Integration of SAARC Nations: Growth, Trends and Challenges

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Abstract

South Asia is emerging as the most promising and energetic region in the global economy. Expansion of domestic economies, rising opportunities for incomes and investments, growing of financial markets, greater pursuit of peace and stability are major driving factors of the current pace of growth in South Asia. Economic growth of the region has picked up at the faster rate in the last two years. Seven out of eight countries in the South Asia region have registered economic growth rates over 6 percent a year, making it one of the dynamic regions in the world.

According to Global Economic Prospects of the World Bank, real GDP growth in South Asia which was at 5.7 percent in 2009 is poised to take leap to 6.9 percent in 2010 and to 7.4 percent in 2011. As compared to other regions, the prospect for South Asia seems to appear much brighter in the near future. Financial markets encompass institutions, financial products, market mechanism and services, which can be convenient tools to build common economic market. Financial market in the SAARC region will be a powerful mechanism to foster economic development and enhance quality of life of the people in our respective countries. This paper tries to highlight the latest trends and developments of SAARC nations, especially the role of India in the bloc.

Key Words: Integration, Export Trade, Tariffs, SAFTA

1. Introduction

The South Asian Association for Regional Cooperation (SAARC) was founded in 1985 by the seven countries, *viz*. Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. While Afghanistan joined recently in 2005 and became the eighth member of SAARC. South Asia has the largest population, home to 1.5 billion people (World Bank 2008). Despite of its political differences, ideology and instability, the region has registered at an average of 6 percent annual GDP growth rate in the last 20 years (refer to Table 1 and Appendix 1). Cooperation among the SAARC nations is based on the five principles of sovereign equality, territorial integrity, political independence, non-interference in internal affairs of the member states and mutual benefit. Regional cooperation is seen as a complement to the bilateral and multilateral relations of SAARC member states.

South Asia, with more than 1.1 billion people, is one of the most densely populated regions in the world. Population density is 275 people per sq km which is six times higher than that of the world average population density. This region is the home of 23 percent of the world's population comprising an area of only 4.8 percent of the total global land. Considering the market-size in terms of population, SAARC is one of the largest economic blocs in the world. This region covers almost 67 percent of the low income population of the world economy. South Asian economies are mainly based on agriculture and therefore, land is an important resource. The region that occupies 4.8 per cent of the world's total land area, displays an extraordinary diversity of landforms due to climatic regimes, latitudes, altitudes and topography. Land, in South Asia, is under immense pressure as agriculture, urban land and wild areas all compete for the same resource.

Central Asia saw growth plummet for a second year, to 2.7% from 6.1% in 2008, with all countries putting in a weaker performance. Southeast Asia's growth slowed sharply to just 1.2% in 2009, the weakest outcome since the Asian financial crisis of 1997–98. South Asia was somewhat different. Growth in 2009 inched up to 6.5% from 6.4% in 2008 but only India and Afghanistan saw gains. Continued fiscal stimulus and monetary easing in India over the years, alongside an improving global environment, prompted large capital inflows as investor and consumer confidence got strengthened. But, due to one factor or the other, the growth in the Asia Pacific pulled back to 2.3% in aggregate in 2009 from 5.4% a year earlier.

South Asia's rebound since March 2009 has been strong. South Asia is poised to grow by about 7% in 2010 and nearly 8% in 2011. Thanks to the strong recovery in India, good performance in Bangladesh, post-conflict bounce in Sri Lanka, recovery in Pakistan, and turnarounds in other countries, including Afghanistan, Bhutan, and Maldives. The recovery is being led by rising domestic confidence and is balanced in terms of domestic versus external demand, consumption versus investment, and private demand versus reliance on stimulus.

Table: 1
Socio-economic figures of South Asia

Item	**South Asia**	**Low Income Countries** (US$ 975 or less)	**High Income Countries** (US$ 11,906 or more)	**World**
Land area (million sq km)	4.8	18.7	33.6	130
Population (billion)	1.1	1.0	1.1	6.7
GNI per capita (current US$)	1473	558	43279	60355
GDP (current US$, trillion)	1470	565	43310	60557
Literacy	72.9	76.6	98.5	86.4
Life expectancy	64.09	58.96	79.81	68.95
Exports (% of GDP)	21.4	33.9	……..	28.9
Imports (% of GDP)	28.2	47.1	………	28.9
Merchandise trade (% of GDP)	41.3	74.9	50.8	52.5

Source: Data compiled and calculated from World Development Indicators database, The World Bank, April 2008

2. Need for Integration

Integration is necessary to meet the challenges of globalisation. Global economic integration facilitates the importance of capital and intermediate goods that may not be available in a country's home market at comparable cost. Similarly, global markets improve the efficient allocation of resources. In addition, countries gain better access to financing, and the suppliers of capital– institutional investors and/or individual savers– receive better returns on their investments. Worldwide integration also allows for the rapid transfer of ideas and technology, which are critical ingredients of today's knowledge-based economies.

The objectives, principles and general provisions contained in the SAARC Charter are as follows:

- To promote the welfare of the peoples of South Asia and to improve their quality of life;
- To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential;
- To promote and strengthen collective self-reliance among the countries of South Asia;
- To contribute to mutual trust, understanding and 2 appreciation of one another's problems;
- To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;
- To strengthen cooperation with other developing countries;
- To strengthen cooperation among themselves in international forums on matters of common interests; and
- To cooperate with international and regional organizations with similar aims and purposes.

2.1 Prerequisites for Effective Integration

Effective integration cannot be achieved without the presence of certain fundamentals. These include:

- Convergence of market forces;
- An enabling environment, which includes political will transformed into common understanding;
- Socio-economic compatibility and cultural acceptability;
- Initial harmonization and eventual unification of the legal and regulatory regimes;
- An effective institutional framework for implementation; Judicial recognition and support; and Professional cooperation and support, e.g. through bodies like SAFA and the South Asian Federation of Exchanges (SAFE), a forum launched by the bourses in South Asia to promote the development of securities markets in region, which establish and maintain common values and standards and provide critical services to the corporate sector and capital market. The inception of SAFE certainly marks an important milestone in the march of South Asian capital markets towards regional and global integration.

2.2 South Asia’s Intra-regional Integration

South Asian countries individually, they are likely to gain even more by expanding trade and cross-border investments with each other—enlarging the South Asia market. A larger South Asian integration, if policies and institutions needed to do so can be improved, could also provide an important platform to reduce real trade costs and behind-the-border barriers in the region, which would then attract greater investment and integration with East Asia—enlarging dramatically the gains. The acceleration of bilateral trade and investment arrangements will be central, where India plays an important role (refer to Table 2 and Appendix 1), and private-sector cross-border investments will be key the instruments. The challenge will be for the region‘s largest and fastest-growing economy. India, to extend quickly such bilateral benefits of closer trade and investment with all its neighbours and to ensure that implementation is faster. But these agreements can go only so far, and a key role will need to be played by *private-sector, business-to-business transactions*, in expediting and enlarging such intraregional trade, leveraging such bilateral agreements.

The potential for such intra-regional trade is large—the current levels of about 5 percent share of intra-regional trade, in total, could quadruple to about 20 percent with such supportive policies, by some estimates. The more likely and faster way to do so is by expanding bilateral trade and investment relations—helping support the eventual goal of formal intra-regional trade cooperation arrangements (the SAPTA and its transition to SAFTA).

A sharp slowdown of economic growth punctuated in 2008 and 2009 as a result of the global financial crisis; the slowdown was more marked in some countries than in others. The region is now recovering rapidly. From 2007 to 2009, growth fell by close to 3 percentage points. It is now expected to recover to nearly 7 percent in 2010 and 8 percent in 2011—close to pre-crisis levels, and quicker than earlier anticipated.

Table 2

India’s Foreign Trade with Economic Region

South Asian Association For Regional Cooperation (SAARC)	**Exports including Re-exports (in lakhs)** April 2010	**Imports (in lakhs)** April 2010
Bangladesh	917450	98356
Bhutan	42402	59345
Maldives	31512	825
Nepal	486365	168854
Pakistan	585536	105801
Sri Lanka	789852	125155
Total	2853117*	558336*

Source: DGCIS, India's Foreign Trade by Economic Region, 2010

India's GDP grew by nearly 9 percent annually in 2002–07, reflecting overall investment rates that climbed to 37 percent (compared to 25 percent in the 1990s), and financed by rising domestic savings. Investment rates elsewhere remained at about 25 percent of GDP. Bangladesh saw a pickup but smaller rise in growth and private investment, and it finances its growth easily with growing remittances and exports. Bhutan's growth was led by large hydropower projects, with little external vulnerability because long-term external inflows (from India) financed such projects. Nepal was the only country with large savings and external surpluses, but it was unable to achieve faster growth and investment dynamism; rising remittances went into non-traded housing and land markets. In contrast, the sources of faster growth in Maldives, Pakistan, and Sri Lanka were relatively well grounded, but the economies saw increasing reliance on foreign savings (external deficits) and experienced greater vulnerability (reflecting growing fiscal deficits). Insecurity and conflict also rose in the region, especially after 2001, and it affected countries in South Asia to varying degrees. Natural disasters took their toll, such as the tsunami (affecting India, Maldives, and Sri Lanka in 2004); earthquakes (affecting Pakistan in 2005); floods (affecting Bangladesh, India, and Nepal in 2007); and droughts (affecting India in 2009 and Pakistan in 2001). But, the South Asia is rebounding to higher growth of 7.0 percent in 2010, rising to nearly 8.0 percent in 2011—slightly below pre-crisis levels. It is driven by a combination of return of greater "optimism" in private consumption and investment, as a result of the effects of the stimulus packages and of the global recovery, especially in capital flows, trade, and tourism.

3. Current Scenario: SAPTA

The South Asian Preferential Trade Agreement was intended as the first step in the process to support Regional Economic Integration. The effectiveness of SAPTA was poor .As far as trade liberalisation is concerned; the approach adopted is top down reduction of tariffs up to 20% in two years of implementation of SAFTA. Its main objective is to Free Trade within the South Asian Region.

Table: 3
Average MFN Tariff Rates Applied in the Eight South Asian Countries

Country	WTO Membership	Year	Total average Tariff	Agriculture	Non Agriculture
Afghanistan	Non Member	2008	5.6	5.8	5.5
Bhutan*	Non Member	2007	21.9	41.4	18.9
Bangladesh	Member	2008	14.8	17.6	14.3
India	Member	2008	13.0	32.2	10.1
Maldives	Member	2008	20.4	18.3	20.7
Nepal	Member	2008	12.7	14.8	12.4
Pakistan	Member	2008	13.5	15.4	13.2
Sri lanka	Member	2008	11.2	25.5	9.0

Note: 2008 data was not available
Source: Compiled from WTO (2008)

Under the SAFTA, it is understood that over time the sensitive list of commodities will be reduced to ensure a more open trading system in the region. Until then the SAFTA members retain the Most-Favoured Nations (MFN) tariff rates for the items included in their respective sensitive list, and these are often quite significant, especially for agricultural products. Since agricultural produces dominate the export baskets of South Asian countries, high tariff rates on these items seriously inhibit intra-regional trade. Table 3 shows the average MFN tariff rates applied in the eight South Asian countries for 2008.

The South Asian region as a whole has been a relatively protected region in the world. In particular, India is considered to be the least open in terms of the average applied tariff rate. In case of Bhutan and Maldives, the rates of Tariff are high as compared to other SAARC nations. Pakistan has to slash down its maximum tariff to around 15 percent against 10% recommended by the World Bank in their tax policy. In case of Sri Lanka Sri Lanka's simple average tariff rate was 11.4 percent in 2007. Import bans and restrictions, services market barriers, import taxes, import fees, import licensing, restrictive standards and regulations, non-transparent government procurement, weak enforcement of intellectual property rights, export subsidies, and corruption add to the cost of trade.

3.1 Limited Duty-Free Imports among SAFTA Members

As noted earlier, South Asian countries send the bulk of their exports outside the region; especially to developed country markets like EC, US, Canada and Japan. This is especially marked for the large countries of India and Pakistan. For the small LDCs, including Afghanistan, Bhutan and Nepal, however, India is a leading destination market. For example, India is the first largest export market for Afghanistan, but imports from Afghanistan face a weighted average MFN tariff of 35.9 percent in India and 70 percent imports into India were duty-free. India has a PTA with Afghanistan, a few items get preferential treatment. On the other hand, the Indo-Nepal free trade agreement is probably the most liberal of all, yet the weighted average MFN on Nepalese imports is 10.3 percent, and 96 percent of these imports into India are duty-free (refer to Table 4 and Appendix 1).

Increasing trade with East Asia is becoming important. East Asia is now home to the third-largest regional market, with a combined GDP of US$6 trillion (versus South Asia's combined GDP of US$1.5 trillion). It has already become the biggest partner for South Asia.

Table: 4

Major Export Markets of South Asian Countries and Duties Faced

Country	*Major markets (by bilateral imports)*	*Year*	*Value of Imports (mlln US$)*	*MFN weighted average of traded TL*	*Value of duty free Import (%)*
Afghanistan	India Pakistan European Community Turkey	2006 2007 2007 2007	75 54 21 12	35.9 13.4 0.5 35.0	70.1 0.0 100 2.8
Bangladesh	European community	2007 2007	6,886 3,410	11.6 15.5	100 6.4

	United states Canada India	2007 2006	502 210	17.2 8.8	100.0 35.1
Bhutan	India Honk Kong Thailand European Community	2006 2007 2006 2007	150 66 2 1	6.9 0.0 13.7 2.5	100.0 100.0 0.0 100.0
India	European Community United States China Hong Kong	2007 2007 2007 2007	31,863 22,299 13,399 6,881	4.6 4.1 2.1 0.0	59.6 71.1 70.3 100.0
Maldives	Thailand European community Japan India	2006 2007 2007 2006	61 51 9 4	5.0 16.5 3.9 7.2	0.0 100.0 100.0 0.1
Nepal	India European Community United states China	2006 2007 2007 2007	337 111 88 14	10.3 6.8 6.0 3.2	96.0 100.0 59.8 69.3
Pakistan	European Community United States China Hong Kong	2007 2007 2007 2007	4,308 3,510 1,068 625	8.8 10.6 5.3 0.0	16.4 10.2 18.8 100.0
Sri Lanka	European Community United States India Russian federation	2007 2007 2006 2006	2,510 2,001 227 181	8.1 13.3 10.0 11.8	99.9 19.6 84.5 41.9

Source: Compiled from country pages, WTO (2009)

3.2 Global Trade

According to the latest monthly data from international monetary fund's (IMF) international Financial Statistics (IFS) in January 2010, world exports showed a positive growth of 20.4 per cent. This was in line with the rise in world commodity prices. There has been strong convergence among the world exports and the exports of advanced economies and emerging and developing economies during May 2009 to November 2009.

4. Conclusion

South Asia is the home to one of the oldest civilisations of the world. South Asia could also more aggressively liberalize services trade and investment. Such liberalisation should not be limited to more visible champions, such as IT and BPO sectors, but should also extend to backbone services—in finance, domestic transport, wholesale distribution, and other professional services—permitting entry on an MFN basis and encouraging competition. The organisation was designed to improve both the economic and social progress of its member states. Covering at least 1.5 billion people across India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan, the Maldives and Afghanistan, SAARC is one of the largest regional organisations in the world. By lowering the trade and transactions costs within this setting, South Asia would benefit by lowering trade barriers to levels similar to East Asia and extending them to all countries to reduce the potential for trade diversion. This would accelerate its South-South trade potential, in light of the global rebalancing.

A growing emphasis on attracting foreign investment and seeking access to new markets in SAARC states indicates that economic progress is central to the future of South Asia. SAARC, however, is likely to play only a limited role in that future because of India's considerable position of power over the other SAARC states. SAARC was expected to be an instrument for the "promotion of peace, progress and stability in this part of the world. It can also enhance our sovereignty and foster peace, freedom and social justice among member states. Individual South Asian countries are already relatively well positioned and are making good progress, as far as formal trade agreements are concerned. Deepening reforms and supporting macroeconomic stability, working with International Finance Corporation (IFC) to improving investment climates, continue scaling up infrastructure partnering with the private sector; supporting the domestic financial sector.

Note: The usual disclaimers apply.

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Appendex I

A.1 Real GDP growth and sectoral growth (percent change from a year earlier)

	1991-00	2004/05	2005/06	2006/07	2007/08	2008/09
SOUTH ASIA (GDP growth)	**5.3**	**7.3**	**9.0**	**9.0**	**8.6**	**6.1**
Bangladesh (GDP growth)[1]	4.8	6.0	6.6	6.4	6.2	5.7
Agriculture	3.2	2.2	4.9	4.6	3.2	4.6
Industry	7.0	8.3	9.7	8.4	6.8	5.9
Services	4.5	6.4	6.4	6.9	6.5	6.3
Bhutan (GDP growth)	5.1	7.5	6.7	13.2	11.7	6.2
Agriculture	1.7	1.4	2.5	1.9	0.4	1.4
Industry	6.1	5.5	5.4	28.1	21.0	5.2
Services	7.8	12.7	11.0	6.8	7.8	9.7
India (GDP growth)	5.6	7.5	9.5	9.7	9.2	6.7
Agriculture	2.9	0.0	5.9	3.7	4.7	1.6
Industry	5.7	10.3	10.2	12.7	9.5	3.9
Services	7.1	9.1	10.6	10.2	10.5	9.8
Nepal (GDP growth)	5.0	3.5	3.4	3.3	5.3	4.7
Agriculture	2.5	1.8	1.8	1.0	4.7	2.2
Industry	7.8	3.0	4.5	3.9	1.9	1.8
Services	6.4	3.3	5.6	4.5	7.1	5.8
Pakistan (GDP growth)	4.0	9.0	5.8	6.8	4.1	2.0
Agriculture	4.4	6.5	6.3	4.1	1.1	4.7
Manufacturing	4.4	15.5	8.7	8.3	4.8	-3.3
Services	4.5	8.5	6.5	7.0	6.6	3.6
Maldives (GDP growth)	8.3	9.5	-4.6	18.0	7.2	6.3
Agriculture	2.7	2.9	12.2	-0.7	-14.9	-4.5
Industry	10.0	12.9	3.0	10.6	10.1	8.4
Services	9.0	9.7	-8.3	24.0	9.1	6.7
Sri Lanka (GDP gowth)	5.2	5.4	6.2	7.7	6.8	6.0
Agriculture	1.9	0.0	1.8	6.3	3.4	7.5
Industry	6.8	5.4	8.0	8.1	7.6	5.9
Services	5.8	6.7	6.4	7.7	7.1	5.6

Sources: World Bank staff estimates for GDP growth; sectoral growth data come from a combination of country sources and World Development Indicators.