation is particularly impacted by the overwhelming footprint of Pakistan-India relationship on the region. The India-Pakistan relationship particularly in the economic cooperation domain is like the sub-continental game of Snakes and Ladders. Every time we feel that we are making progress and take a few steps to overcome the hurdles, we go back to the starting point as some political event or incident overtakes the negotiations. It seems that the political leadership buckles under local expediency to sacrifice the gains made. The negotiations are a hostage to extremist elements on both sides but currently more so in India than in Pakistan. While in Pakistan there is general consensus among the political parties of the need to achieve a breakthrough on trade issues with India and the current political leadership in Pakistan can claim to be champions for trade and peace with India, it seems there are no such champions for promoting the relationship with Pakistan in India.

The progress in this regard has to wait for the Indian elections to take place before meaningful dialogue can be restarted. Apart from the lack of political will to pursue the agenda at this point in time, there is still a strong underlying sentiment in each country that views regional trade promotion not as a win-win situation, but views it in a relative gain perspective. Thus each country feels satisfied if it runs a trade surplus in its bilateral trade but feels cheated if it runs a big deficit in its trade balance. The bigger the deficit the weaker is the political position of the proponents of free trade.

Thus progress in implementing SAFTA and liberalized trade falls victim to the fear factor prevalent in each country that freer trade will strengthen the opposing country and swamp their own domestic production. Thus each country devises ways to protect their domestic markets while pursuing freer trade. Thus whereas the implementation mechanisms of the SAFTA agreement are well drafted and powerful implementing committees are in place, enhancing trade to its full potential in SAFTA is severely limited due to a protective mindset that promotes restrictive sensitive lists, safeguard measures, anti-trade non-tariff barriers, domestic production subsidies etc. All these efforts affect even playing field in the SAARC region. These measures that are thriving because the leadership is not willing to risk political capital on taking a stand against forces opposed to opening up of free cross border trade. More and more this fear is also spreading amongst players in various segments of the economy that they may not be able to compete in a freer regional market place.

So far in the discourse we have not examined the capacity of each country to compete with each other in an open market environment. As some speakers mentioned in their presentations Pakistan has free trade agreements with a number of countries including China. We have outstanding political and strategic relationship with China yet we have not been able to have a breakthrough in exports to China in spite of efforts by leadership of China to push greater imports from Pakistan. Thus we need to examine our own state of competitiveness to see that even if we get an even playing field with India, will we be able to compete from a position of strength.

In the last few months I have been following Pakistan's performance in various global economic performance indices and the results have been quite disappointing. Last week we slipped in Ease of Doing Business rankings of the World Bank from 107 position to 113; earlier in the world economic forum competitiveness index we dropped to 134 rank amongst 148 countries. Again, in the latest human development index our ranking is slipping and we are ranked at the bottom of the league. In the prosperity index we again have a dismal position. This underperformance in international standing shows a malaise which reflects grave governance and capacity issues facing the country. This state of affairs will be highly detrimental to the ability of Pakistan to participate in a fully liberalized free trade environment envisioned in SAFTA.

The Global competitive Index (GCI) directly deals with perceptions of competitiveness of various countries in the global context. While in the 2013-14 rankings Pakistan is ranked 133rd, India is ranked 60th and China

30th. The current trade deficits Pakistan has with these countries clearly reflect the respective competitiveness ratings. The GCI comprises 12 pillars of competitiveness and each pillar has many subcomponents for which relative rankings are published. The pillars are:

- Pillar 1. Institutions
- Pillar 2. Infrastructure
- Pillar 3. Macroeconomic environment
- Pillar 4. Health and primary education
- Pillar 5. Higher education and training
- Pillar 6. Goods market efficiency
- Pillar 7. Labour market efficiency
- Pillar 8. Financial market development
- Pillar 9. Technological readiness
- Pillar 10. Market size
- Pillar 11. Business sophistication
- Pillar 12. Innovation

The first pillar deals with Institutions. This includes both government and private institutions. Pakistan ranks 123 and India is ranked 72. The pillar includes efficacy of government spending, corporate performance and law and order issues relating to crime and terrorism.

The second pillar deals with infrastructure. This includes physical, energy, communication as well information and computer technology. Pakistan ranks 121 and India stands at 85. Inadequate infrastructure adds significantly to the cost of doing business.

The third pillar relates to macroeconomic performance. Pakistan ranks 145 while India ranks 110th. The pillar encompasses budget balance and national savings rates.

The fourth pillar relates to health and primary education. Pakistan ranks 128 while India ranks 102nd. Clearly human development is substandard in both countries.

The fifth Pillar related to higher education and training. Pakistan ranks 129 while India is at 91. This pillar is critical for success in achieving successful business capability and wealth creation.

The sixth Pillar relates to goods market efficiency. Pakistan ranks 103 and India scores 85. The rankings indicate level of competition and vibrancy of domestic markets which is critical for domestic businesses to compete in regional markets.

The seventh pillar relates to labour market efficiency. Pakistan ranks 138th and India 99th. The index comprises labour relations, labour productivity and female participation in the labour market. For example Pakistani women participation is 144 out of 148 countries.

The eighth pillar relates to financial market development. Pakistan ranks 67th while India ranks 19th. Financial sector development is a key element in a nation's competitiveness.

The ninth pillar is technological readiness. Pakistan ranks 118th and India 98th. The rankings suggests that both countries are dependant on imported technologies.

The tenth pillar relates to size of domestic market. Pakistan is 30th while India ranks 3rd.

The eleventh pillar is business sophistication. Pakistan ranks 85 while India is at 42. If the private sector is driver of regional trade then India is in a very strong position.

The 12th pillar is innovation. Pakistan ranks 77th and India ranks 41st.

The GCI is a clear indicator of Pakistan's relative competitiveness disadvantage compared to India. It is surprising that in spite of Indian superiority in the competitiveness arena it is a leader in creating non-tariff barriers to keep out imports and protect its domestic producers. Maybe this is a blessing in disguise as while freer trade is delayed we can use the time to put our own house in order. Seven years ago our rankings were comparable to India's and we were negotiating with India with confidence that we will be able to compete. Now the situation is hugely different. It is in the interest of all countries of the region that we ensure compatibility in competitiveness among member countries.

A clear joint venture that needs to be initiated in the SAARC region is to establish a competitiveness research Hub that evaluates the relative competitiveness of SAARC countries and how they will fare in a free trade environment. We should encourage member states to develop complementarities in their economies so that we can move forward in a relatively balanced manner. This is important because we need to alter perceptions of fear, dominance and one sided benefits. The establishment of a SAARC University could be a follow up activity.

Secondly we need to promote travel and tourism within the SAARC region to build confidence amongst the people of the region for greater economic cooperation. If tourism can take off, trade, investment and economic cooperation can follow. A Joint Tourism Infrastructure could develop quickly if the Governments can create the right environment for facilitating travel for tourism purposes.

In the meantime we need to establish a joint Infrastructure fund to facilitate connectivity in the region, At some point in the future we can establish joint investment company that facilitates cross border investments.

This could lead to establishment of a SAARC Bank to facilitate trade and investment. Finally, we have to be patient. Ultimately, SAARC cooperation will be a reality.■

Chapter 14

Replacing Conflict with Peace in South Asia

Ambassador (R) Nihal Rodrigo

This Conference, organized by the Islamabad Policy Research Institute, provides an important opportunity to discuss productive regional trade, investment, energy-sharing, stable infrastructure and other aspects of economic connectivity within South Asia, and beyond as well, in the emerging "Asian Century". Conclusions and recommendations of the Conference need to reach Governments of the South Asian Association for Regional Cooperation (SAARC) for their serious consideration and reactions.

Sri Lanka has replaced a violent conflict with productive peace in the island, ending decades during which its people have had to suffer the separatist mono-ethnic terrorism of the so-called "Liberation Tigers of Tamil Eelam" (LTTE). The terrorist organization has on its record, the assassination of a Sri Lanka President, an Indian Prime Minister, a Sri Lanka Foreign Minister (himself a brilliant member of the Tamil community the security of which the LTTE claimed to be protecting), as well as tens of thousands of civilians including other politicians. Many issues do however remain to be settled in Sri Lanka at the human and developmental levels to sustain continued peace. Human rights groups however continue to place undue emphasis on the "final stages" of the conflict with the LTTE, but remain soft and even silent on Government attention paid to humanitarian aspects such as providing civilians essential food and medical care in areas then under LTTE control.

Nevertheless, the Joint Statement issued by the Secretary General of the United Nations and the Government of Sri Lanka, at the end of May 2009 following his visit to the country and tours to the conflict areas, provided a relatively balanced first hand assessment of the situation (1). The Statement indicated inter alia, that Sri Lanka had "entered a new Post Conflict beginning" in which the Government and people would be dealing with "the immediate and long term challenges relating to the issues of relief, rehabilitation, resettlement and reconciliation". The economic aspects of rehabilitation have been heightened and India, as Sri Lanka's closest neighbour, has also been engaged in contributing to the process. The present Indian High Commissioner in Colombo, Y.K. Sinha has indicated that over 13,000 housing units in the former conflict areas would be completed with Indian assistance by the end of 2013 (2). The UN Security Council also issued a consensual press statement through its Chairman which acknowledged "the legitimate right of the Government of Sri Lanka" to combat terrorism. The statement demanded in the concluding stages of the conflict (for which period, Sri Lanka is still being blamed by various groups and TV channels wanting viewers), that it was the LTTE that needed to "lay down its arms and allow tens of thousands of civilians mostly innocent Tamils (as their human shields) in the conflict zone to leave". The LTTE forced tens of thousands of civilians, including women and children into the conflict zones to serve as its human shields (3).

Domestic Issues Affecting South Asian Bilateral Cooperation in the Emerging Asian Century

The Summit Conference of the Commonwealth took place in Sri Lanka from the 15th to 17th of November, adopting a consensual Declaration(4). Preparatory encounters involving the youth, civil society and the corporate sector contributed to its substance. Five of the countries among the eight members of SAARC (India, Pakistan, Bangladesh, Maldives and Sri Lanka) are members of the Commonwealth. India, Sri Lanka's closest neighbour, has been a major factor in assisting the process of economic re-development in the conflict-affected areas. However, the Indian Prime Minister Manmohan Singh regretted his inability to lead the Indian delegation to the Commonwealth Summit Conference. Indian External Affairs Minister, Salman Khurshid headed the delegation. The Prime Minister's non-participation is due entirely to certain internal ethno-centric conflicts within India's own complex domestic political framework. These factors are being widely projected as having an influence on India's own democratic national elections which are scheduled to be held early next year. Election campaigning processes are continuing in India. The votes of Tamil Nadu state are being considered as essential for the Congress Party to return to power in the national elections.

Sri Lanka's Northern Province, a majority Tamil area, in which conflict has now been replaced with peace has successfully concluded elections to its Provincial Council in September this year. The Tamil National Alliance (TNA) has succeeded in winning 30 of the Council's 38 seats. On the other hand, the party which was supported by Sri Lanka's Central Government, the Eelam Peoples Democratic Party (EPDF), has however secured only a mere seven seats. The TNA is led by an eminent, highly respected former Supreme Court Judge, a member of the Tamil community, C.V. Wigneswaran who secured 68 per cent of the votes. It proved clearly that the process under which the elections were held had been certainly fair, and free of any tinkering by the Government or its security forces. An editorial in India's independent newspaper, *The Hindu*, on September 24th 2013

correctly reported that "Sri Lanka has crossed an important milestone towards national reconciliation with the holding of the elections…which gives the war-ravaged North its first-ever democratic political set up that will share governance with the centre. The huge turn out conveyed its own message about the elections for the voters. The dire predictions of some human rights groups that the Sri Lanka Army would use its overwhelming presence in the Province to influence the outcome of the elections proved incorrect". An important conclusion in the editorial is that that the TNA, "steering clear of the extreme nationalist pronouncements by Tamil diaspora organizations, has made a good start by stating that the victory does represent the wish of the people for adequate self-rule within a united and undivided Sri Lanka". Chief Minister Wigneswaran had rejected sectarian calls emanating from Tamil Nadu and the Tamil diaspora elsewhere that the Indian Prime Minister boycott the CHOGM Summit in Colombo as a form of protest. The Indian Prime Minister was invited by the Chief Minister to pay a visit to the Northern Province so that he could personally observe for himself that peace has, indeed, replaced conflict. On earlier occasions, when Indian actions against Sri Lanka at the United Nations human rights forums in Geneva were continuing, in order to appease Tamil sectarian interests in India, including those by its diaspora, the process was apologetically and frankly described by India as unavoidable due to its own "coalition compulsions" in electoral processes.

Virtually all the SAARC countries are now committed to democratic forms of Government and election processes. None of the SAARC countries are monolithic in their ethnic, religious or social composition. This has its impact, internally on governance, on bilateral relations, on conflicts with neighbours, as well as in respect of relations with other member states of SAARC. Indeed, when the last SAARC Summit took place in Addu Atoll in the Republic of Maldives in November 2011, a Maldivian media handout on the myriad social and other aspects of the South Asian region was projected as reaching "across one hundred languages, across ten major religions, across one-fifth of the world population, across the lowest lying islands to the highest mountains". The last two references were respectively to Addu Atoll in the Southern Hemisphere and Mount Everest in Nepal in the Himalayas.

Election processes, within the individual South Asian countries, are adversely affected by such myriad factors. Equally, they have a tendency to creep into bilateral relations and indeed adversely impact on South Asian regional cooperation as well. If and when they degenerate into disputes, conflicts or violence, either within individual states, or between/among neighbouring SAARC states, economic cooperation would be hampered in the region. This is despite its major potential and its rising expectations to contribute to, and benefit by, the emerging Asian Century.

In Maldives, results of a Presidential election that had been held, were twice declared to be invalid, on varied reasons, based on the grounds that none of the three candidates had secured over 50 per cent of the vote. Mohamed Nasheed, the former President, who assumed power in a democratic election in 2008 had been allegedly removed from power in circumstances that his supporters claimed amounted to a coup. The three presidential candidates, in the larger national interest did meet together in Male attempting to reach a mutually acceptable solution to the matter. Eventually, following much controversy, Abdullah Yameen was inaugurated as the 6th President of the Maldives

Nepal is the host of the next, already over-due, SAARC Summit. It is being delayed due to internal difficulties. National elections in the country took place on November 19th. There had been some rising controversy about the deployment of the armed forces to ensure security considerations, inter alia due to the discovery of caches of some improvised bombs and some earlier violence committed against candidates that had been reported. By November 25th, tentative results announced indicated that the Nepali Congress Party had secured 105 of the total of 240 directly elected seats. The Communist Party of Nepal had won 91 seats with the United Communist Party (Maoist) trailing with 25 seats.

The next elections in Bangladesh are being scheduled to take place in January 2014. There are rising concerns, likely to erupt into protests, by the main opposition party, the Bangladesh Nationalist Party about the lack of an independent "non-Party" caretaker administration to impartially supervise the polls.

Within India, apart from the Tamilnadu-Sri Lanka factor, the deadly explosion that took place on 27th October this year in Patna at an election meeting being addressed by the opposition's Prime Ministerial candidate Narendra Modi also has had an impact on the forthcoming Indian national elections. The World Socialist Website has asserted that "Modi has made (his State) Gujarat a magnet for domestic and international investment" (6). He is reported to be therefore seeking to "appeal to mass anger over rising prices and poverty, declaring that poverty is the primary problem of Hindus and Muslims alike" particularly as his image has also been affected by reports of his being responsible for attacks against the Muslims.

Apart from these contemporary aspects of political conflict within South Asian states which are affecting national as well as regional economic cooperation and growth, bilateral complexities between states have also been addressed to some extent through diplomatic means. The SAARC Charter, when being drafted, came to include the stipulation that "bilateral and contentious issues" should not be included for discussion in the Association's formal agenda as they could cause conflicts and jeopardize consensual decisions and action. However, pragmatically, all SAARC Summits do, informally, provide space, time and opportunities for bilateral close encounters of the confidential kind which, of course need to take place outside the formal meetings of Conferences. Such informal confidential bilateral engagements have in the past, helped considerably in easing tensions and providing space for seeking pragmatic solutions to bilateral and contentious issues and for maintaining some regional economic impetus. In 1999, a SAARC Ministerial Meeting taking place in the salubrious Sri Lankan hill resort, called Nuwara Eliya, was expected to take a decision on a definite time frame for the next Summit scheduled for Nepal. The forest resort provided opportunities for a confidential Walk in the Woods by the Foreign Ministers of India and Pakistan. This private encounter certainly helped clear some sensitive aspects, as well as facilitate decisions for the convening of one of SAARC's earliest corporate meetings. In 2000, the South Asian Business Leaders' Summit in Karnataka, India took place, attended by Ministers as well. It also contributed to help clear the road to the 11th SAARC Summit. The corporate sector's practical approaches towards furthering mutual economic benefits among SAARC countries have been a major asset which their governments appreciate. To some extent, it has also helped tone down traditional (even historical) bilateral political complications in favour of the larger context of regional economic cooperation which brings better results for their respective people.

The genuine engagement of the people is a primary aspect of democracy which is essential to replace conflict with a peace that can endure. This needs to extend beyond the election processes, however regularly they may be held. In many economic processes, projects however beneficial they may be seen by governments, do need in the long term, the support of the affected people and their engagement. Conflicts with the public are often involved, setting back peace and obstructing development projects which may be ill-conceived. At the last SAARC Summit held in the Maldives in 2011, some Heads of State were alive to, and articulated on circumstances under which some development measures could be harmful to the public and even cause conflict. For example, Nepal's Prime Minister Bhaburam Bhattarai referred to "the increasing gap between rich and poor that had given way to enormous stress on social harmony…peace and security" in the region. His point was that socio-economic processes vitally needed to be "genuinely people-centred and justice-based" and not lead to conflict. Sri Lankan President Rajapaksa, noting that while conflict had indeed been replaced by peace in his own country, did warn however, that there was also "a mood of great urgency, even of impatience (as) a large part of our societies consist of young people, inspired by new ideas and looking forward to a promising future. Patience is not infinite"

As I had indicated at a South Asia-China Cooperation Conference in Kunming in June this year, democratic governance clearly needs to protect and preserve rural communities from the dangers of excessive greedy corporate exploitation that could lead to damage and destruction of dwindling forest reserves and pollution of water resources which sustain rural communities. These resources are, in effect, part of a nation's vital natural environment. Replacing Conflict with Peace alone, without providing inclusive development, would not endure. Mass demonstrations by the people have taken place throughout SAARC countries, including, for example, India where thousands have agitated for early, conclusive action against gender, social and caste discrimination. Professor Ratna Kapur has described the cruel gang rape and killing of a female student on December 12th last year as "the crisis of Indian masculinity" which "occurring with alarming regularity" compels the country "to reflect upon who we are as a society" (7)

The Indian Ocean Region

Apart from the political, economic, social and security factors interwoven within the complex internal fabric of individual SAARC countries which cross borders causing impediments to positive, people-centric regional cooperation, the prospects of peace and security in South Asia are also obviously affected by global developments which figure in the Asian Century.

These include, for example, perilous volatile developments and non-traditional security threats affecting peace in the Indian Ocean Region (IOR). Global developments and issues, including those in the Middle East Region, have muddled the prospects of peace considerably. The United States, the world's largest economy and military power, which had involved itself in the Middle East, is currently seeking to "pivot" to a focus on the Indo-Pacific which it considers essential for its own perceived security concerns, economic connectivity and national interests. This affects the South Asian region as well as South East Asia and East Asia. India, Pakistan, Bangladesh, Sri Lanka and Maldives are located in the Indian Ocean Region (IOR). In terms of economic, human, security and other connectivity, the Indian Ocean is one of the most widely traversed ocean in the world. The 13th Meeting of the Indian Ocean Rim Association for

Regional Cooperation (IORARC) which met in Australia's Indian Ocean city, Perth in early November this year, identified the following main characteristics of the Indian Ocean: It is the third largest of the world's oceans; the people living in the IOR account for almost 40 per cent of the total world population; Indian Ocean ports (including Pakistan's Gwadar, Sri Lanka's Colombo and Hambantota, and Bangladesh's Chittagong) handle over 30 per cent of global trade; around 60 percent of sea-borne oil trans-shipments cross the Ocean; and 40 per cent of the world's gas reserves are in the Indian Ocean region. It is a vital region that affects progress towards the Asian Century (8). In addition, the Indian Ocean also provides sinister under-world criminal connectivity for internationalized criminal cartels involved in people smuggling, drug trafficking, gun-running, credit card frauds and other cyber-crimes. Some elements within the rump residue of the LTTE which have been involved in these activities have also allied themselves with these globalised cartels, including even with Somali pirates who have posed major threats to fishermen from Maldives and Sri Lanka. Piracy, according to World Bank estimates, costs the global economy around $ 18 billion annually in increased trade costs.

16. The Booz-Hamilton-Allen security think tank in the United States (from within which Ed Snowden emerged and later chose to expose) anticipating China's rise, postulated that, across the Indian Ocean, "a string of pearls" (later more ominously even described as "a necklace of thorns") had been placed around India by China to cripple, if not strangle it. The so-called necklace consists of Indian Ocean naval points and ports in SAARC countries, specified by Booz-Hamilton-Allen as being centred in Pakistan (Gwadar), Sri Lanka (Hambantota), Bangladesh (Chittagong) as well as Sitwe (Myanmar) in South East Asia. All these ports are certainly being developed with considerable economic and technical assistance from China. Such engagement, Booz-Hamilton-Allen implied, has been to primarily serve the selfish strategic security interests of China in the Indian Ocean region which the think-tank concluded was endangering Indian as well as US interests in the Indo-Pacific region as the Asian Century was dawning. Shyam Saran, a former Special Envoy of the Indian Prime Minister has assessed some time ago that around 70 per cent of shipping to and from Indian ports is being handled by the port of Colombo. He has indicated also that a great deal of Indian break-bulk also needs to be handled through Colombo. Hambantota is being developed to take pressure off Colombo and provide commercial connectivity and not to strangle India.

In fact, in 2008, Indian Prime Minister Manmohan Singh and China's (then) Prime Minister Wen Jia Bao, signed a historic document entitled "A Shared Vision for the 21st Century" (9). The two countries agreed to assume what was described as "a significant historical responsibility" to promote "comprehensive, balanced and sustainable development in Asia and the world as a whole". The document also clearly rejected "drawing lines on the basis of ideology and values or on geographical criteria as not conducive to peaceful and harmonious development". There is no cold war type of animosity between India and China though described as, respectively, the world's largest democracy and the world's largest Communist country.

China has certainly played a major role in building naval linkages to provide it easier connectivity across the Indian Ocean which benefits South Asian and other countries as well. This is not a recent phenomenon. The Chinese navigator Zhen He had sailed in naval fleets across the Indian Ocean as early as the 15th Century. In fact his fleet of ships had even reached the eastern shores of the present United States before Christopher Columbus was said to have "discovered" America (10). Zhen He's ships have landed in India, Sri Lanka and other Asian countries for economic reasons. A stone inscription of the period in Arabic and Chinese discovered near the Southern harbour of Galle has been dated, by archaeologists, as having been erected in 1411. It praises Sri Lanka for its faith and belief in the pacifist philosophy of Buddhism (10A).

Strategic Maritime Cooperation in South Asia and Beyond in the Asian Century

Sri Lanka has launched a wide-ranging global consultative process described as the Galle Dialogue which has already held four annual sessions to build greater synergies and cooperation in the Indian Ocean and beyond. Sri Lanka's Secretary of Defence, Gotabaya Rajapaksa has emphasized the need for regional cooperation to face the island's common challenges by harmonizing its naval resources and capabilities (10 B). The 2012 Galle Dialogue was held under the theme "Strategic Maritime Cooperation & Partnerships to Face the Future with Confidence". This year's session in November, engaged a wide range of defence analysts and naval experts from all regions : Australia, Bangladesh, Benin, Canada, China, France, Germany, Ghana, Greece, India, Indonesia, Iran, Israel, Japan, Malaysia, Maldives, Netherlands, Nigeria, Pakistan, Qatar, South Korea, Russia, Seychelles, Senegal, Singapore, South Africa, Switzerland, Thailand, Togo, Turkey, UK, US, Viet Nam and Zambia. Defence Secretary Gotabaya Rajapaksa, stated that "throughout history, the Indian Ocean has been a major conduit of international exploration, migration and commerce". He indicated clearly that, in the current age, "the overall security and stability of the entire Indian Ocean region is critical for the global economy (and that) fostering greater cooperation and partnership amongst the naval powers active in the region is necessary to support the future prosperity of the Indian Ocean region". Most significantly, dismissing the Booz-Hamilton-Allen theory, he asserted the strength of Sri Lanka's relations with both India and China and described China's support for building Hambantota as "commercial in nature and not to be misconstrued as fitting the 'string of pearls' paradigm". In fact, Hambantota is one aspect of Sri Lanka's "Five Hub Growth Strategy" which aims to position and build the island as a global Naval, Aviation, Commercial, Energy and Knowledge Centre.

The Asian Development Bank on "Realizing the Asian Century"

Apart from some variations in national responses, as a region, all countries of South Asia, under SAARC, agree on the need to cooperate in economic and other activities to promote and facilitate the emergence of the Asian Century rather than being excessively inward-looking and domestic-oriented.

In August last year, the Asian Development Bank (ADB) presented its Report "Asia 2050: Realizing the Asian Century" at the Emerging Markets Forum in Tokyo (11). In introducing the report, the ADB President indicated clearly that the Asian Century could not be that of Asia alone but be the century "of shared global prosperity". The Report covered national, regional and global aspects. It postulated that if Asian countries continued on "its recent trajectory, by 2050 its per capita income could rise six-fold in purchasing power parity (PPP) to reach Europe's levels (of) today". Caution was part of the Report's thrust when it indicated that Asia's rise is "by no means pre-ordained". To summarise: it stressed the following "multiple risks and challenges" that needed to be dealt with: the inequality within countries that could undermine social cohesion and stability; intense competition for finite natural resources as the newly affluent Asians aspire to higher living standards; income disparities across countries that could destabilize them; global warming and climate changes; poor governance; and weak institutional capacity being faced by virtually all countries.

The ADB Report in summary states that building Asia's regionalism will require "collective leadership that recognizes a balance of power" among "Asia's major economic powers" identified as the Peoples Republic of China, India, Indonesia, Japan, the Republic of Korea and Singapore. China has territorial issues to contend with in its bilateral relations with India, Japan, Philippines and others in ASEAN which could complicate the Asian Century. Ren Xiao of Fudan University's Centre for the Study of Chinese Foreign Policy has stated that "as China grows, its maritime power also grows. China's neighbouring countries should be prepared and become accustomed to this."

The Economic Surge of China and South Asia

The economic surge of China, despite some debilitating aspects being addressed, is advancing as a major aspect of the Asian Century. Rigid Communist economic policies have long given way to pragmatic changes in China. Its outward reach in development policies has no ideological constraints on cooperating with the United States and other countries which China had once dismissed, in the past, as hostile to Communism. Some far-sighted foreign policy aspects of China which are being more pragmatically advanced were clearly evident in the extensive engagements that have already been further advanced since China's President Xi Jinpin formally assumed leadership this year. All SAARC countries have economic policies which engage China in different ways. China is an Observer in SAARC as are also Australia, Iran, Japan, the Republic of Korea, Mauritius, Myanmar, the United States of America and the European Union. Together with ASEAN countries, and indeed most of the SAARC observers, South Asia can bring benefits to its people in the Asian Century.

It was as early as 1999, when I was serving as Secretary-General of SAARC, that Wang Yi (currently Foreign Minister of China) visited the Secretariat in Kathmandu to have frank discussions on prospects and means for cooperation in diverse areas with SAARC as an association. This was in addition to the varied bilateral connectivity that China already had by then formed with each individual SAARC country. Much has developed on some of the activities in China-SAARC cooperation which were tentatively discussed at that time. China has been hosting many close encounters of the economic kind through Conferences and Seminars with individual South Asian countries as well as at regional level. Exchanges between think-tanks, corporate sectors, cultural and religious and even with individual political parties within countries are developing well, and do provide governments ideas and options on which to develop inter-state cooperation as well.

I have participated in a number of such Seminars and Conferences which China has hosted to access and strengthen its multiple areas of cooperation with South Asian countries. In June this year, the China-South Asian Countries Think Tank Forum was held in Kunming. I indicated at the Forum that Yunan has lived up on its motto to function as a "Gateway" to regional and international cooperation. It has linked up more than in mere nomenclature with the theme of the last SAARC Summit held in Addu Atoll in the Maldives : "Building Bridges". The Forum was sponsored by a number of Chinese Institutes dealing with political and economic themes. Three parallel sessions were held covering regional connectivity; regional economic cooperation and people to people connectivity. Eventually, a consensual document was finalized. Pakistan was represented inter alia by Fazal-u-Rahman of the Strategic Studies Institute; Khalid Rahman of the Institute of Policy Studies (12)

Concurrently, the first China-South Asia Expo was also held in Kunming at which Sri Lanka's Prime Minister D.M. Jayaratne in his inaugural address, covered economic as well as people to people contacts. He referred to the stay of the Chinese Buddhist monk, Fa Xian, at the Abhayagiri Temple in Sri Lanka as early as the 5th century, and the enduring religious links between Sri Lanka and China notwithstanding the latter's early description of religion as "the opium of the masses". During my period as Ambassador in Beijing, the Sri Lanka Embassy was able to assist China in holding the first World Buddhist Forum in Hangzhou which focused on the universal theme, "A Harmonious World Begins in the Mind". Religious leaders from around Asia participated, promoting the philosophy of peace, tolerance and harmony by avoiding conflict. Its impact was strong. At the 17th National Congress of the Communist Party of China which followed the Forum, a significant amendment in fact was incorporated in the Republic's Constitution. It affirmed support for "the peace-building activities linked to religious matters and encouraged religious adherents to making contributions to economic and social development in the life of the people". Ideological differences of course have been bridged between China and Sri Lanka from the earliest times. Even before the two countries established formal diplomatic relations and had conflicting political systems, agreements offering mutual benefit have been entered into between Communist China and what was then a strongly right-wing Ceylon. In 1952, the two countries signed the Rubber-Rice Pact in the interests of the two nations. Even then, internal ideological aspects in China did not adversely affect its foreign policy.

China's Approach to the Asian Century

With the trumpets of the Asian Century blowing now, a series of bilateral and multilateral engagements are being carefully developed in considerable harmony with the world's two largest economies, the United States of America and the Peoples' Republic of China. The SAARC countries are also engaged and playing their own part in a relatively harmonious manner. A few discordant notes are of course also being heard, although the strident warped voice of Booz-Hamilton-Allen is hardly disturbing the growing harmony.

Chinese President Xi Jinping's Opening Address at the Annual Conference of the Boao Forum for Asia in Hainan Province in April this year is a useful score/ prelude to harmonize the Asian Century (13). The Boao Forum is the Chinese version of the Davos Conference in Europe and brings different countries with varying political systems together. The appropriate theme of the Boao Forum this year was "Asia Seeking Development for All: Restructuring, Responsibility and Cooperation". President Xi, in a carefully balanced manner, acknowledged that the world is experiencing "profound and complex changes", which are also increasingly "interconnected and interdependent", yet "far from being peaceful". Though over 50 per cent of global growth is from Asia, President Xi, a writer of poetry, perceived that the region had four main challenges to face: (i) To "break new ground for boosting common development" as "nothing remains constant… Shift the growth mode; adjust economic structures" making "life better for the people". To "reform the "international economic and financial systems, improve global governance mechanisms". Asia should "ride on waves of the times make change in Asia "reinforcing and global development" to benefit all. (ii) To work together to uphold peace to provide security…boosting common security. "Without peace, development is out of the question". Global peace and security are essential so as to "turn our global village into a big stage, for common development, rather than an arena where gladiators fight each other". Differences should thus be resolved through dialogue, consultations and peaceful negotiations. (iii) Quoting a Chinese proverb, President Xi said "a single flower does not make spring, but hundreds of blooming flowers do". So similarly, "a country should accommodate legitimate interests of others in pursuing their own development" so that South-South cooperation and North-South dialogues could promote balanced development consolidating the foundation for stable growth of the global economy. (iv) "We should respect the right of a country to independently choose its social system and development path, removing distrust and misgivings, and turning the diversity of our world and differences among countries into a dynamic… driving force for development", by "drawing upon practices of other continents", sharing development resources and promoting regional cooperation. Point (v) of the President summarized above holds considerable relevance to the concept of the Asian Century which is not exclusive, but one which involves mutual engagement and cooperation also with continents and countries outside Asia. Some focussed engagements of the President, Foreign Minister and other personalities of China across Asia, and indeed the world this year, are particularly relevant to SAARC.

China-Sri Lanka Relations

Sri Lanka President, Mahinda Rajapaksa was invited in May 2013 by President Xi Jinping, rather early after coming into power, to pay a State Visit to China, which is at the highest political and diplomatic level of contact at the international level (14). Following their close encounter, China-Sri Lanka relations have been uplifted to the status of a Strategic Cooperative Partnership. Among the areas of the Partnership are trade and investment facilitation, security issues particularly in respect of what China and Sri Lanka term as "the Three Evils" (i.e .terrorism, separatism and extremism). China's assistance and intelligence helped Sri Lanka in successfully contending with the distinct three evils of the Liberation Tigers of Tamil Eelam and replacing conflict with peace. Cooperation will continue to advance on economic, tourist, cultural and religious exchanges, and also take in space technology. A priority area was high level exchanges and maintenance of political links against corporate criminal activities and non-traditional security threats in the Indian Ocean area. Accordingly, a Joint Committee on Coastal and Marine Cooperation will promote coordination in ocean observation, eco-system protection, marine and coastal zone management, combating piracy, and search and rescue operations.

Now that peace has replaced conflict in Sri Lanka, China has also expressed full support for contributing further to Sri Lanka's present post-conflict programmes of consolidating national unity, reconciliation and promoting economic development. The Chinese Government will be encouraging its financial agencies to assist Sri Lanka's "social development efforts, including in the sectors of ports and aviation, power generation, roads and expressways and irrigation". These will provide Sri Lanka closer connectivity within the country as well across the South Asian region and beyond as the Asian Century develops. It was agreed on the basis of strengthening cooperation "under the Asia-Pacific Countries Trade Agreement to launch negotiating process on a China-Sri Lanka Free Trade Agreement". An Expert Group will carry out feasibility studies. In addition to all round government to government cooperation, both countries agreed to "further intensify exchanges and pragmatic cooperation between Parliaments, political parties, armed forces and law-enforcement authorities".

Sri Lanka appreciated China's contribution to SAARC through conferences supporting and encouraging greater interaction, including at the people-to-people levels. China agreed to promote Sri Lanka's application for Observer Status in Shanghai Cooperation Organisation. The two countries have agreed to continue coordination at the United Nations and other multilateral fora particularly on human rights, climate change and fighting transnational crime. At the Business Forum of the Commonwealth Summit Conference held in Sri Lanka, although China is not a member of the Commonwealth, about 50 Chinese corporate and technical groups had been engaged actively in "Reflections of Sri Lanka", an exposition on Trade, Tourism and Investment being held concurrently.

Chinese Prime Minister Li Keqiang visited India and Pakistan also in May 2013, on which my colleagues from the two respective countries at the Conference would report. President Xi Jinpin has already visited Indonesia and Malaysia. Prime Minister Li Keqiang has visited ASEAN countries including Brunei, Malaysia, Thailand and Vietnam as well. China continues with high level visits to ASEAN and other countries, in the interest of contributing to the Asian Century, including countries such as the Philippines and Japan with which China has complex territorial disputes.

China-US Relations in the Asian Century Impacting on South Asia

President Xi visited the United States of America in June 2013, including, in particular, to clarify aspects of the Asian Century and China's perceptions of its expectations. Relations between the largest and 2nd largest economies continue despite complexities. The US Congressional Research Service indicated that some in the United States are concerned that a "rising China" challenges the US economy and US global leadership. President Obama however has been quoted as informing President Xi that it was "very much in the interest of the United States for China to continue its peaceful rise, because if China is successful that helps to drive the world economy and it puts China in the position to work with the United States, as equal partners in dealing with many of the global challenges that no single nation can address by itself". On the other hand, there are certain aspects, for example those relating to conflicting maritime claims in the South China seas between China and respectively, Philippines, Japan, Malaysia, Vietnam and Brunei — all of which affect the bilateral relations between China and the United States as well.

No formal consensual Joint Press Statement was issued following the informal Sino-US close encounters at Rancho Mirage in California. However, the two Presidents met the press, jointly, to answer questions. The respective responses were recorded and thereafter released by the White House (15). Cyber security was an issue and China was the main concern for the US at that time. However, currently US cyber-listening and tapping of even confidential matters including those of allies such as Angela Merkel of Germany have been exposed. Xi said that "the application of new technology is a double-edged sword. We need to pay close attention to this issue and study ways to effectively resolve this issue in a pragmatic way." Xi said that it would be an issue that both sides will continue to discuss in the context of the China-US Strategic and Economic Dialogue. Furthermore, in depth candid discussions on the domestic and foreign policies of China and the US would "build a new model of major country relationships". US and China gave an impression that in an age of economic globalization they must find a "common new path" avoiding confrontation and conflict as in the past. US-China exchanges in economy and trade, energy, environment, people to people interactions and cultural engagements would continue to deepen their shared interest. The two countries felt it was vital to build "a new model of military relationships" between them. All this affects South Asia's economic development and security as well.

In his concluding remarks, President Obama stated that "President XI summarized very well the scope of our conversations and that it is an example of concrete progress that can advance this model of US and China Relations." President Obama indicated that much work needs to be done to take these broad understandings to the level of specifics which will require further discussions. He stated he is absolutely committed to making sure that China and the US would not miss the opportunity. China's newspaper the *People's Daily* quoted Tom Donilon, one of President Obama's national security advisors who had said that " discussions were positive, constructive, wide-ranging… quite successful achieving all the goals that we set forth for this meeting…in a uniquely informal atmosphere" at Rancho Mirage.

Indo-US Relations in the Asian Century and Impact on South Asia

Three months later, President Obama also held talks with Indian Prime Minister Manmohan Singh in Washington. It was more formal and structured than the Rancho Mirage US-China encounters. A Joint Statement of about 30 paragraphs was adopted on September 27th. (16). It was the third such Indo-US Summit in which the two leaders "reflected proudly on the transformation of US-India relations during the last decade, affirming that the partnership between the two democratic nations is stronger than at any point in their 67-year relationship". Highlighting "shared democratic values", the Joint Statement covered, inter alia, security cooperation, bilateral trade and investment, science and technology, energy, climate and environment, the global architecture on counter terrorism, cyber space, health security, Indian Ocean security and conservation of its natural resources. The Joint Statement made clear that "the US and India should look to each other as partners of first resort in addressing global changes." The two leaders condemned all terrorist attacks.

Significantly, in relation to the "US rebalance to Asia" and India's own "Look East policy", the two leaders "expressed a desire to partner closely" with Asia-Pacific countries including "greater coordination with Japan, China and ASEAN" through the "evolving institutional architecture of the region". This links to a subsequent Joint Statement issued by the Chinese Prime Minister Li Keqiang and Prime Minister Manmohan Singh in October 2013 (17) which also fits in with earlier discussions between the two when the former visited India.

All this strengthens the theme of working towards the Asian Century and economic cooperation of China with SAARC countries. It belittles the not so sober Booz-Hamilton-Allen theories about the Chinese placing a "string/necklace of pearls/ thorns" around India in collaboration with Pakistan, Sri Lanka, Bangladesh and Myanmar. Prime Minister Manmohan Singh's speech on October 25 at the Central Party Conference, in Beijing though primarily on India and China in the New Era also, implicitly, covers aspects relevant to the Asian Century and prospects of economic cooperation between China, the second largest economy in the world and South Asia (18).

Conclusions

Delivering the opening address at the inauguration of the Commonwealth Business Forum 2013, in Colombo on November12, Sri Lanka President Mahinda Rajapaksa described the Commonwealth as bringing together some of the world's "richest and poorest citizens…of different religions, ethnicities, cultures, economic and political ideologies" (although the United States and China, as number one and two of the world's largest economies were not members). He asserted, in general, that "wealth creation is not merely creation of physical wealth and financial assets… but is the sustainable and continuous improvement of human and natural capital" and that therefore, "it is vital that all nations, as one cohesive body, adopt a collaborative approach to find and develop ways and means in our own economies to link wealth creation together with social and human development at all times".

Future issues in respect of shifts in global power balances are debated often quoting the case of China replacing Japan as "Number Two". An article in the *Beijing Review* provides some interesting perspectives, though not all of them can be totally conceded (19). Certainly, Asia's rising strength, despite its many social, economic and other issues will be a major aspect. The South Asian region needs to keep in touch and relate closely with all power centres, developing economic, political, cultural and people-to-people linkages that are free of ideological hangovers and constraints. Our own region needs to build greater solidarity, contending with bilateral and trust issues that hamper greater coordination. While " bilateral and contentious" issues are banned for entry into the agenda of SAARC, informal "South Asian" meetings to examine some of these, particularly those which contaminate greater coordination in the group hampering closer cooperation with the larger Asian community, need to be delicately, but frankly handled. Engagement of non-government groups, informally, could also assist.■

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Chapter 15

Sustainable and Result Oriented Dispute Resolution Mechanism between Pakistan and India

Pervaiz Iqbal Cheema

No dispute resolution mechanism can effectively work without demonstrated political will to resolve the dispute by the involved parties. It becomes even more difficult if there is a pronounced asymmetry between powers of the parties and the stronger party is not willing to renounce the use of force. Admittedly, both parties prefer to initiate negotiations from a position of strength but visible difference in power could easily inject complications. The threat of imposition of will by the stronger party often impresses upon the weaker party to seek justice from a collective body like UN or a regional organization.

While there exists no consensus among nations on what is the best method to resolve inter-state disputes, the United Nations, in its Charter, provided a guideline to resolve the disputes peacefully. The Chapter VI of the Charter clearly states to seek solution of the dispute by ‘negotiation, enquiry, mediation, conciliation, arbitrations, judicial settlement, resort to regional agencies or arrangements or other peaceful means of their own choice’.[1] In addition the UN Security Council is authorized to impress upon the disputant parties to settle their disputes by employing the above mentioned approaches. All these approaches are meant to facilitate the disputants to resolve their dispute peacefully. This paper initially focuses on the existing UN approaches followed by regional efforts. Finally, it discusses the possibility of sustainable and result-oriented mechanism for both India and Pakistan.

[1] See UN Charter’s Chapter VI entitled as ‘Pacific Settlement of Disputes’. Charter of the United Nationsand Statute of International Court of Justice, United Nations, New York, August 1971.

I

Existing Approaches

Among frequently applied approaches could be easily grouped into three categories; realistic, idealistic and legalistic approaches. The realistic approaches consist of negotiation, mediation and conciliation whereas the legalistic approaches revolve around arbitration and judicial settlements. The idealistic would be unconditional acceptance of the decision of the regional organization or the UN Security Council's (UNSC) decision or that of regional organization. Since neither the decisions of UNSC nor of the regional bodies are accepted and implemented without reservations, the practice seems to be to relying heavily upon approaches listed under the realistic approaches.

Negotiations

Perhaps the best method is direct negotiation between the disputants. While negotiations are considered to be a voluntary approach but sometimes it is initiated because of encouragement or pressures from outside such as the international or regional organizations. Bilateral negotiation implies both parties would forcefully argue their case and try to convince the other about the righteousness of its own cause. It involves certain amount of give and take or a trade-off and often a compromise is worked out but it also frequently happens that the two involved parties are stuck on some point or issue and the entire process is either held hostage to the process of implementation or gradually and carefully sabotaged. Most leaders of world community prefer that the complicated issues or disputes are dealt with through bilateral negotiations. Such a course of action spares other forms being involved. However it needs to be mentioned here that almost all strong and powerful states prefer this approach especially when dealing with a weaker opponent. Negotiating from a stronger position is a preferred option for all involved. Another point that needs to be seriously considered is that if any of the party involved believes that continuation of conflict pays more, then in that case the negotiation process is either unlikely to start or irreparably damaged during the early phase.

Third Party Involvement (Mediation and Conciliation)

In case the two parties are unable to reach an acceptable solution to the issue or resolve the dispute bilaterally, a neutral party can be asked to mediate. This implies that parties have to agree to the involvement of a third party. Invariably weaker party, unable to impress upon the stronger party, opts for third party involvement whereas the stronger party tends to resist and even avoids if it senses that the involvement of third party may not be helpful to secure its interest. For example, India is consistently opposed to the involvement of a third party in its conflict with Pakistan especially over the Kashmir dispute. The main reason for Indian refusal is that the involvement of a third party is likely to compromise the advantageous position it enjoys and its power to dictate terms to Pakistan could be neutralized.[2] It seems pertinent to stress here that when India did not enjoy advantageous position vis-i-vis the other involved party, it would readily agree to other methods. This is precisely what India did following the defeat in Sino-Indian war. In this war India lost a big chunk of its territory and in order to regain lost territories, Nehru 'proposed to make use of adjudicative methods for settlement of their differences'.[3]

Third party could be an individual (i.e. representative of great power) or universal body like United Nations or World Bank or regional organization. Mediation by a third party 'signifies a process by which a third party helps the parties in a dispute reach an agreement by reconciling the opposing claims and appeasing the feelings of resentment which may have arisen'.[4] The main task of a mediator is to explore alternative means to secure peace and cooperation on the one hand and facilitate the involved parties to reach a compromise by exploring varied options on the other.[5] Not only the mediator sets the rules of session but may also control the process of sessions. He/She may also approach the parties separately with a focus on how to work out a compromise and also safeguard the interests of the involved parties. 'A successful mediation affords the parties an opportunity to generate a creative solution to their dispute in a manner that focuses on the future and not the past'.[6]

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[2] 'Third Party Role in India-Pakistan Conflicts' by Ijaz Hussain in Conflict Resolution and Regional Cooperation in South Asia edited by Pervaiz Iqbal Cheema and Imtiaz H. Bokhari (Islamabad: Islamabad Policy Research Institute and Hanns Seidel Foundation, 2004) pp. 152-157.

[3] Ibid.

[4] Ibid.

[5] A Handbook for Conflict Resolution in South Asia by Sundeep Waslekar, Konark publishers Pvt Ltd, Delhi, 1996, pp/15-17.

[6] See Dispute Resolution Mechanisms and Constitutional Rights in Sub-Saharan Africa by Bolaji Owasanoye in Alternative Dispute Resolution Methods, UNITAR (United Nations Institute for Training and Research) Document No.14, 2001, pp. 15-25.

Conciliation

Conciliation also involves third party and a conciliator is appointed. The conciliator discusses the dispute with the parties in detail and then prepares a compromise solution and tries to convince the parties separately.[7] Not only the conciliator attempts to satisfy both parties but could also seek help from outside consultants in order to make the option more attractive for both parties. The main task of the conciliator is to secure consensus of the parties on the crafted solution whereas in mediation the parties are guided to devise an acceptable solution. Conciliation is a useful device for social problems like divorce or settling labour disputes etc.

UN Special Representative

Another form of mediation is that a special representative of UN is assigned the task to meet the disputants and facilitate them to reach a working or a compromise formula. It is an established practice that UN Security Council assigns this form of mediation to an eminent individual. For example India took the Kashmir dispute to the UN and as a consequence of its inability to secure the desired resolution of the dispute at the Security Council level, it agreed to the appointment of a special representative to make efforts to resolve the dispute. During the first ten years of the Kashmir dispute Sir Owen Dixon, Dr. Frank Graham and Gunner Jarring (officially appointed representatives of the UN Security Council) made earnest and concerted efforts but were unable to resolve the dispute.[8]

Good Offices

It is not too uncommon to use the good offices of an individual or an institution to help bridge the difference-gap between the disputants. Invariably this method is being employed by the international community to resolve varied kinds of disputes between states. Recently, the current Secretary General of UN Ban-ki-Moon has offered his services to resolve the ongoing Kashmir dispute provided both parties agree to his good offices.

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[7] Ibid.,pp.16-17.

[8] There are many good book are available that have extensively covered different aspects of the Kashmir dispute. However the two most balanced books, in my perception, are Alastair Lamb's Kashmir: A Disputed Legacy 1846-1990(Karachi: Oxford University Press, 1962) pp.158-181 and Josef Korbel's Danger in Kashmir (Princeton: Princeton University Press, 1954), pp. 165-197.

Arbitration

Arbitration is not only voluntary but perhaps one of the oldest and most effective methods of resolving disputes. Even during the era of the Greek city states this method was frequently practiced. Arbitration means submitting the dispute to an impartial penal of judges/persons whose decision or award would be final and binding on the parties. 'The arbitrators are chosen by the parties to the dispute or by some neutral agency designated by them'. [9]

Adjudication

Adjudication implies legal proceedings to resolve the dispute. The decision is formally announced in a court of law. The court hears both sides and then gives its decision. The consent of both parties is an essential element of the whole process.

II

Existing Approaches and South Asia

Almost all of the above mentioned approaches have been employed in one form or the other with a view to resolving disputes in South Asia and more specifically between India and Pakistan.

Negotiations

Negotiations can be either bilateral or multilateral. However it needs to be stressed here that multilateral negotiations are often referred to as multilateral diplomatic efforts. Bilateral negotiations are often used to resolved the dispute or defuse the crisis.

Bilateral Negotiations

Bilateral negotiations start either on the initiative of either party to the dispute or are suggested and encouraged by an international organization. Bilateral negotiations between India and Pakistan have a mixed record. While some issues have been resolved through bilateral negotiations, there were others which defied such efforts and the two countries failed to reach the desired agreements. Among the failed efforts perhaps the ongoing

[9] See The World Book Encyclopedia, vol. 1. Field Enterprises Educational Corporation, Chicago, 1969, p.552.

Kashmir dispute tops the list. Not only the UN encouraged both parties to undertake bilateral negotiations periodically but following the 1962 Sino-Indian war, bilateral negotiations started between Zulfikar Ali Bhutto and Swarn Singh primarily because of pressures applied by UK and US. Many disputes have been resolved by bilateral negotiations in South Asia and more specifically between India and Pakistan. Among the disputes that were resolved through bilateral negotiations the following are more prominent;

Liaquat-Nehru Pact (1950)

The pact was designed to alleviate the fears of religious communities and to promote communal peace and harmony. It was signed on April 8, 1950 and promised to ensure 'complete equality of citizenship, a full sense of security and equal opportunity' to minorities in both countries.[10]

Simla Agreement (1972)

The Simla Agreement which was signed following the 1971 India-Pakistan war did not or perhaps could not address the issues for which it was called for. The major objectives that were advanced at the time were the establishment of durable peace in South Asia and normalization of relations between India and Pakistan, repatriation of prisoners of war and civilian internees and a final settlement of Kashmir dispute. It was signed in 1972 to address the above mentioned issues. The final clause of Simla Agreement clearly stated that the respective Heads of governments or their representatives would meet in future at a mutually agreed time and date to address those issues.[11] However the Simla agreement has been projected as an important agreement that is the product of bilateral negotiations.

Delhi Agreement (1974)

In many ways it was a product of both bilateral and trilateral efforts. On April 1972, a three-way agreement was signed by India, Bangladesh and Pakistan. The agreement paved the way for repatriation of the prisoners of

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[10] See Burke, S.M., Pakistan's Foreign Policy: An Historical Analysis, (Karachi: Oxford University Press, 1973) pp57-58.

[11] For a detailed analysis see Chari, P.R. and Cheema, Pervaiz Iqbal, The Simla Agreement 1972: Its Wasted Promise, (New Delhi: Mnohar, 2001) Published by the Regional Centre for Strategic Studies, Colombo (Sri Lanka). Also see Abdul Sattar, Pakistan's Foreign Policy 1947-2005: A concise History (Karachi: Oxford University Press, 2007) PP.pp.124-143.

war and Bangladesh agreed not to proceed with announced trials of Pakistani civilians on humanitarian grounds.[12]

Visa Agreement (2012)

The Visa Agreement was signed in December 2012 not only to facilitate travel for the Indians and Pakistanis but also to promote people to people contact. According to this agreement the number of places to visit increased and special provisions were made for persons over 65, 'nationals of one country married to nationals of other country' and 'children below 12 years accompanying parents'. 'Exemption from police reporting for business visa granted to businessmen with an annual income above Pak Rs.5 million or equivalent or annual turnover above Pak Rs.30 million or equivalent'. [13] Group Tourist Visa was allowed for 30 days provided for groups having at least 10 members.

Mediation

Among the relatively more prominent cases in which the mediation efforts successfully resolved the crises and in some cases reduced tension include the Indus Water Treaty, Tashkent Declaration, Rann of Kutch Award and the four years of peace process (2004-2008).

The Indus Water Treaty

The Indus Water treaty (IWT) was signed in 1960 after efforts by the President of World Bank Mr. Eugene Black. The Indus Water Treaty resolved the water dispute between India and Pakistan. The treaty allocated the waters of three eastern rivers Ravi, Beas and Sutlej to India and the waters of three western rivers Indus, Jhelum and Chenab to Pakistan. The non-availability of waters of eastern rivers was to be replenished by a mechanism of link canal system. However, it needs to be mentioned here that India categorically committed to allow the flow of waters of western rivers for Pakistan's use except for certain limited uses in upstream areas in Kashmir for agricultural purposes, electric generation and certain other uses spelled out in annextures of the treaty.[14] The Treaty allowed the

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[12] See the Text of the tri-patriate agreement of Bangladesh-Pakistan-India. http://www.genocidebangladesh.org/?p=196 retrieved on 6th Nov.2013.

[13] For details see India, Pakistan activate new visa regime by Arun Rajnath, in *The News*, Dec.15, 2012.

[14] For a detailed analysis see Choudhury, G. W., Pakistan's Relations with India 1947-1966, (London: Pall Mall Press, 1968), pp.155-169.

construction of run-of-the-river power plants but forbade 'the construction of dams on western rivers in excess of prescribed limits'.[15]

The first major test to the Treaty came in 1976 when series of talks about Salal hydroelectric project started. Pakistan asked for detailed information about the project in 1974. When India provided the desired information Pakistan raised serious objections to its design and storage capacity. The project aimed at generating 690 mw in two stages by building a dam at a place in Riasi Tehsil of Udhampur (a district of occupied Kashmir) which was just 72km upstream of Marala Headwork in Sialkot district of Pakistani Punjab.[16] The Salal settlement was signed in 1978. The efficacy of the treaty was further tested subsequently by projects like Wullar Lake, Baghlihar, and currently by Kishenganga projects etc.

Rann of Kutch Award

In the spring of 1965, the long standing dispute over the Rann of Kutch once again surfaced when Indian forces attacked the Pakistani held posts on April 4, 5 and 8 in the northern half of the disputed territories of the Rann which was repulsed with heavy losses to the Indians.[17] These Indian attacks and consequent Pakistani actions resulted into what is often described as a 'little war' on 9th April 1965.

The conflict over Rann of Kutch originated during the days of British rule in India. The conflict over the desolate land was primarily revolved around unsettled boundary which involved about 3500 km of disputed territory. The British government and more specifically, the Prime Minister, Herald Wilson, persuaded both parties to sign an agreement on 30th June to resolve the dispute peacefully.[18] Consequently a three member tribunal was formed with two members nominated by Pakistan and India respectively whereas the third was nominated by the UN Secretary General. 'The tribunal announced its verdict on February 17, 1969 awarding about 350 square miles in northern parts of the disputed Rann of Kutch to Pakistan and rest to India'. [19] While the Rann of Kutch award was criticized by both India and Pakistan, a prominent Indian leader Jayaprakish Narayan asked

[15] Sattar, Op.Cit., pp.190-192.

[16] See 'Energy Challenges to Indus Water Treaty' by Shaeen Akhtar in Regional Studies, Vol.xxviii ,no.4, Autumn 2010, pp.3-66.

[17] See Choudhury, op. cit., pp.2288-292. Also see Sattar, op. cit, pp.91-99.

[18] See Burke, op.cit, pp.323-325.

[19] Ibid. Also see Sattar, op. cit., pp.91-93.

his compatriots to look at the Kutch agreement 'as an object lesson in peace making' and apply this method to all disputes including Kashmir.[20]

Tashkent Declaration

Following the 1965 Pakistan-India war, the Soviet Prime Minister offered his good offices to arrange a settlement between India and Pakistan. President Ayub Khan and Prime Minister L.B. Shastri were both invited to Tashkent for peace talks on Jan.4, 1966 which enabled both sides to withdraw their forces to previously agreed cease-fire line by 25th February 1966.[21]

Not only the Tashkent Declaration provided for the exchange of prisoners of war and resumption of normal diplomatic activities but also the restoration of 'economic and trade relations as well as communication'.[22] One of the significant fallout of Tashkent settlement was that the Soviet leader emerged as the peace maker.

III

SAARC Dispute Resolving Mechanism

South Asia is viewed as a late comer in terms of establishing a regional organization. While almost all regions of the world had formed some kind of regional groupings or organizations, South Asia continued to lag behind primarily because of India-Pakistan hostile relationships. Among the known hurdles that delayed the advent of a regional organization in South Asia were structural and geographical setting of the region in which one state was not only huge in terms of area, population, resources, power and occupied central position geographically, but also suffered from lack of common threat perception, and complex inter-state disputes.[23]

Theoretically SAARC was born in 1985 at the Dhaka Summit of seven regional countries; later it was expanded to include Afghanistan. The major objectives of the organization are to promote the welfare of South Asians in terms of improving the quality of life. For this purpose acceleration of economic growth, collective self-reliance, developing mutual trust and pursuing active collaboration with a view to strengthening

[20]Ibid., Also see Burke, p.526.
[21] Choudhury, op. cit., pp.299-304
[22]Ibid.
[23] For a detailed analysis see 'SAARC Needs Revamping' by Pervaiz Iqbal Cheema in South Asian Survey, vol.3, Nos.1-2, 1996 pp.309-319.

cooperation among the member countries as well as with other regional and international organizations.

While SAARC has been making noticeable but steady progress but it has not delivered as was anticipated. 'Just as the UN Security Council did not live up to the expectations of a vast majority of the member states, SAARC also disappointed many in the region especially in terms of tangible outcomes that could substantively affect the life of ordinary citizens of the member countries'.[24] However, one needs to take cognizance of the fact that it came into existence with a baggage of disabilities and constraints. Confronted with regional pressures along with the existence of complex regional disputes, the association not only moved forward though slowly during the last 28 years, but has also been able to impress upon the member countries to realize the significance of cooperation.

Compared to ASEAN, SAARC was unable to develop a conflict resolution mechanism. The ASEAN in its 26th Ministerial meeting established the ASEAN Regional Forum (ARF) to foster not only 'constructive dialogue and consultation on political and security issues of common interest and concern' but also 'to make significant contributions to efforts towards confidence building and preventive diplomacy in Asia-Pacific region'.[25]

On 13th November 2005, the SAARC foreign ministers signed an agreement to establish SAARC Arbitration Council. Clause 3f clearly referred that the Arbitration Council would act as a coordinating agency in SAARC dispute resolution system. This is an 'inter-governmental body mandated to provide a legal framework/forum within the region for fair and efficient settlement of commercial, industrial, trade, banking, investment and such other disputes as may be referred to it, between one member state to another through conciliation and arbitration'.[26]

As mentioned above, SAARC came into existence with a huge baggage which is impeding the desired pace of progress. Undoubtedly the existence and continuation of bilateral political disputes does not allow the organization to move forward at a desired pace. The ongoing India-Pakistan dispute over Kashmir takes a heavy toll of goodwill and well intentioned efforts. Since partition, the ongoing Kashmir dispute has not only dominated the relations between India and Pakistan but it has continuously generated a certain amount of anxiety among other members of SAARC. In addition there exist many irritants which have periodically emerged on the

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[24] *News*, Nov 21, 2004

[25] Regional Forum, http://aseanregionalforum.asean.org/about.html retrieved on November 12, 2013.

[26] SAARC Arbitration Council http://sarco.org.pk/ retrieved on November 12, 2013.

South Asian scene and contributed their share towards the incumbent arsenal of complex relationships.

SAARC does not have a forum like ARF where the states of South Asia could discuss their political dispute with a desired level of honesty of purpose. However this does not mean that SAARC does not provide opportunity to member states to discuss issues and disputes of political nature. The annual Summit and periodic ministerial meetings frequently provide an opportunity to member states to at least exchange views on controversial issues. In addition it needs to be mentioned here that the member states have already begun to provide what is often referred to as 'retreat'. While the Charter does not permit the member states to place a political dispute on the table in all formal sessions, one day is provided during the Summit for the leaders of the member countries to discuss their political disputes informally.

VI

Sustainable Dispute Resolving Mechanism

No regional dispute resolving mechanism is likely to work if there is no political will on the part of member states. In fact the future of all regional organizations is heavily dependent upon the goodwill of member countries. Larger and powerful partners are expected not only to facilitate the strengthening of the principle of collective advantages but also demonstrate the spirit of cooperation even if it entails some disadvantages. However, if the larger and powerful members of the regional organization try to use the organization with a view to promoting their own interest, the regional organization is unlikely to move forward towards the declared aim of collective advantage. For example, the Economic Cooperation Organization (ECO) was unable to attract genuine cooperative efforts from the Central Asian States as they realized that the original three members (Iran, Pakistan and Turkey) were trying to use the organization in order to promote their own interests rather than making serious efforts towards integration.[27] All regional organizations have faced and in all probability would continue to face periodically emerging complex issues.

To establish a sustainable dispute resolving mechanism, the following preconditions need to be seriously considered:

[27] See 'Regionalization as Peace Instrument: Central Asia' by Devendra Kaushik in Peace As Process: Reconciliation And Conflict Resolution in South Asia edited by Ranabir Samadder and Helmut Reifeld (New Delhi: Manohar, 2001) pp. 119-135.

a) **Existence of political will:** Perhaps the most important pre-condition is the existence of political will. Without the existence of political will to resolve the disputes/issues, all efforts to establish some kind of dispute resolving mechanism would be useless. It is expected that the involved parties would do their homework and come to the forum not only with a spirit of resolving disputes but also equipped with some alternative options. If the states involved are unable to demonstrate their desire and political will to resolve the dispute, mere public statements would not generate sufficient confidence or convince the adversary. Political will also implies that you are ready to make concessions and work for a compromise formula in order to settle the issue or resolve the dispute. One can learn from the working of ARF or OSCE (Organization for Security and Cooperation in Europe) in order to resolve the dispute and pave the way for peace.

b) **Recognizing the need for some mechanism or forum to address problems of security and political cooperation** in order to provide practical models for resolving the dispute. The ARF model appears to be relatively more suitable to the environment prevailing in South Asia. The existence of political will along with the dispute resolving mechanism could not only reduce the tensions between the disputants but could also influence parties to initiate a series of dialogue. These dialogues should be continuous and should not be allowed to be hijacked by either of the parties involved. Not only the consistency of regularly held dialogues is maintained but if the parties reach a dead end, the other members of the organization should be allowed to participate in the dialogue process with a view to helping and facilitating the process. Consistency of dialogue is extremely necessary and if the parties are unable to resolve the dispute/issue, they should announce the time and date of the next meeting/round of talks before dispersing.

c) **Need to recognize the usefulness of informal diplomacy:** History is studded with innumerable instances/examples in which invaluable contributions were made by informal diplomacy. In recent times when the parties were unable to move forward such as during the negotiations of Brasstacks and Simla crises, it was the informal diplomacy that effectively dealt with the undesired impediments and facilitated the parties to move forward. If an organization does not allow the contentious issues/disputes to be discussed in formal meetings similar to what SAARC is practising, then it is imperative that some time is given to the participants to discuss issues/disputes in informal setting. SAARC Summit devotes one day, what is often called the 'Retreat', which is utilized for informal diplomacy. The participants are enabled to discuss difficult and complex issues in a totally relaxed and informal environment with view to finding a compromise formula which could satisfy both sides.

d) **Need to secure acceptance of alternative dispute resolution methods:** The parties should not only be informed but also express their willingness that if the bilateral efforts fail to resolve the dispute then alternative dispute resolution methods may be employed. For instance mediation has been relatively more successful in most parts of the world. If the mediation process also fails to deliver, then the case could be referred to an arbitration tribunal. The main reason that contributed towards the successful resolution of disputes in ASEAN is the willingness of member states to move to other available dispute resolution methods such as mediation and arbitration.

India-Pakistan and Dispute Resolution

South Asia is an area where many UN approved methods of dispute resolution have been employed with varying degrees of success. However it needs to be stressed here that only those issues were resolved where both India and Pakistan demonstrated a desired level of political will. 'The history of dispute settlement between India and Pakistan teaches us that a third party role, even if it is in the nature of a facilitator, is indispensable in order to move things forward'.[28] Complex disputes like the ongoing Kashmir dispute managed to defy all internal and external efforts mainly because one party never agreed to take to the arbitration tribunal if all efforts of negotiation, mediation and reconciliation failed. On the other hand, when both India and Pakistan agreed to submit the Rann of Kutch dispute to an arbitration tribunal after mediation of the British Prime Minister, Herald Wilson, and the case of Baglihar Dam which was submitted to a neutral umpire, both disputes were resolved.

The main dispute between India and Pakistan is over Kashmir and it is a well-known fact that desired level of normalization between India and Pakistan will never come to South Asia unless it is resolved. While Kashmir dispute has been subjected to bilateral negotiations and mediation by UN official representative, it has not yet been resolved. Innumerable solutions have been put forwards by many scholars but the dispute continues to test

[28] Hussain, Op. Cit., p.157

the abilities and patience of the international, regional and local communities.[29]

Given the history of hostile relationships between Pakistan and India, it is not easy to suggest a sustainable and result orientated dispute resolution mechanism for these two countries. However, if they comply with the above mentioned four conditions -- political will, forum for discussion of political disputes, consistency and allowance for informal diplomacy, and expressed willingness to take the dispute to next stages- such as mediation or arbitration -- the chances to resolve even a complex dispute like the ongoing Kashmir dispute would rapidly multiply. In the event, mediation also fails to produce results, parties should be willing to submit the dispute to arbitration.■

[29] The list of periodically suggested solutions for the Kashmir dispute is available and published. See PILDAT Briefing Paper No. 19, Proposals for Resolving the Kashmir Dispute, (Islamabad: Pakistan Institute of Legislative Development and Transparency, June 2005). Also see 'Kashmir: Identifying elements of a Sustainable Solution' by Moeed Yusuf and Adil Najam in Sustainable and Development and Governance in the Age of Extremes edited by Sustainable Development Policy Institute, 2005, Pakistan.

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