

Abu Salah Md. Yousuf
Mohammad Jasim Uddin

ECONOMIC INTEGRATION IN SOUTH ASIA

Abstract

In theory, integrating economies of various countries means unifying their policies on trade and economy as well as reducing several barriers on the two. The motivations of such economic integration are rationalising comparative advantages and increasing economic productivity. In South Asia, economic integration continues with several setbacks, even though South Asian Association for Regional Cooperation (SAARC) is aimed at promoting regionalisation with a firm belief that an effective economic integration process can forward the region towards economic prosperity and development. This paper conceptualises the meaning of economic integration, discusses the factors of economic integration in South Asia and makes an endeavour to address the difficulties of economic integration in the region. The paper concludes with the argument that the outcomes attained in regards to the integration are insignificant, although there are some arrangements that could assist the progress of South Asian economic integration.

1. Introduction

Regionalisation in South Asia began formally with the formation of South Asian Association for Regional Cooperation (SAARC).¹ The formation of SAARC Preferential Trading Arrangement (SAPTA) and then South Asian Free Trade Area (SAFTA) substantiated the desire for economic integration in the region. South Asia considers that economic integration would generate more intra-regional trade and investment in the region. Being an energy deficit region, South Asia believes that if a regional energy cooperation framework develops, huge hydroelectricity can be produced and then be traded. If intra- and inter- regional connectivity widen, South Asia could be a bridge between South and Southeast Asia, between South and Central Asia, and between South and West Asia. Therefore, economic integration is one of the important agenda for South Asia.

Abu Salah Md. Yousuf and **Mohammad Jasim Uddin** are Research Fellows at Bangladesh Institute of International and Strategic Studies (BIISS). Their e-mail addresses are yousuf@biiss.org and jasim@biiss.org

© Bangladesh Institute of International and Strategic Studies (BIISS), 2013.

¹ Ananya Mukherjee Reed, "Regionalisation in South Asia: Theory and Praxis", *Pacific Affairs*, Vol. 70, No. 2, Summer 1997, pp. 235-251.

What is economic integration? What factors are important for economic integration in South Asia? What are the challenges of economic integration in the region? This paper makes an endeavour to address the questions. In order to do so, this paper reviews existing literature on economic integration in South Asia, and uses the method of 'analytic narratives'. Cases studies in the New Institutional Economics (NIE) are also known as 'analytic narratives'. Considering economic integration as a unit of analysis this paper considers South Asia as a case. While 'analytic' elucidates some theoretical concepts, 'narratives' incorporates qualitative along with quantitative evidence.² Data from case studies can come from many sources of evidence. One of those is documentation that importantly incorporates memoranda, communiqués, agendas, announcements, minutes of meetings, written reports, administrative documents, formal studies or evaluations, newspaper clippings and other articles appearing in the mass media. Quantitative evidence this paper includes are government and private institutions' yearly and individuals' statistical assessment and academic works on South Asian trade, investment, and connectivity. Secondary and descriptive statistical data are used to see the sectoral trends of economic integration in South Asia. Using of data and statistics stands alongside and complements quantitative information to provide the depth and richness to an investigation. Therefore, this research benefits from both qualitative and quantitative evidence.

This paper is structured as follows. Section one is introduction. Section two conceptualises economic integration, and the subsequent two sections will elaborate South Asian economic integration through trade, investment and connectivity. The sections also cover challenges of and way-outs for South Asian economic integration. Section five concludes the paper.

2. Conceptualising Economic Integration

The term 'integration' in economics was first exercised in business firms to unify them through economic contracts.³ In theory, integrating economies of various countries means unifying their policies on trade and economy as well as reducing several barriers on the two.⁴ The motivations of such economic integration are rationalising comparative advantages and increasing economic productivity.⁵ Trade simulation effects featured by economic integration are important aspect of Theory of the Second Best that recognises free trade, with free competition and without trade barriers, is the best option.⁶ Sometimes,

² Lee J. Alston, "The Case for Cases Studies in Political Economy", *The Political Economist* 12, Issue. 4, Spring-Summer 2005, p. 8.

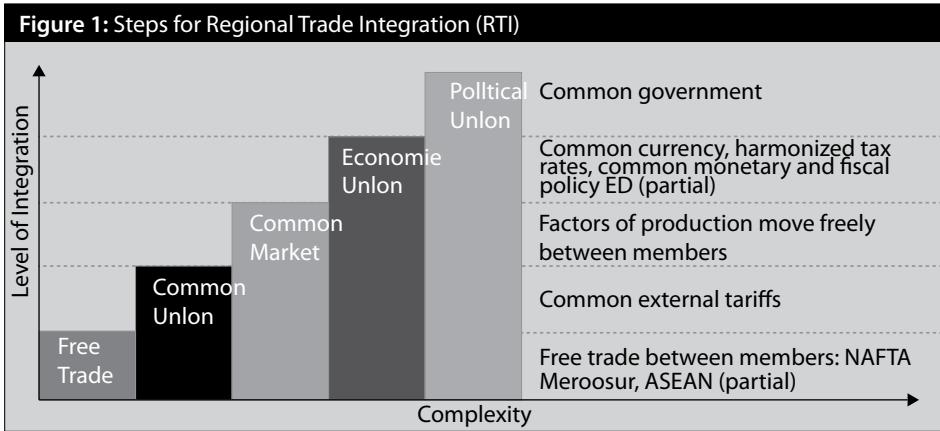
³ Fritz Machlup, *A History of Thought on Economic Integration*, New York: Columbia University Press, 1977, p. 3.

⁴ R. T. Dalimov, "The Dynamics of the Trade Creation and Diversion Effects under International Economic Integration", *Current Research Journal of Economic Theory*, Vol. 1, Issue 1, 2009, pp. 1-4.

⁵ Luca Antonio Ricci, "Economic Geography and Comparative Advantage: Agglomeration Versus Specialisation" *European Economic Review*, Vol. 43, 1999, pp. 357-377.

⁶ T. Negishi, "Customs Unions and the Theory of the Second Best", *International Economic Review*, Vol. 10, 1969, pp. 391-398.

free trade seems to be unrealistic but economic integration is considered as the second best alternatives for international trade where barriers persist on full free trade.⁷ Then, level of integration advances with complexities (Figure 1).



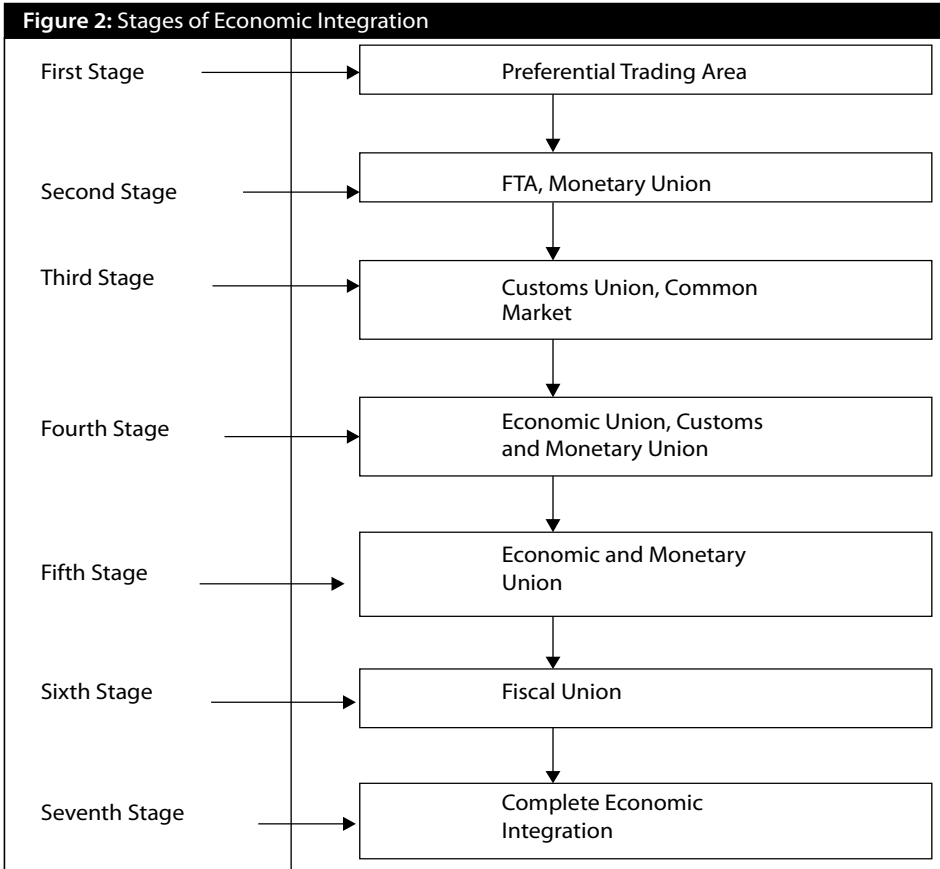
Source: Rodrigue, J.P., Levels of Economic Integration, Hofstra University, New York <http://people.hofstra.edu/geotrans/eng/ch5en/conc5en/economicintegration.html>, accessed on 1 January 2013.

Figure 1 indicates that RTA begins by free trade between or among countries within a regional arrangement. Free trade then leads to unification of customs with complexity of common external tariffs. If factors of production move freely between members, the idea of common market in a region begins. The booming combination of free trade, customs union and common market facilitates to the economic union with common currency, harmonised tax rates, common monetary and fiscal policy. RTI is not vibrant until political union with common government is featured by economic union. On the other hand, A. Tovias⁸ identifies seven stages of economic integration for a region (see Figure 2), though they may vary based on policies and extents of states' economic union. The study of A. Tovias also emphasises on regional political integration for total economic integration.⁹

⁷ *Ibid.*

⁸ A. Tovias, "The Theory of Economic Integration: Past and Future", Second ECSA-World Conference on *Federalism, Subsidiarity and Democracy in the European Union*, Brussels, 5-6 May, 1994.

⁹ *Ibid*; also see, <http://www.proprofs.com/flashcards/upload/a6873937.gif>, accessed on 1 January 2013.



Source: Compiled from the idea of A. Tovias

Theory on regional economic integration sometimes seems to advocate that several initiatives on lessening costs for trade within a set of states in a region may offer crucial incentives for intra-region trade and investment.¹⁰ At times, particular measures for regional integration may contribute to the flows of Foreign Direct Investment (FDI) among partner states, and among partner states and outsiders.¹¹ Likewise, increased access to a bigger market might pull FDI towards states, having advantages of location.¹² The advantages might come from the accessibility of low-priced labour

¹⁰ Luiz R. de Mello Jr., "Foreign Direct Investment in Developing Countries and Growth: A Selective Survey", *The Journal of Development Studies*, Vol. 34, No. 1, 1997, pp. 1- 34.

¹¹ Indra Nath Mukherji, "Indo-Sri Lanka Trade and Investment Linkages with Special Reference to SAPTA and Free Trade Agreement", *South Asia Economic Journal*, Vol. 1, No. 1, March 2000, pp. 53-77 ; Indra Nath Mukherji, "India's Trade and Investment Linkages with Nepal: Some Reflections", *South Asian Survey*, Vol. 5, No. 2, September 1998, pp. 183-197.

¹² "Foreign Direct Investment and Economic Integration in the SAARC Region", paper presented at the Second Conference of the *South Asia Network of Economic Research Institutes (SANEI)* held in Kathmandu on 28-29 August 2000, by the Institute of Policy Studies of Sri Lanka, Colombo, available at http://saneinetwork.net/Files/01_02.PDF, accessed on 3 January 2013.

and capital, better connectivity, stable polity, sustainable policy guidelines, and other several aspects. Wilfred J. Ethier in his paper "The New Regionalism" recognises that partnership in Regional Integration Arrangement (RIA) may offer essential economic incentives to states that could assist them draw huge inflows of FDI.¹³ For states associated with RIA, preferential arrangements may produce not only 'investment creation' effect but 'investment diversion' also.¹⁴ Economic integration may have an effect on states' growth rates and then contribute to intra-regional FDI inflows.

Economic integration is almost unattainable without better communication and transportation systems.¹⁵ Trade and economic integration highly rely on improved infrastructure and physical connectivity. Studies on geographical simulation show that if the two are inadequate, trade facilitation measures and intra-regional trade costs are vulnerable.¹⁶ Other than physical connectivity, contemporary economic integration engages people-to-people networks and connectivity through Information and Telecommunication Technologies (ICT) where information on trade, customs authorities and businesses are exchanged and conversed, overcoming locational disadvantages.¹⁷ The notion 'connectivity' in this paper therefore regards both cross-country physical connectivity as well as ICT connectivity for a region. Consequently, this paper limits South Asian economic integration through specific three indicators of economic integration: trade, investment and connectivity.

3. Economic Integration Through Trade and Investment

3.1 Trade Integration

Trade integration among the member countries of a region is a key to economic integration. Such realisation induced SAARC Preferential Trading Arrangement (SAPTA) in 1995. Later on, SAARC initiated regional approach of Free Trade Area (FTA) in 1997, and then decided establishing South Asian Free Trade Area (SAFTA) by 2001. However, SAFTA was not signed until 2004 owing to political instability in the region. Though framework agreement of SAFTA was signed in 2004, it came into force on 1 June 2006. SAFTA consists of six core elements such as Trade Liberalisation Programme, Rules of Origin (RoO), Institutional Arrangements, Safeguard Measures, Special and Differential (S&D) treatment for the Least Developed Countries (LDCs), and Dispute Settlement Mechanisms. It stipulates trade with zero customs duty of almost all products in South Asia by 2016 (see Table 1).

¹³ Wilfred J. Ethier, "The New Regionalism", *The Economic Journal*, Vol. 108, No. 449, July 1998, pp. 1149-1161.

¹⁴ *Ibid.*

¹⁵ Jean-Paul Rodrigue, Claude Comtois and Brian Slack, *The Geography of Transport System*, London: Routledge, 2006, p. 74.

¹⁶ "Regional Connectivity and Economic Integration", Economic and Social Survey of Asia and the Pacific 2011, available at: <http://www.unescap.org/pdd/publications/survey2011/download/08-Chapter3-Survey2011.pdf>, accessed on 3 January 2013.

¹⁷ *Ibid.*

To implement SAFTA and to facilitate and enhance intra-regional trade, SAARC has recognised the need to address major barriers (sensitive lists of items, Non-Tariff Measures (NTMs) and Para-Tariff Measures (PTMs) standing in the way of effective trade liberalisation. It has revised sensitive lists giving special consideration to the LDCs, and called for creating regional customs union by 2012 and economic union by 2020. SAARC has also underscored the need for taking some concrete measures to adopt common tariff nomenclatures and harmonise customs procedures. Recently, the bloc has signed SAARC Agreement on Trade in Services (SATIS) and called for immediate ratification of the agreement.

Table 1: Schedule of Tariff Reduction under SAFTA			
Countries	Existing Tariff Rates	Tariff Rates Under SAFTA Agreement	Time Schedule
SAFTA First Phase			
India, Pakistan and Sri Lanka	More than 20% Less than 20%	Reduce to 20% Annual Reduction of 10%	2 years 2 Years
Bangladesh, Nepal, Bhutan, Maldives and Afghanistan	More than 30% Less than 30%	Reduce to 30% Annual Reduction of 5%	2 years 2 Years
SAFTA Second Phase			
Pakistan and India	20% or below	0-5%	5 Years
Sri Lanka	20% or below	0-5%	6 Years
Nepal, Bhutan, Maldives and Afghanistan	30% or below	0-5%	8 Years

Source: Sharif M. Hossain and Ishtiaque Selim, "Regional Cooperation in South Asia: Future of SAFTA", *BISS Journal*, Vol. 28, No. 2, 2007, p. 397.

3.1.1 Intra-regional Trade and World Share

Though signing of SAFTA raised hope for intra-regional trade in South Asia, share of bilateral/regional trade as a percentage of world trade (see Table 2), share of regional trade in South Asia's trade with the world (see Table 3), and intra-regional trade share in South Asia are insignificant (see Table 4).

Table 2: Share of Bilateral/Regional Trade as a Percentage of World Trade in 2006

Export								
	Bang	Bhutan	India	Maldives	Nepal	Pak	Sri L.	Afg
Bangladesh	-	0.03	1.15	0.00	0.01	0.50	0.08	0.008
Bhutan	0.00	-	75.31	0.00	0.00	0.48	0.00	0.00
India	1.60	0.10	-	0.06	1.09	0.64	1.88	0.14
Maldives	0.00	0.00	0.76	-	0.00	0.00	11.81	0.00
Nepal	0.39	0.00	67.83	0.00	-	0.31	0.003	-
Pakistan	1.52	-	2.66	0.02	0.01	-	1.10	7.65
Sri Lanka	0.23	0.00	9.32	0.45	0.00	0.58	-	0.03
Afghanistan	0.96	0.00	22.00	0.00	0.00	21.02	0.49	-
Import								
	Bang	Bhutan	India	Maldives	Nepal	Pak	Sri L.	Afg
Bangladesh	-	0.07	12.49	0.00	0.01	0.94	0.06	0.01
Bhutan	0.00	-	69.08	0.00	0.00	0.17	0.01	0.00
India	0.07	0.06	-	0.00	0.33	0.10	0.34	0.03
Maldives	0.00	0.00	11.18	-	0.00	0.38	5.65	-
Nepal	0.60	0.00	61.75	0.00	-	0.11	0.03	-
Pakistan	0.28	0.00	2.39	0.01	0.01	-	0.24	0.22
Sri Lanka	0.09	0.00	19.55	0.22	0.00	1.22	-	0.00
Afghanistan	0.02	0.00	5.06	0.00	0.00	37.50	0.07	-

Source: Calculated from IMF, Direction of Trade Statistics database

Table 3: Share of Regional Trade in South Asia's Trade with the World, 2008 (%)

Import									
	Afg.	Bang.	Bhutan	India	Mald.	Nepal	Pak.	Sri L.	SAARC
Afghanistan	0.00	0.05	0.00	6.99	0.00	0.00	36.35	0.00	43.38
Bangladesh	0.01		0.06	14.69	0.00	0.37	1.24	0.07	16.44
Bhutan									
India	0.04	0.10	0.06		0.00	0.19	0.12	0.15	0.66
Maldives	0.00	0.00	0.00	9.21		0.00	0.35	4.51	14.08
Nepal	0.00	0.22	0.00	55.25	0.00		0.12	0.01	55.59
Pakistan	0.20	0.19	0.00	3.69	0.01	0.01		0.15	4.26
Sri Lanka	0.00	0.08	0.00	18.94	0.12	0.00	1.41		20.56
SAARC	0.06	0.11	0.05	2.70	0.01	0.16	0.77	0.15	
Export									
	Afg.	Bang.	Bhutan	India	Mald.	Nepal	Pak.	Sri L.	SAARC
Afghanistan		0.27	0.00	23.54	0.00	0.00	17.70	0.00	41.52
Bangladesh	0.02		0.02	2.34	0.00	0.04	0.58	0.08	3.08
Bhutan									
India	0.20	1.45	0.06		0.07	0.87	0.87	1.40	4.91
Maldives	0.00	0.00	0.00	0.00		0.00	0.00	8.54	8.54
Nepal	0.00	9.16	0.00	54.83	0.00		0.42	0.01	64.42
Pakistan	8.62	1.25	0.00	1.45	0.02	0.02		0.85	12.21
Sri Lanka	0.00	0.18	0.00	4.48	0.68	0.00	0.74		6.09
SAARC	1.00	1.32	0.05	0.72	0.08	0.70	0.80	1.21	

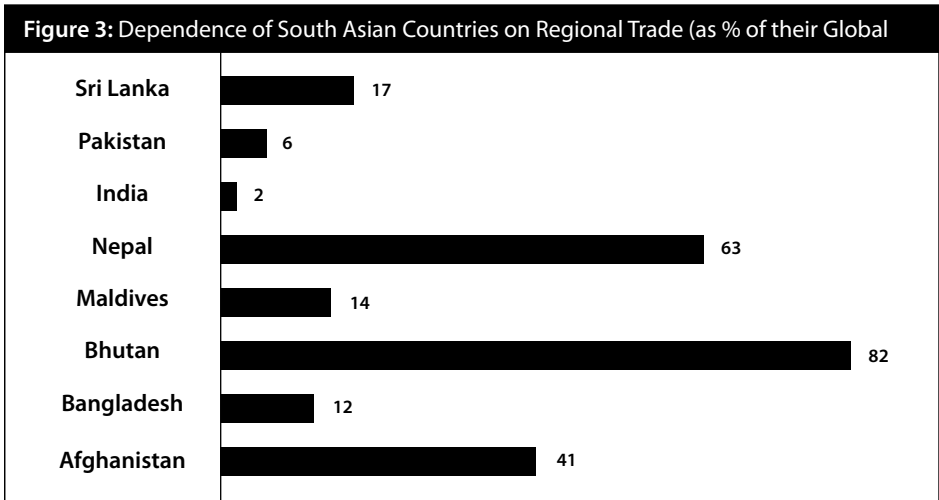
Source: Calculated from IMF, Direction of Trade Statistics database

Table 4: Intra-regional Trade Share in South Asia

	Afghanistan	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka
Afghanistan	-	0.01	0.08	0	0	2.72	0.01
Bangladesh	0.09	-	0.66	0	0.15	0.44	0.16
India	6.3	7.98	-	9.72	63.35	2.22	15.54
Maldives	0	0	0.03	-	0	0.02	0.31
Nepal	0	0.02	0.64	0	-	0.01	0.02
Pakistan	36.76	0.82	0.32	0.33	0.16	-	1.2
Sri Lanka	0.03	0.09	0.81	5.01	0.02	0.39	-
SAARC	43.18	8.92	2.53	15.06	63.68	5.79	17.23

Source: Calculated from IMF, Direction of Trade Statistics database, 2011.

In contrast to the figures of 25 percent of the ASEAN countries and 14 percent of the Southern Common Market (MERCOSUR)¹⁸, intra-regional trade is less than 6 percent¹⁹ of total global trade of South Asian countries, and dependence of South Asian countries on regional trade is meagre except Bhutan, Nepal and Afghanistan (see Figure 3).



Source: Calculated from IMF, Direction of Trade Statistics database, 2012.

¹⁸ Paras Kharel, "Advances in South Asian Economic Cooperation: Stay the Course, Trade Insight. [South Asia Watch on Trade, Economics and Environment (SAWTEE), Nepal], Vol. 8, No. 2, 2012, pp. 16-20, also available at: <http://www.sawtee.org/publications/Trade-Insight-23.pdf>, accessed on 9 December 2012.

¹⁹ *ibid.*

3.1.2 Intra-regional Trade with Several Issues

Article 7(6) of SAFTA stipulates that imports from the LDCs will be duty free.²⁰ Simultaneously, there are S&D treatments, Mechanism for Compensation for Revenue Loss (MCRL), and technical assistance clauses in SAFTA to enhance exports from the LDCs.²¹ Although these dispensations may possibly increase exports and trade opportunities,²² some issues are also crucial that can restrain SAFTA benefits. For example, RoO is yet to be negotiated. If it excludes light manufacturing products, trade facilitation may possibly be in question. Owing to several factors such as excessive trade concentration with a single economy,²³ lack of trade complementarities,²⁴ Para-Tariff Barriers (PTBs) and Non-Tariff Barriers (NTBs),²⁵ existing sensitive lists under SAFTA (see Table 5)²⁶ and lack of trade facilitation,²⁷ the velocity of regional trade integration in South Asia has been sluggish. Therefore, number of sensitive products in the lists under SAFTA has to be gradually reduced. Since liberalisation of tariffs continues, important initiatives on trade facilitation and eliminating NTBs would also be crucial for effective trade integration in South Asia.

²⁰ Satyajit Mohanty, "Afghanistan in SAFTA: Issues and Implications", *Institute of Peace and Conflict Studies*, 28 August 2006, available at <http://www.ipcs.org/article/afghanistan/afghanistan-in-safta-issues-and-implications-2101.html>, accessed on 10 July 2010.

²¹ Mohammad Jasim Uddin and Mahfuz Kabir, "SAARC's Potential Role in Promoting Economic Development in Afghanistan", *BIISS Journal*, Vol. 32, No. 3 (July), 2011, pp. 219-235.

²² Fahmida Khatun, "Trade Integration in South Asia Pruning Sensitive Lists and Beyond", *Trade Insight* [South Asia Watch on Trade, Economics and Environment (SAWTEE), Nepal], Vol. 8, No. 2, 2012, pp. 21-23, also available at: <http://www.sawtee.org/publications/Trade-Insight-23.pdf>, accessed on 9 December 2012; "Passport to Development", *Centre for Asian Strategic Studies*, 20 May 2009, available at <http://www.cassindia.com/fullarticle.asp?recno=167>, accessed on 20 July 2010.

²³ Trade of Bhutan and that of Nepal with India is 81.79 percent and 63.25 percent respectively. Afghanistan's trade with Pakistan is 40.68 percent. Bangladesh's trade with India is increasing. Likewise, India and Sri Lanka have adopted FTA between the two. Bangladesh is eager to have an FTA with India. Also, recent developments between India and Pakistan have raised hopes for furthering trade relations between the two. See Paras Kharel, *op. cit.*; Fahmida Khatun, *op. cit.*

²⁴ Paras Kharel, *op. cit.*; Sharif M. Hossain and Ishtiaque Selim, "Regional Cooperation in South Asia: Future of SAFTA", *BIISS Journal*, Vol. 28, No. 2, 2007, p. 397.

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ Gazi Towhid Ahmed, "Trade Deficit with South Asian Nations Crosses \$2b", *The Daily Star* (Dhaka), 27 March 2012.

Table 5: Sensitive Lists under SAFTA (Phase II)

Country	Number of sensitive products in the initial list	Number of sensitive products in the revised products in the revised lists (phase II: with effect from 1 January 2012)
Afghanistan	1,072	850
Bangladesh	1,233 (LDCs); 1,241 (NLDs)	987 (LDCs); 993 (NLDCs)
Bhutan	150	150
India	480 (LDCs); 868 (NLDCs)	25 (LDCs); 695 (NLDCs)
Maldives	681	152
Nepal	1,257 (LDCs); 1,295 (NLDCs)	998 (LDCs); 1,036 (NLDCs)
Pakistan	1,169	936
Sri Lanka	1,042	845 (LDCs); 906 (NLDs)

Source: Fahmida Khatun, *op. cit.*, p. 22.

SAARC countries have to be engaged in productive exchange of ideas, confidence building and resuming essential initiatives to signify glowing trade integration in South Asia. They should be pro-active to any disagreeable barrier that could delay effective trade integration in the region. Therefore, involvement of civil society with trade integration processes would be crucial.

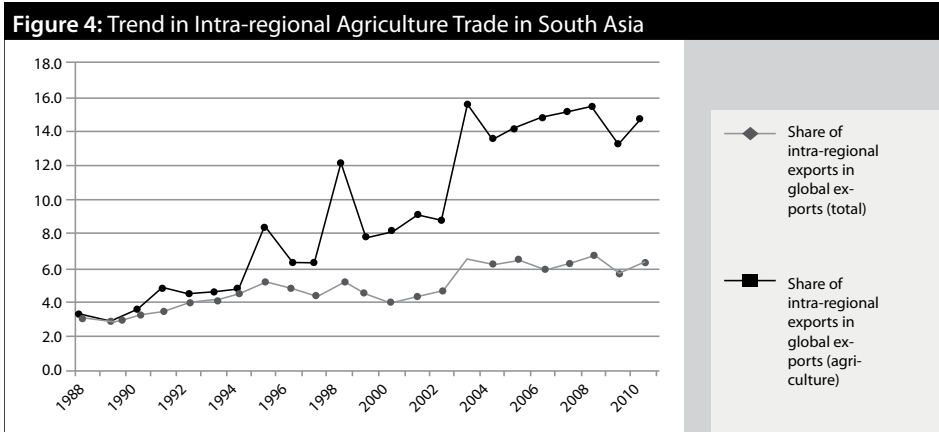
3.1.3 Intra-SAARC Agricultural Exports

Although share of intra-regional exports in total global exports has been sluggish, share of intra-regional agriculture exports in global agriculture exports is increasing (see Figure 4) in South Asia.²⁸ For FY 2000-2010, while intra-regional yearly average trade growth rate was 6 percent, average annual intra-regional agriculture trade growth rate in South Asia was 13 percent.²⁹ The rate would likely be 38 percent higher than the existing one and it is supported by the study of Asian Development Bank (ADB) and United Nations Conference on Trade and Development (UNCTAD).³⁰

²⁸ Rashmi Banga, "Regional Integration in Agriculture Trade in South Asia Potentials and Constraints," *Trade Insight* [South Asia Watch on Trade, Economics and Environment (SAWTEE), Nepal], Vol. 8, No. 2, 2012, pp. 12-15, also available at: <http://www.sawtee.org/publications/Trade-Insight-23.pdf>, accessed on 9 December 2012.

²⁹ *Ibid.*

³⁰ *Ibid.*



Source: Rashmi Banga, *op. cit.*, p. 14.

Though supply chains as well as prospective arenas of trade integration could be noticed in agriculture, particularly in the sectors of food processing, NTMs and tariffs are the key concerns for South Asia. Therefore, crucial is to have legal documents and pledges on reducing NTBs gradually in the SAFTA and harmonising NTMs for South Asia. Another vital initiative could be setting up of SAARC Regional Standard Organisation (SRSO) to attain indistinguishable standards of quality in South Asia.

Another area of economic integration in South Asia is trade in services. The region could be benefited from the process of liberalisation in services. It has huge prospects in trade in services such as energy, ICT, tourism, fiduciary services, health, professional services and education. In 2010, South Asian countries signed SATIS, a derivative accord of SAFTA, for liberalising services trade. Of late though it has placed request and offer principles for negotiations, SATIS is yet to be executed effectively. As liberalisation process maintains positive list approach, SATIS members have to be far-sighted in order to oversee domestic services providers' interests.³¹ At the same time, services sector in South Asian trade agreement must go ahead of bindings by the World Trade Organisation (WTO) to boost economic integration in the region.³²

3.1.4 Trade in Services: Energy

Since Organisation of Petroleum Exporting Countries (OPEC) embargo on oil exports in 1973, energy has been one of the major global security concerns. With the recent increase in oil price, energy insecurity turns out to be more critical than ever. The impact of the price hike has also been felt in the SAARC countries, which are mainly

³¹ "SAARC: Towards Meaningful Cooperation", co-edited by Tomislav Delinic and Nishchal N. Pandey, published by Centre for South Asian Studies (CSAS) and Konrad Adenauer Stiftung (KAS), June 2012, also available at: http://www.kas.de/wfi/doc/kas_32458-1522-1-30.pdf?121022073121, accessed on 12 December 2012.

³² *ibid.*

dependent on imported oil and where per capita energy production capacity is only 0.1 kilowatt.³³ Therefore, energy security issue emerges as one of the key priorities in regular meetings of SAARC. Since its inception, SAARC has taken various steps to reinforce intra-SAARC energy cooperation under SAARC Integrated Programme of Action (SIPA), and has approved establishing of SAARC Energy Centre (SEC) to develop energy resources through promoting regional energy trade, developing renewable and alternative energy resources, and enhancing energy efficiency in the region. It has stressed on concerted effort for conserving use of conventional energy and building up of renewable energy resources, and has given importance to development of regional and sub-regional energy resources in an integrated manner for tapping potential in this sector.

SAARC has suggested for developing and sharing of regional hydroelectric potentiality, grid connectivity and gas pipelines. It has also urged for commissioning a definite survey to determine actual quantum of energy resources, and to devise a way in which energy could be used for maximum benefits of the member states. SAARC has envisaged a network of trans-regional oil and gas pipelines, and has emphasised the need to undertake studies for developing regional energy projects, infrastructure and trade; energy conservation and development of labelling and standardisation of appliances, and sharing of energy efficiency expertise, capacity, knowledge and technologies. Besides, it has called for creating a web portal on energy conservation to exchange information and share best practices among the SAARC member states.

The cooperation in the energy sector began in January 2000 with the establishment of Technical Committee on Energy (TCE). SAARC formed a Working Group (WG) in 2004. The fifth Meeting of the WG was held in 2009. It set up expert groups on oil and gas, electricity, renewable energy, technology and knowledge sharing. The fourth Ministerial Level Meeting held in 2011, SAARC countries agreed to boost capabilities for energy cooperation with their energy reserves (see Table 6). Existing cooperation is limited to electricity production and trade in petroleum products. Cooperation in electricity exists between India, Bhutan and Nepal. Petroleum trade continues between India, Bangladesh, Bhutan, Nepal and Sri Lanka. Electricity products are based on indigenous hydropower resources. Bangladesh imports oil, petroleum and coal. Petroleum trade is based on India importing and refining crude oil and exporting petroleum products to Bhutan, Nepal and Sri Lanka. India also exports diesel in Bangladesh.

³³ Mohammad Jasim Uddin and Mahfuz Kabir, *op. cit.*, p. 225; Ishtiaque Selim and Mohammad Jasim Uddin, "15th SAARC Summit: SAFTA, Food Security and Energy", *BISS Journal*, Vol. 29, No. 4, 2008.

Table 6: Energy Reserves of SAARC Member States

Country	Coal (million tons)	Oil (million barrels)	Natural Gas (rillion cubic feet)	Hydropower (megawatts)	Biomass (million tons)
Afghanistan	440	NA	15	25,000	18-27
Bhutan	2	0	0	30,000	26.60
Bangladesh	884	12	8	330	0.08
India	90,085	5,700	39	150,000	139
Maldives	0	0	0	0	0.06
Nepal	NA	0	0	42,000	27.04
Pakistan	17,550	324	33	45,000	NA
SriLanka	NA	150	0	2,000	12

Source: Asian Development Bank, 2011.

Bangladesh is keen to get benefit from the regional energy cooperation. An electricity transmission interconnection of 500 megawatt (MW) capacity between Bangladesh and India is currently under implementation with the assistance of the Asian Development Bank ADB. Bangladesh is also in connection with Nepal and Bhutan for importing electricity. The process is under consideration. Like Bangladesh, almost all the countries are failing to generate sufficient electricity to meet their demands. It has been estimated that energy needs of South Asia will increase three times in next fifteen to twenty years.³⁴ As South Asia has potential renewable energy resources (such as hydropower, wind power and solar power) still to be exploited, regional cooperation in the areas of energy has emerged as a prerequisite for a sustainable regional economic integration.³⁵

3.1.5 Energy Trade in South Asia

There is insignificant amount of energy trade within South Asian region, between South Asia and energy-rich Central Asia, and between South Asia and West Asia.³⁶ Afghanistan can work as energy corridors through trans-border transport networks.³⁷ Afghanistan could be a key transit for energy, providing a route for imports of hydropower from Central Asia, and gas from Central Asia and Iran. In this respect, Afghanistan’s proposal to open corridors through Turkmenistan-Afghanistan-Pakistan-India (TAPI) [gas pipeline] is a good sign for the country.³⁸ Moreover, previously a study

³⁴ Sultan Hafeez Rahman, Priyantha D. C. Wijiyatunga, Herath Gunatilake and P. N. Fernando, “Energy Trade in South Asia: Opportunities and Challenges”, Asian Development Bank, December, 2011.

³⁵ *Ibid.*

³⁶ Razia Sultana, “Expansion of SAARC: Implications for South Asia”, *BISS Journal*, Vol. 28, No. 2, 2007, p. 150.

³⁷ Connecting South Asia by land with Central Asia, see Razia Sultana, *op. cit.*

³⁸ “Afghanistan Becomes Full Member, India New Chair”, *The Daily star* (Dhaka), 4 April 2007.

on gas pipeline was prepared but it was not implemented because of unwillingness to involve Afghanistan in the project. As Afghanistan is now a member of SAARC, India and Pakistan can consider the venture with a concerted effort. The effort would facilitate Afghanistan's expected hope in developing a regional oil and gas pipeline to open its largely untapped market for business and investing on energy.³⁹

On the other hand, Afghanistan itself has natural gas reserves estimated to be nearly 1.6 trillion cubic feet (cft), and the country produces about 20 million cubic feet per year; all of it is consumed internally.⁴⁰ Afghanistan has also reserves of copper, iron ore, oil and coal. At present, the country has 95 million barrels of oil and 400 million tonnes (mt) of coal, which could be mined or extracted to increase its energy trade and investment under the arrangement of SAARC.⁴¹ Therefore, Afghanistan's access to SAARC could possibly mean a major energy gain for the bloc. Regional energy cooperation frameworks could be implemented though setting up of regional power market, regional refinery system, liquefied natural gas terminal, regional power plant as well as pursuing non-conventional regional energy to facilitate energy production and trade in South Asia. Public-private partnership is crucial to develop energy cooperation in the region.

3.1.6 *Economic Integration through Investment*

Investment facilitation is crucial for boosting trade and productivity.⁴² Therefore, increasing intra-regional trade could generate intra-regional investments within South Asia. Transportation and connectivity, modernising regulatory organs, measures for facilitating trade, sharing of technical, technological and fiduciary issues, and amplifying agriculture productivity are likely be the key sectors of intra-regional investments in South Asia.

³⁹ "Afghanistan Joins South Asian Association for Regional Cooperation", The Embassy of Afghanistan Washington DC, 4 April 2008, available at: <http://www.embassyofafghanistan.org/04.04newssaarc.html>, accessed on 14 July 2010.

⁴⁰ Sudeshna Sarkar, "SAARC: Afghanistan Comes in from the Cold", *International Relations and Security Network*, 16 May 2007, available at: <http://www.isn.ethz.ch/isn/Current-Affairs/Security-Watch/Detail/?ots591=4888CAA0-B3DB-1461-98B9-E20E7B9C13D4&lng=en&id=53216>, accessed on 24 July 2010.

⁴¹ Razia Sultana, *op. cit.*

⁴² "SAARC: Towards Meaningful Cooperation", *op. cit.*

Table 7: Intra-Regional FDI in South Asia (% of Country Total)

	India		Bangladesh		Pakistan		Nepal		Sri Lanka
	2001-03	2006-07	1995-96	2005-06	2001-06	2006-08	Up to 2006	2006-07	2005
India			0.62	0.54	0.00	0.00	40.71	46.60	6.20
Bangladesh	...	...			0.05	0.10	0.75	...	0.18*
Pakistan	...	...	1.40	1.87			0.47	...	0.60*
Nepal	...	...	...	...	...	...			...
Sri Lanka	0.01	0.01	0.23	0.41	...	...	0.13	...	
Bhutan	...	...	0.01	...	...	...	0.01	...	...
Maldives	0.01	0.01	0.00	...	...	...	0.00	...	n.a.
Share of South Asia	0.02	0.02	2.25	2.82	0.06	0.10	41.80	46.60	7.00

Source: See A. Aggarwal, 2008. Regional Economic Integration and FDI in South Asia: Prospects and Problems. ICRIER Working Paper 218. ... = Data not available, * pertain to the year 2000

Although owing to inadequate competence (of firms in most states of South Asia) to presume considerable amount of outward FDI, relatively inflexible measures on outward FDI and comparatively unreceptive setting for inward FDI and intra-SAARC investments are still relatively insufficient, South Asian recent liberalisation process has imparted stimulation to the economies of the region in some aspects. Some economies are going to be open further, outer leaning, and additionally open to global trade and investment. Meanwhile, some South Asian promising companies are making joint ventures with international companies, intensifying their prospects and undertaking measures to generate FDI in other states.⁴³ Therefore, South Asia has emphasised on promoting efforts to enhance intra-regional investments.

Although there are negotiations continuing on SAARC Investment Protection and Promotion Agreements (SIPPA), the Committee of Experts has still failed to conclude the agreement. If it is concluded, the SIPPA might be imperative to contribute to the flows of intra-SAARC investments. Therefore, conclusion and implementation of SIPPA is crucial. On the other hand, SIPPA and SMAADT (SAARC Multilateral Agreement on Avoidance of Double Taxation)⁴⁴ must move simultaneously to uphold intra-SAARC investments that may influence intra-regional trade and economic integration in South Asia.⁴⁵

4. Economic Integration through Connectivity

Article 8 of SAFTA posits that states shall take steps to secure transit facilities for efficient intra-SAARC trade, particularly for the land-locked countries.⁴⁶ SAARC, since its inauguration, has recognised the importance of improving intra-regional connectivity, particularly physical, economic and people-to-people connectivity to

⁴³ "Foreign Direct Investment and Economic Integration in the SAARC Region", *op. cit.*

⁴⁴ SMAADT is signed in 2005.

⁴⁵ "SAARC: Towards Meaningful Cooperation", *op. cit.*

⁴⁶ Satyajit Mohanty, *op. cit.*

have smooth flow of goods and services, technologies, knowledge, capital, culture and ideas for sustaining South Asia's economic integration.

In the 12th SAARC Summit in 2004, the member states decided to strengthen transport, transit and communication linkages in South Asia. It was followed by a SAARC Multi-modal Transport Study (SRMTS), which was completed in June 2006. The SRMTS identified 10 road corridors, 5 rail corridors, 2 Inland Water Transport (IWT) corridors, 10 maritime gateways and 16 aviation gateways for regional transport connectivity. During the 14th SAARC Summit in 2007, the member states approved the proposals provided by the SRMTS, urged transport ministers to oversee the points and called for early implementation of the recommendations contained in the study in a gradual and phased manner, and through mutual consultations among its member states.

SAARC has also directed Inter-Governmental Group on Transport to identify and develop sub-regional and regional projects based on prioritised recommendations of the SRMTS and to develop appropriate agreements on regional connectivity. Furthermore, SAARC has made progress of drafting Motor Vehicle Agreement (MVA), and has directed its member states to expedite work on examining technical inputs related to Regional Transport and Transit Agreement and Regional Multilateral Railway Agreement. Recently, it has called for collaborative efforts to achieve greater intra-regional connectivity and, therefore, it has declared 2010-2020 as the 'Decade of Intra-regional Connectivity in SAARC' to expedite negotiations with a view to finalising two agreements on motor vehicles and railways.

4.1 Afghanistan's Access to SAARC and Connectivity

In recent times, Afghanistan's access to SAARC has made the idea of connectivity even more crucial to South Asian region, and provided SAARC a gateway to Central Asia and beyond. It would also enable SAARC to identify and develop sub-regional and regional projects, and draft appropriate regional agreements to build a series of corridors linking South Asia and eventually the bloc with Central Asia and West Asia.⁴⁷ Therefore, fresh impetus to regional connectivity linking South Asia to Central Asia and beyond may facilitate transit-border transport networks, expansion of regional trade, and free flow of people and ideas.

It was widely known that Pakistan had been building a four-lane highway that would have linked Afghanistan to India through Pakistan. One estimate showed that about 70 per cent of the highway had already been completed.⁴⁸ However,

⁴⁷ India, Afghanistan and Iran have an agreement in place for development of over 200 km highway linking Afghan town of Delaram with Zaranj in Iran. See, <http://mrunal.org/2012/08/diplo-delaram.html>, accessed on 3 January 2013.

⁴⁸ Available at: <http://www.cassindia.com/fullarticle.asp?recno=167>, accessed on 20 July 2010.

the information needs re-examination. On the contrary, since 2002, India, Iran and Afghanistan had formalised cooperation on development of Iranian port, Chahbahara to serve as transit point for goods traffic to and from Afghanistan.⁴⁹ Simultaneously, India, over the last few years, had also been demanding transit facilities through Pakistan to allow its goods and services to reach Afghanistan and Central Asia. However, Pakistan and Afghanistan signed a transit agreement allowing Afghan Lorries to use a land route⁵⁰ through Pakistan to carry goods to India, and giving Afghanistan an access to Pakistani ports to boost its trade with other countries.⁵¹

The initiatives indicate that Afghanistan is now at the centre of trans-national transport connectivity. However, political mistrust between India and Pakistan and instability in Afghanistan have become the key challenges to advance arrangements for formal regional physical connectivity.⁵² Therefore, Afghanistan's accession to SAARC may offer a new multilateral dimension to India's quest for an overland transit facility through Pakistan for trade and investment with Afghanistan and Central Asia. Similarly, the accession may possibly improve Afghanistan's connectivity not only within South Asian region but also between South Asia and Central Asia.

It is important to note here that from trade to energy hub, Afghanistan has already emerged as a central focus of many nations. Since, its strategic location straddles between energy-rich republics of Central Asia and South Asia, sharing borders with Iran, Pakistan, China, Tajikistan, Turkmenistan and Uzbekistan. With such an opportunity to exploit its geo-physical positioning, Afghanistan is now focused on integrating itself with trans-border transport networks,⁵³ whereas SAARC has called for an extension of SRMTS⁵⁴ to include Afghanistan as well, and has proposed outlining Dhaka-Kabul corridor to enhance transport connectivity in South Asian region.⁵⁵ Therefore, it is expected that SAARC with its existing initiatives would help improving Afghanistan's physical connectivity in the region and beyond.⁵⁶

⁴⁹ *Ibid.*

⁵⁰ A sensitive Pakistani land route through the Wagah border crossing, see Mohammad Jasim Uddin and Mahfuz Kabir, *op. cit.*, p. 231.

⁵¹ "Pak-Afghanistan transit agreement signed Pakistan allows Afghan Lorries to use its land to go to India", *The Daily Star* (Dhaka), 20 July 2010.

⁵² Ishtiaque Selim and Mohammad Jasim Uddin, *op. cit.*

⁵³ "Regional Cooperation", *Ministry of Foreign Affairs, Islamic Republic of Afghanistan*, 25 February 2007, available at <http://www.mfa.gov.af/regional-cooperation.asp>, accessed on 9 July 2010.

⁵⁴ It is identified with road, rail and air links to South Asian region that would be extended to Afghanistan.

⁵⁵ Razia Sultana, *op. cit.*

⁵⁶ Sudesna Sarkar, *op. cit.*

4.2 Connectivity: Bangladesh and India

Bangladesh and India, considering the agenda of trade facilitation such as improving physical connectivity particularly for the states that are land-locked, have agreed on several issues on transport connectivity.⁵⁷ For example, making Mongla and Chittagong sea ports available for the use of Nepal, Bhutan and India; making Rohanpur/Singabhad-Kathiwar-Raxual-Birgunj broad gauge rail link (see Map 1) accessible for Nepal's third country trade through Mongla Sea port, and for bilateral trade between Bangladesh and Nepal. Other important issues are constructing Akhaura-Agartala rail link; designating Ashuganj as a new port of call and transshipment port for Indian transit traffic by IWT and then for onward movement to Tripura by road transport; and allowing goods between India and Bangladesh to be carried on containers through rail and water transport routes.⁵⁸

Map 1: Rohanpur-Katihar-Birgunj Rail Link

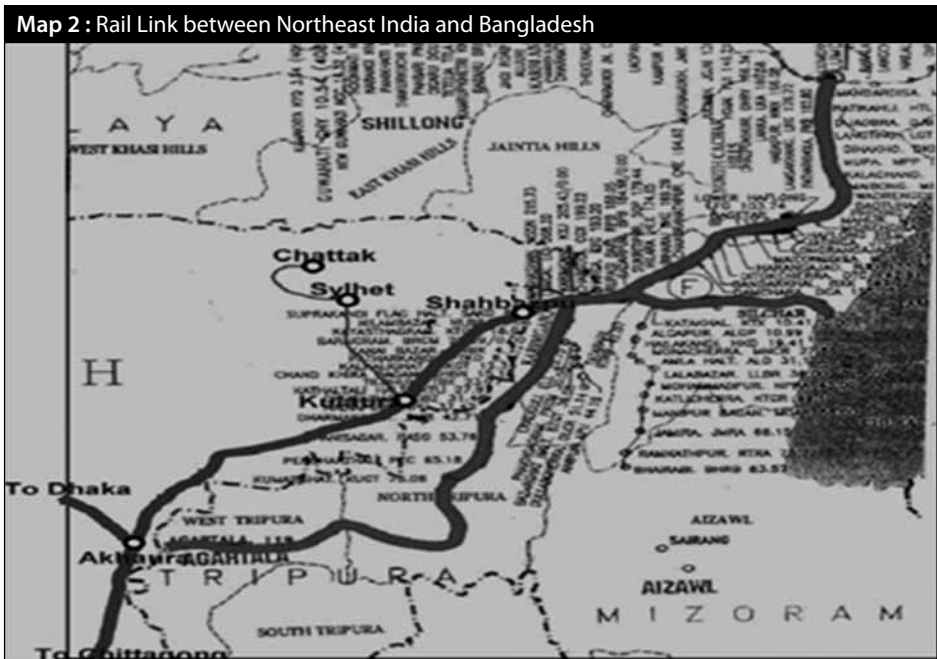


Source: M. Rahmatullah, *op. cit.*, p. 134.

⁵⁷ M. Rahmatullah, "Regional Transport Connectivity in South Asia", Saman Lakegama, Ratnakar Adhikari, Puspita Sharma and Paras Kharel (eds.), *Regional Economic Integration Challenges for South Asia During Turbulent Times*, Chapter 7, 2012, pp. 127-142, published by South Asia Watch on Trade, Economics and Environment (SAWTEE), Kathmandu, and South Asia Centre for Policy Studies (SACEPS), Kathmandu.

⁵⁸ Prime Minister Sheikh Hasina of Bangladesh visited India in 2010. Bangladesh and India during that time signed a Joint Communiqué (JC), where the JC identified the issues on transport connectivity

If India allows Bangladesh to connect with Nepal and Bhutan, physical connectivity among the countries would benefit their trade and economic integration. Besides, India expects to get transit through Bangladesh connecting its North-eastern region. The existing rail link between Northeast India and Bangladesh is shown in Map 2. However, by opening these connectivity Bangladesh may gain from the earning of transport charges, port charges, border crossing charges, earnings from using major bridges such as Jamuna Bridge.



Source: M. Rahmatullah, *op. cit.*, p. 134.

There is a lack of political commitment to open up connectivity in the South Asian region. At the same time, security concerns, domestic political compulsions, traditional mindset and inter-linkage between connectivity and other issues like border management are preventing the region to unearth huge potentials from regional connectivity. After having sufficient commitments, owing to inadequate implementation on connectivity, South Asia is facing challenges towards economic integration. The transportation costs are high in the region and the cost of non-cooperation hampers development process, market expansion and economic integration. Logistic costs are also high in South Asia ranging between 13 to 14 percent of the commodity value.⁵⁹ Therefore, intra-regional trade is also poor in comparison with that of other regions. Consequently, the immediate task is to strengthen not only

⁵⁹ M. Rahmatullah, *op. cit.*, p. 136.

physical connectivity in South Asia but also to introduce integrated telecommunication and ICT systems for better economic integration in the region.

4.3 Instituting Connectivity through Integrated Telecommunication and ICT

The countries of South Asia in the 9th SAARC Summit in 1997 agreed that inadequate communication facilities amongst the member states were a major hindrance for strengthening economic integration. In this respect, SAARC countries gave emphasis on developing communication infrastructure in the region. To pursue the decision, the first SAARC Communication Ministers' Meeting was held in Colombo in May 1988. The ministers agreed that communication infrastructure may not be a source of revenue, but it would open up a multifaceted process for enhancing economic integration.

The second Conference of SAARC Telecommunication Ministers was held in 2004 and it adopted a revised SAARC Plan of Action on Telecommunication with some goals and objectives. Three important goals are (i) promoting integration to enhance telecommunication links and utilise information technologies within SAARC, (ii) lessening disparities within and among SAARC members in telecommunication, and (iii) sharing of information on customs authorities. Another key objective is to harness telecommunication technology for socio-economic progress of SAARC through infrastructure development by optimal sharing of available resources and enhanced cooperation in technology transfer, standardisation and human resource development. The most crucial goal is to evolve a coordinated approach on issues of common concerns in international telecommunications forum.

A WG was formed regarding the objectives aforesaid and since 2004, it is working to find out new way outs for strengthening telecommunication networks in South Asia. However, like many other issues, SAARC did not succeed to make telecommunication less costly in the region.⁶⁰ Moreover, the ICT cooperation is also not worth mentioning in South Asia. These necessitate improved and better integrated telecommunication and ICT systems for South Asian economic integration.

5. Conclusion

Though there are some arrangements to stimulate South Asian economic integration, outcomes in this regard are insignificant. For example, intra-SAARC trade is less than six percent of total South Asian trade. Supply chains as well as prospective arenas of trade integration though could be noticed in agriculture, particularly in the sectors of food processing, NTMs and tariffs are the key concerns for South Asia. Services trade liberalisation since 2005 has become one of the important agenda

⁶⁰"Regional Connectivity and Economic Integration", *op. cit.*

of SAARC but achievements on liberalising trade in services are sluggish. Although regional cooperation in the areas of energy has emerged as a prerequisite for sustainable regional economic integration, there is insignificant amount of energy trade within South Asia. Even after having continuous dialogues on SIPPA, it is yet to be concluded and implemented. Then again, inadequate arrangements for intra-regional physical connectivity and lack of integrated telecommunication and ICT systems have been the key impediments to enhance economic integration in South Asia. Therefore, South Asian economic integration is in question.

While many traditional factors are identified for the sluggishness of economic integration in South Asia, there could be some fresh challenges upcoming and then complicating the process of integration. Therefore, evaluation and calculation of costs of non-cooperation can push SAARC members towards meaningful economic integration. In addition to reduce PTBs, NTBs and have adequate trade facilitation measures, minimisation of political debate and involvement of civil society can be effective to root out the existing hurdles of regional economic integration. For getting full payback of SAFTA, South Asia should develop its fiscal and tariff structure. At the same time, all countries should emphasise on deriving mutual trade benefits under SAFTA process of phased trade liberalisation programmes and agreed lists of commodities to be traded on which market access negotiations could be focused. As an emerging economy, the role of India in economic integration in South Asia is crucial since economic cooperation in the region mostly depends on the policies adopted by the country. For this, present sensitive lists of India for the LDCs under SAFTA should be maintained.

Strengthening of trade-investment linkages ought to be focused. To overcome trade-investment linkages through infrastructural development, customs clearance and other facilitation measures including multi-modal transport operations must be reinforced, whereas SAARC should constitute adequate regional transit arrangements for developing road and communication links. It would help the region to be a route for connecting South and SEA, CA and West Asia. To develop infrastructure for connectivity and energy, accommodation of a sufficient fund is crucial. Therefore, boosting intra-regional trade, investment and connectivity are the major imperatives to promote economic integration in South Asia.

⁶⁰“Regional Connectivity and Economic Integration”, *op. cit.*