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Regional Integration in South Asia: The Era of the South Asian Free Trade Agreement[*]

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Abstract

South Asia accounts for 22 percent of the world's population, two percent of the world's gross national product and is home to about 40 percent of the world's poor. However, the region's seven countries contribute only about one percent to world trade. Combining this low level of economic development with political and ethnic disparities makes this region economically and politically very sensitive. With the ratification of the South Asian Free Trade Agreement (SAFTA) in March 2006 by all the member states, the process of liberalising trade and investment has been set in motion. It has been two decades since the South Asian Association for Regional Cooperation (SAARC) came into being and even though the process of trade liberalisation has been slow, it has not died. This paper highlights the journey of South Asia from the SAARC to the South Asian Preferential Trading Arrangement and now to the SAFTA and draws comparisons between the provisions. It also brings forth the issues that need to be addressed if the South Asian economies want to benefit from this free trade agreement (FTA). The paper argues that South Asia needs to re-look at some fundamental trade and political issues and give precedence to trade if it wants a well-implemented FTA encompassing substantial trade among the member states.

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Introduction

The process of regional integration has gone hand in hand with multilateralism for several decades. Following the collapse of the Soviet Union and the end of the bipolar cold-war world, the process of regionalism intensified. The European Commission single market, the North America Free Trade Agreement, ASEAN Free Trade Agreement and the Southern Common Market are evident instances of this process. Now with the collapse of the Doha Round, developing countries have started pursuing regional and bilateral agreements with a new vigour.

South Asia has not been a forerunner in the movement of regional integration. It remained untouched by the initial wind of regionalism that swept different sub-regions of Africa and Latin America in the early 1960s. The region, from the beginning, has been embroiled in geo-political tensions, leading to distrust which has reflected in the hurdles that it has faced with every step towards regional integration and its integration with the rest of the world.

South Asia accounts for 22 percent of the world's population, two percent of the world's gross national product, and is home to about 40 percent of the world's poor. To top this, the region's seven countries contribute only about one percent to world trade. Combining this low level of economic development with political and ethnic disparities makes this region economically and politically very sensitive.

First Milestone

These ethnic, geopolitical and economic disparities were the very reasons that the then Bangladesh President Zia-Ur-Rehman took the initiative to establish a regional cooperation forum in South Asia in 1983. This decision was, to a certain extent, also influenced by the formation of the ASEAN and to enable the states of South Asia to consider and react collectively to international events. The Soviet attack on Afghanistan and the United States' direct military links with Pakistan to counter the Soviet Union hastened the pace of formation of this regional bloc.

Initially, India and Pakistan did not take easily to the idea. While India thought that it was an attempt by the smaller nations to gang up against India and put collective pressure on it regarding matters that affect them. Pakistan thought that it would deepen the hegemonic powers of India and simultaneously hamper Pakistan's integration with West Asia. Nevertheless, in spite of these misgivings, the South Asian Association for Regional Cooperation (SAARC) came into existence in 1985 when its charter was officially adopted with the aim to promote political stability and deal with external developments.

Second Milestone

Cooperation under the SAARC did not extend to hard-core economic areas of trade, manufacturing and finance for nearly 10 years after the establishment of the Association. Trade was brought under the ambit of the SAARC in 1991 with the signing of the South Asian Preferential Trade Agreement (SAPTA) which was operationalised in 1995 when the outcome of the first round of trade negotiations were notified.

In 1998, the SAARC also put in place SAARCFINANCE with the aim to propose harmonisation of banking legislations and practices within the region to monitor global financial developments and promote research on economic and financial issues. However, the achievements of this body leave much to be desired.

The SAPTA did not achieve much either in terms of increasing intra-regional trade in South Asia. Intra-SAARC trade, as a percentage of South Asia's world trade, increased from 2.42 percent (US$1.59 billion) in 1990 to 4.56 percent (US$6.53 billion) in 2001 and marginally improved to 4.7 percent by 2003.[1] This slight increase has been mostly attributed to rapid liberalisation under bilateral trade agreements and World Trade Organization (WTO) regimes, rather than to the SAPTA.

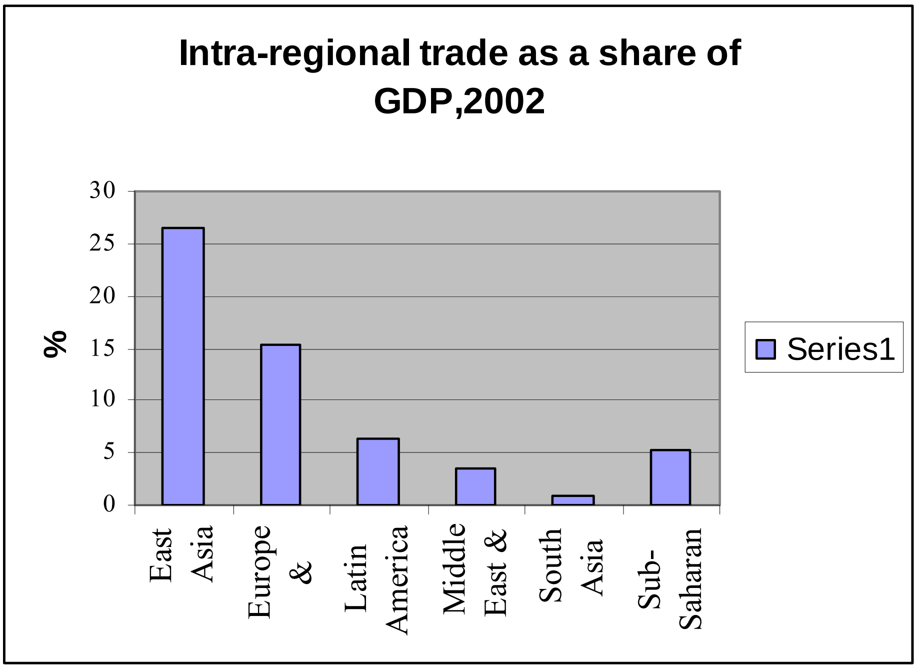
Third Milestone

The idea for the SAFTA was first brought to the discussion table in 2002 and culminated into an agreement in 2004. The SAFTA came into effect in January 2006 and was ratified by all the member states by March 2006. The SAFTA lists additional measures not included under the SAPTA such as the harmonisation of standards, reciprocal recognition of tests and accreditation of testing laboratories, simplification and harmonisation of customs clearance, import licensing, registration and banking procedures; removal of barriers to intra-SAARC investment, etc.

Intra-regional Trade

The trade performance of South Asia has been dismal in comparison to other regions. The levels of inter- and intra-regional trade in South Asia have remained extremely low. Intra-regional trade as a percentage of total trade volume has hovered below five percent since 1980. Among all the regions, South Asia is the least integrated when measured as a share of GDP (Figure 1). Intra-regional trade in South Asia is only 0.8 percent of gross domestic product (GDP), a fraction of East Asia's nearly 27 percent of GDP and is even lower than Sub-Saharan Africa.[2]

Figure 1: Intra-regional trade as a share of GDP, 2002



Source: Taking Advantage of Regional Trade: Review of SAFTA and Bilateral FTAs, Zaidi Sattar, World Bank.

1 South Asian Regional Agreements: Perspectives, Issues and Options, Jayanta Roy, CII, June 2005.
2 Ibid.

Table 1: Intra- regional trade (as a percentage of total trade 1980-2004)

Regional Bloc	1980		1985		1990		1995		2000		2004	
	Ex	Imp	Ex	Imp	Ex	Imp	Ex	Imp	Ex	Imp	Ex	Imp
EU-25	61	54	59	58	67	64	66	64	67	62	67	64
CARICOM	5	9	6	5	8	6	12	8	14	8	13	9
MERCOSUR	12	8	6	9	9	14	20	18	20	20	12	18
NAFTA	34	33	44	34	41	34	46	38	56	41	55	36
ASEAN	17	14	19	17	19	15	25	18	23	22	23	22
SAARC	5	2	4	2	3	2	4	4	4	3	5	4

Source: UNCATD handbook of statistics, www.unctad.org (accessed on 26 January 2007).

As we can see from Table 1, the level of intra-regional trade in the SAARC has never gone above five percent of the total trade. The reasons for low level of intra-regional trade are evident and glaring. Firstly, there is lack of trade complementarity. Most of the South Asian countries have expertise in the production and export of the same primary products in agriculture as well as in textile and clothing, and other labour-intensive goods. For instance, both India and Sri Lanka export tea and compete to secure overseas markets.

Secondly, there is prevalence of informal trade in the region. High tariff and non-tariff barriers, coupled with weak transportation links, are responsible for the informal/unaccounted trade that takes place between South Asian countries. The cost and time of transportation, along with security issues, hamper cross-border trade. For instance, all Nepalese export/import is routed through the port of Kolkata in India and the absence of a direct rail link between Kolkata and Nepal has been a major impediment to trade.[3] Countries in South Asia tend to impose the highest tariff on the most-traded commodities. They, thus, elude the benefits of trade liberalisation. Therefore, as of now, trade liberalisation would not have any trade diversion effects since the members are not currently taking advantage of the goods in which they have comparative advantage.

Thirdly, the region is bedevilled by intra-state conflicts and border disputes – notably the intractable dispute between India and Pakistan over Kashmir – which goes to show that politics dominate economics in this region. This is in contrast with Southeast Asia, which has largely succeeded in transforming its region from a battlefield to a market place. These political tensions have also led to the re-routing of trading between the SAARC nations. Of the US$2 billion India's informal trade with Pakistan, almost half is traded through third countries like Afghanistan and Dubai.

Political differences between neighbours can often create inefficiencies in the trading system. Pakistan, for example, imports tea from Kenya at a much higher price when it can secure it more cheaply from within the region. Given the prominence of the two in South Asia, Indo-Pakistan relations will mould the progress of regional cooperation in the future. Their relations have been volatile, though there has been resumption in economic ties of late. It is noted that defense services accounts for 20.34 percent and 16.13 percent of the total budget expenditures for Pakistan and India respectively (Budget 2005-2006).[4] India is the largest player in the region in terms of size, GDP and trade capacity. Table 2 shows the percentage share of other south Asian countries in India's total trade.

Table 2: Percentage share of SAARC countries in India's total trade

Country	2001-02	2002-03	2003-04	2004-05	20005-06
Bangladesh	1.11	1.08	1.28	0.87	0.71
Bhutan	0.03	0.06	0.10	0.08	0.07
Sri Lanka	0.73	0.89	1.07	0.92	1.03
Nepal	0.60	0.55	0.67	0.56	0.49
Pakistan	0.22	0.22	0.24	0.32	0.34
Maldives	0.03	0.03	0.03	0.02	0.03

Source: http://dgft.delhi.nic.in

[3] Trade Facilitation – Reducing the Transaction Cost or Burdening the Poor, Centre for International Trade, Economics and Environment (CITEE), Jaipur, India, 2004.

[4] South Asian Regional Agreements: Perspectives, Issues and Options, Jayanta Roy, CII, June 2005.

All South Asian countries, except Sri Lanka, contribute less than one percent to India's foreign trade. According to a study by the Associated Chambers of Commerce and Industry of India, India's trade with the SAARC countries declined from 3.39 percent in 2003 to 2.84 percent in 2006.[5]

Due to the landlocked nature of Bhutan and Nepal, trade takes place primarily with India. While Nepal has consciously tried to reduce its trade dependence on India, Bhutan remains dependent on India both as a supply source and export destination. India and Bhutan signed a 10 year agreement in July 2006 and, under this agreement, Bhutan will get four more entry and exit points in to India. The pact also simplifies import and export procedures between the two countries.

Till 2004-05, Bangladesh was the largest trading partner of India, in the region. Major items of exports from India to Bangladesh are cotton yarn, fabrics, machinery, instruments, glass/glassware, ceramics and coal. India imports raw jute, jamdani saris, inorganic chemicals, leather, etc., from Bangladesh. Bangladesh's trade deficit with India increased from from US$1.2 billion to US$1.5 billion between 1998/99 and 2003/04. However, Sri Lanka overtook Bangladesh this year. The rise in bilateral trade between India and Sri Lanka can also be attributed to the recent tariff cuts by Sri Lanka on major imports from India such as cement. Sri Lanka's bilateral trade deal with India requires tariffs to be phased out over an eight-year period for goods that are not in the sensitive list.

South Asian Preferential Trading Arrangement and South Asian Free Trade Agreement

A free trade area (FTA) takes a regional trade agreement to the next level. While under a preferential trading agreement, a country can put quantitative restrictions on the preferential treatment it would like to give to a member country. Under an FTA, all tariff barriers to a member country are removed. The Eminent Persons Group report has pointed out that the process of the SAFTA will have to be much different from the SAPTA. The SAPTA was based on a preferential agreement under the enabling clause of the WTO. The SAFTA, on the other hand, is required to be justified under the more rigorous Article XXIV of the General Agreement on Tariffs and Trade.[6]

The SAFTA is a SAPTA-plus in terms of national treatment, dispute settlement and modification and withdrawal of concessions. For instance, Article 5 of the SAFTA makes provisions for national treatment while there are no provisions under the SAPTA for the same. The SAFTA also addresses the issues of revenue compensation and simplification of banking procedures for import financing, the SAFTA was ratified by all nations in March 2006 and three major agreements were signed in the last SAARC Summit in November 2005.[7] The Dhaka Declaration made at the end of the Summit covered among others issues of poverty alleviation, environmental challenges and natural disasters, social challenges, funding mechanisms and combating terrorism.

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5 www.centad.org

6 Article XXIV of GATT needs to be notified to the WTO and has to fulfil conditions such as "covering substantially all trade between the members" whereas the Enabling Clause is meant mainly to pursue schemes such as GSP (Generalised System of Preference) or enable developing countries to get together and offer preferential treatment.

7 Three major agreements signed during the Summit, are- the avoidance of double taxation, mutual administrative assistance in Customs matter and the creation of a SAARC Arbitration Council.

Table 3: India's Direction of Foreign Trade with the SAARC Countries (US$ million)

Country	Year											
	2000-01		**2001-02**		**2002-03**		**2003-04**		**2004-05**		**2005-06 P**	
	Export	Import	Export	Import	Export	Import	Export	Import	Export	Import	Export	Import
Bangladesh	935.0	80.4	1002.2	59.1	1176.0	62.1	1740.7	77.6	1631.1	59.4	1632.4	118.8
Bhutan	1,1	21.1	7.6	23.9	39.0	32.2	89.5	52.4	84.6	71.0	99.1	88.9
Maldives	24.6	0.2	26.9	0.4	31.6	0.3	42.3	0.4	47.6	0.6	67.2	2.0
Nepal	140.8	255.1	214.5	355.9	350.4	281.8	669.4	286.0	743.1	345.8	859.4	380.0
Pakistan	186.8	64.0	144.0	64.8	206.2	44.8	286.9	57.6	521.1	95.0	681.9	177.5
Sri Lanka	640.1	45.0	630.9	67.4	921.0	90.8	1319.2	194.7	1413.2	378.4	2018.5	571.7

Source: Ministry of Commerce – www.commerce.nic.in (accessed on 17 October 2006).

The Heads of State of the South Asian governments decided to put in place a SAARC Poverty Alleviation Fund with contributions, both voluntary and/or assessed, as may be agreed. They called upon the Finance Ministers to formulate recommendations on the operational modalities of the Fund, taking into consideration the outcome of the Meeting of the Financial Experts. They also approved the SAARC Development Goals, as recommended by the Commission, and called for follow-up and implementation of the Plan of Action on Poverty Alleviation, adopted at the 12th SAARC Summit.[8]

Under the SAFTA, provisions have been made for liberalising trade and for special and differential treatment for least developed countries (LDCs) of the region namely, Bhutan, Nepal, Maldives and Bangladesh. Under the Trade Liberalization Programme (TLP), the non-LDCs of the region have been given seven years (Sri Lanka will get eight years) to reduce their tariff rates to 0-5 percent while the LDCs have been given 10 years for the same.[9] The non-LDCs will reduce their duties for the products of the LDCs to the free trade level within three years compared to the five years to be taken for reducing duties to that level on the developing countries imports.

Table 4: Tariff Reductions under the SAFTA

Countries	**Existing Tariff Rates**	**Proposed SAFTA Reduction**	**Timeline**
		First Phase	
India , Pakistan, Sri Lanka	>20 percent <20 percent	Reduce to 20 percent Further annual reduction	2 years 2 years
Bangladesh, Bhutan, Maldives, Nepal	> 30 percent < 30 percent	Reduce to 30 percent Further annual reduction	2 years 2 years
		Second Phase	
India, Pakistan , Sri Lanka	≤20 percent	Reduce to 0-5 percent	2 years
Bangladesh , Bhutan, Maldives and Nepal	≤ 30 percent	Reduce to 0-5 percent	3 years (primary products) 5 years (other products)

Source: South Asian Free Trade Area: An Analysis for Policy Options for Bangladesh, Bangladesh Institute of Development Studies.

8 The 13th SAARC Summit: A Step in the Right Direction, Aparna Shivpuri Singh, Institute of South Asian Studies Newsletter, http://isas.dreamvision.com.sg/newsletter/Newsletter percent20- percent20Jan percent202006. pdf

9 The non-LDC countries will reduce their tariff to 20 percent in the first 2 years. Subsequently they will be given 5 years (except SL which gets 6 years) to reduce from 20 percent to 0-5 percent. The LDCs have been asked to reduce their tariffs by 30 percent in the first two years. Subsequently, they will be given 8 years to reduce their tariffs from 30 percent to 0-5 percent.

Table 4 gives a clear picture of the time frame given to the various SAARC members regarding tariff reductions. These provisions will not apply to the products under the sensitive list, but this sensitive list will be reviewed after every four years or earlier as decided by the SAFTA Ministerial Council with a view to reducing the number of items under the sensitive list.

A Committee of Expert has also been instated which will have a number of functions, including acting as the Dispute Settlement Body and monitoring and facilitating the implementation of the provisions.

The contracting states recognise that the least developed contracting states may face loss of customs revenue due to the implementation of the TLP under this Agreement. Until alternative domestic arrangements are formulated to address this situation, the contracting states agree to establish an appropriate mechanism to compensate the least developed contracting states for their loss of customs revenue. This mechanism and its rules and regulations shall be established prior to the commencement of the TLP.[10]

Notwithstanding any of the provisions of this Article, safeguard measures under this article shall not be applied against a product originating in a least developed contracting state as long as its share of imports of the product concerned in the importing contracting state does not exceed five per cent, provided the least developed contracting states with less than five percent import share collectively account for not more than 15 percent of total imports of the product concerned.[11]

These above-mentioned provisions do address the concerns but leave the solutions to further negotiations. Special attention has been paid to the needs of the LDCs. However, certain issues affecting smooth flow of goods and services need to be addressed.

To start with, there is the Issue of Rules of Origin (RoO). Generally, the RoO are based on three methods:[12]

1. minimum domestic value addition;
2. tariff classification at the four-digit level; and
3. product specific process tests.

Under the SAPTA, the RoO were based on the first option of the minimum domestic value addition. However, these percentages are specified not in terms of local value addition but in terms of maximum allowable import content. The percentage test applied is that the products manufactured in a SAPTA member should not have the total value of import content exceeding 60 percent of the free-on-board value of the product, to be eligible under the SAPTA preferential tariff arrangement. Products originating in the least

[10] www.saarc-sec.org/data/agenda/economic/safta/SAFTA percent20AGREEMENT.pdf –
[11] Ibid.
[12] Background Paper: SAFTA- Problems and Prospects, Prof. Muchkund Dubey, The Commonwealth Business Council SAFTA Roundtable, New Delhi, December 2004.

developed SAPTA members are allowed 10 percent concession over the percentage applicable to other countries.

The SAPTA as well as the SAFTA excludes services from the agreement**.** Services have become an important driver of the economies of the SAARC countries and account for being the single largest contributor to GDP in South Asia, (40-50 percent of the GDP).[13] Accounting for nearly 50 percent of the GDP of most of these countries, they also figure prominently in the informal trade that is taking place in the region, particularly between India and other member countries.

Energy cooperation is another area that needs attention. Cross-border energy trading can increase the reliability of power supply, achieve economy in the operation of power plants and can act as one of the most effective confidence building measures between countries whose relations are marked by frequent tensions and strife. A number of studies have been conducted on the potentialities, prospects and measures for energy cooperation, and the single most important conclusion common to all these studies is that there is a need for a common distribution system in the region based on a single regional energy grid, which interconnects the national grids. This point was underlined in the Declaration adopted at the 12th SAARC Summit which called for "a study on creating South Asian Energy Co-operation, including the concept of an Energy Ring" to be undertaken by the Working Group on Energy.[14]

The South Asian countries also need to put in place a mechanism for ensuring easy movement of goods. Increased intra-regional trade and investment require well-developed infrastructure which is missing in this region.

Even though three new agreements were signed in the last SAARC Summit to promote intra-regional trade, liberalisation of investments in the region has been ignored. Free movement of capital is an important factor for development and trade and removal of constraints to free movement of capital is essential.

Trade facilitation is also an important issue especially for a landlocked country like Nepal and no drastic measures have been initiated under the SAFTA to facilitate trade across borders. The southern border of Tripura is only 75 kilometres (kms) from the Chittagong port. Nevertheless, since no access for Indian goods is allowed to the Chittagong port, goods from Agartala have to cover a distance of 1,645 kms to reach Kolkata. If transit was allowed through the Bangladesh territory, the distance for reaching the Kolkata port would have been reduced to 350 kms. Similarly, if shipment of Assam tea was allowed through the Chittagong airport, which was the traditional route, it would have been possible to cut the journey by 60 percent.[15]

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[13] Improvement Needed in SAFTA: Menon, The Hindu, May 2006.

[14] Background Paper: SAFTA- Problems and Prospects, Prof. Muchkund Dubey, The Commonwealth Business Council SAFTA Roundtable, New Delhi, December 2004.

[15] Ibid.

In terms of paperwork related to trade, the number of required documents is roughly the same as in ASEAN-4 and China but the number of signatures required on these documents is considerably higher in South Asia. While it only takes an average of five signatures to export goods and seven to import in ASEAN-4, the corresponding number of signatures in South Asia is 12 to export and 24 to import. In India, the number is as high as 22 to export and 27 to import. It takes a long time to clear goods for export and import through customs in South Asia.

The slow processing time is mainly due to lack of computerisation in customs and the excessive number of signatures required. Many steps in customs clearance require manual intervention, including extensive physical examination of goods. It takes more than 10 days to get customs clearance on a container in South Asia compared to less than five days in East Asia.[16]

The costs of road transport can be high. For example, the average transport costs on the Kolkata-Petrapole route between Bangladesh and India is Rs2,543 (approx. US$57) which is about 40 percent higher than other highways.[17] Other restrictions are based in licensing restrictions, for example, foreign trucks are not permitted to enter Bangladesh. All of these conditions prevent shippers from taking the most efficient routes – extending time and cost which impede opportunities for international and intra-regional trade.

Compared to East Asia, South Asia continues to lag behind in deploying technology in customs administration. For example, Electronic Data Interchange (EDI) is widely adopted in Southeast Asian countries such as Singapore, Thailand, the Philippines and Indonesia. In contrast, the EDI systems are not yet to be implemented in Bhutan, Nepal, and Sri Lanka. India moved to adopt the EDI systems in 1992.

Countries in the South Asia region have moved over the past decade, however, to improve customs. For example, India has launched a modernisation project in customs that includes leveraging EDI technology which allows exchanging documents and forms electronically, to streamline clearances. With assistance from the World Bank, Pakistan has started reforms in the Central Board of Revenue, including customs offices, and is expected to have a revenue increase by Rs.65 billion (US$1.40 billion) in the fiscal year 2004-5. Pakistan has also introduced electronic filing of a single shipping document at Port Qasim as part of an effort by its customs service to reorganise clearance and trim down transaction costs.

In Bangladesh, the steps required for import and export clearance of fiber, fabric, and garments have been reduced by 75 percent. Afghanistan is working on customs modernisation in a new US$31 million World Bank project. Nepal is currently undertaking reforms under a Three-Year Customs Reform and Modernization Action

[16] Conference on SAFTA - Business Opportunities and Challenges, Special Address by Michael Carter, Country Director, World Bank, New Delhi March 13, 2006.

[17] Trade Facilitation & Regional Integration: Accelerating the Gains to Trade with Capacity Building, The World Bank/ International Monetary Fund 2004 Annual Meetings, John S. Wilson & Tsunehiro Ostuki, Washington D.C, 1 October 2004.

Plan. Reforms include upgrading physical facilities, administrative structure, automation of customs, and simplification and harmonisation of procedure (Government of Nepal Ministry of Finance).

When considering intra-regional trade, if countries in South Asia raise capacity halfway to the East Asia's average, trade is estimated to rise by US$2.6 billion. This is approximately 60 percent of the total intra-regional trade in South Asia. The category of trade facilitation that will produce the greatest gains is service-sector infrastructure (US$1,224 million), followed by efficiency in air and maritime ports (US$712 million)[18].

The agreement does not subscribe categorically the phasing out of the sensitive list. The Agreement only provides that the sensitive list "shall be reviewed after every four years, with a view to reducing the number of items". Moreover, a lot will depend on the size of the list. If it is too long, it will limit the scope of free trade and detract from the provision of Article XXIV of GATT (1994) that a free trade area should cover "substantially all trade". However, notwithstanding the provisions made in the paragraph above, the non-LDC countries shall reduce their tariffs to 0-5 percent for the products of LDCs within a period of three years beginning from the date of coming into force of the agreement.

Conclusion

All the above state evidence shows that while the SAFTA has taken cognizance of a number of issues it has also failed to make any substantial progress on a number of important issues which are essential for trade and economics. The SAFTA should be a stepping stone towards a Custom Union but it needs to buckle up and tackle the much obvious and discerning issues. That is the only way regional integration can gather momentum.

The member countries need to ask a few questions to them, namely, are they pooling science and technology resources adequately for the development of the region? Do they intend to include services in the agreement in the very near future? Would they be ready to talk about energy cooperation under the ambit of the SAFTA? Do they intend to put together funds for the development of infrastructure and human resource in the region? The South Asian countries have been pursuing bilateral FTAs with their neighbours like Singapore and ASEAN and Japan in a big way. During this period of external expansion, it is very essential for the SAARC to maintain its relevance and importance and to assess its objectives in view of moving towards a Custom Union.

The South Asian countries, especially India, are the forerunners at the multilateral level for liberalisation of Mode 4. The member countries of the SAARC need to realise that benefits of trade liberalisation can only be maximised if factors of production like labour and capital are allowed to move freely and adjust to the demands of the market. However, at the regional level, the countries are reluctant. Trite as it may sound, the border

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18 Trade Facilitation & Regional Integration: Accelerating the Gains to Trade with Capacity Building, The World Bank/ International Monetary Fund 2004 Annual Meetings, John S. Wilson & Tsunehiro Ostuki, Washington D.C, 1 October 2004.

problems between India and its neighbours seem to have cast a dark shadow on the progress of regional integration. Pakistan, for instance, has refused to grant the most-favoured nation status to India under the SAFTA which hampers India's market access into Pakistan.

Another important area of coordinated action is the laying of pipelines across the region, for transporting gas from Iran, Qatar, and Turkmenistan in the West and from Bangladesh and Myanmar in the East, to the energy deficit countries of the region, mainly India and Pakistan.

The low level of foreign direct investment (FDI) also reflects the potential that the region has. With the right domestic regulatory environment and encouraging long term FDI, the South Asian countries can boost employment opportunities, provide backward linkages. However, the south Asian countries need to be open to this. FDI is not a panacea for all economic evils plaguing a country. The quality of FDI is important. It is also important to devise national strategies to attract right kinds of FDI in right sectors. The creation of a common investment area in the SAARC could enhance the credibility of smaller and weaker nations. However, this idea has not been pursued.

The standardisation of the Harmonised System (HS) codes is also extremely essential. Different HS codes are used by different South Asian countries. For instance, though India and Bangladesh maintain the HS codes at the 8-digit level for levying custom tariffs, the total number of HS codes and the codes differ from each other. Also, for the purpose of levying excise duty India still uses 6-digit codes.[19] Also, currently, there are two product classification systems being used in the region which makes it difficult to list and compare goods. All of the countries, except Pakistan, use the HS codes to identify and codify commodities. Pakistan uses the Standard International Trade Classification, a statistical classification designed to provide the commodity aggregates needed for economic analysis and international comparison. This issue also needs to be sorted out.

There is no denying that the SAFTA needs to broaden its scope and deepen its impact by including trade in services and putting in a mechanism for phasing out the sensitive list but the SAFTA on the positive side will provide the smaller countries with a bigger playing field and at the same time give them special and differential treatment. But we also need to figure out that co-existence of the SAFTA and the other bilateral agreements that the south Asian countries have with each other. A different set of rules will only lead to a "spaghetti bowl" effect.

There is no need to reiterate the importance of political stability and harmony in the region, to promote trade and investment linkages.

At present, Pakistan is all set to begin its second phase of agreed tariff reduction under the SAFTA. The tariff reductions will be applicable on 1,077 products from India

[19] Harmonization & Classification Issues: Is Harmonized commodity Description & Coding System an Impediment to Indo-Bangladesh Ties?, Dr. Mostafa Abid Khan, Bangladesh Enterprise Institute, Dhaka, November 2004.

figuring in the positive list. In case of Bangladesh, the Maldives and Nepal, the reduction will be on 4,800 tariff lines. India has also decided to reduce the tax on refined edible oils imported from Sri Lanka and Pakistan from 68.75 percent to 52.5 percent, making the tax levied the same for all the South Asian countries. The duty on crude palm oil from the SAFTA member nations has been reduced to 50 percent by India.

To conclude, the SAFTA has the potential of making a much deeper impact on the member states and bringing about changes that would promote intra-regional trade and push forward the laggard economies. Much depends on the spirit of the member countries and how they implement the provisions and uphold the provisions of Article XXIV of the GATT. Many compromises will have to be made, a lot of push will be required to overlook political tensions but that is the only road ahead, a road less travelled but a road that leads the region to its destination.

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