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**FDI and Regional Economic Integration in SAARC Region:
Problems and Prospects**

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Abstracts

Regional integration has the potential to promote economic development in member countries irrespective of size and the level of growth. This potential can be exploited only through deeper cooperation. However, there are a number of challenges which restrict this region to tap its potential. As most of SAARC countries are underdeveloped economic integration is much needed for the development of this region. The process of economic integration in South Asia gathered momentum with the implementation of the South Asian Preferential Trade Agreement (SAPTA) in 1995 under the broad framework of the South Asian Association for Regional Cooperation (SAARC). SAPTA has, however, comes to be viewed as an interim platform in the move towards economic integration in South Asia. It is argued that regional integration has the potential to promote FDI flows and economic development of the region. This will pave the way for the most efficient use of the region's resources through additional economies of scale, value addition, employment and diffusion of technology. Though the regional integration has yet not boosted the SAARC share in world trade, but it has attracted more FDI inflows and its share has been rise in Asia and the world respectively. In 2008 the SAARC share of FDI inflows in Asia was 7.92 percent and 2.89 percent in world. The concept of regionalism and regionalisation is new for the economies of South Asia and there are several factors combine a negative case for a viable free trade agreement in the short-term.

The objective of this paper is to analyze the role of regional integration in south Asia in the promotion of region's trade and attracting FDI. It argues that there is need for deeper integration within the region.

Introduction

The South Asian Association for Regional Cooperation (SAARC) is an organization of South Asian nations, founded in 1985 and dedicated to economic, technological, social, and cultural development emphasizing collective self-reliance. Its seven founding members are Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. Afghanistan joined the organization in 2007. SAARC was the result of increasing proliferation of preferential trading arrangements (PTAs) in different regions of the world and has been considered important development over the last two decades. And this was a step toward the regional cooperation. The main objectives of SAARC as stated in the charter are; a) to promote the welfare of the peoples of South Asia and to improve their quality of life; (b) 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 realise their full potentials; (c) to promote and strengthen collective self-reliance among the countries of south Asia; (d) to contribute to mutual trust, understanding and appreciation of one another's problem; (e) to promote active and mutual assistance in the economic, social, cultural, technical and scientific fields; (f) to strengthen cooperation with other developing countries; (g) to strengthen cooperation among themselves in international forums on matters of common interests; and (h) to cooperate with international and regional organisations with similar aims and purposes." (<http://www.saarc-sec.org>).

The basic motive of these objectives is to integrate the SAARC countries and to get benefit from economic interdependence. The process of economic integration in South Asia gathered momentum with the implementation of the South Asian Preferential Trade Agreement (SAPTA) in 1995 under the broad framework of the South Asian Association for Regional Cooperation (SAARC). SAPTA has, however, come to be viewed as an interim platform in the move towards economic integration in South Asia. In 1996, South Asian governments committed themselves to the creation of a South Asian Free Trade Area (SAFTA). Although it was decided at the ninth SAARC Summit to establish SAFTA by 2001, this has proved too ambitious a target.

The objective of this paper is to analyze that how economic integration is helpful in increasing FDI inflows and trade in South Asia. This paper has been divided into four sections. First, the state of economic integration has been shown. Second section deals with trade in SAARC and other regions. Third section is about FDI inflows in SAARC region. And last is conclusion.

South Asia has been the second fastest growing region in the world. Having more than 22 per cent of the world's population living on only 3.8 per cent of the total land area of the world, it is home for more than half a billion poor people, or 40 per cent of world's poor. Its shares of world GNP and purchasing power are very small (around 2 per cent and 7 per cent, respectively). Its share in total world trade is even smaller, only about one percent. But from 1981 and 2001 there had been a marked improvement; the proportion of the extreme poor has gone down from 52 percent to 31 percent. Although this is not as significant as it is in East Asia, where the proportion plummeted from 58 percent to 15 percent, it was nevertheless a significant achievement for the region.

Economic Integration in SAARC

Economic integration refers to trade unification between different states by the partial or full abolishing of customs tariffs on trade taking place within the borders of each state. An increase of welfare has been recognized as a main objective of economic integration. And the other objective for the states pursuing economic integration is to become regionally and globally competitive, as the goods in the states outside economic blocks become more expensive (i.e., less competitive). These are the reason which makes global economic integration inevitable. The degree of economic integration can be categorized into six stages: a) Preferential trading area ; b) Free trade area; c) Customs union; d) Economic union; e) Economic and monetary union; f) Complete economic integration. The goal of economic integration is to increase in trade .The trade stimulation effects intended by means of economic integration are part of the contemporary economic Theory of the Second Best, where, the best option is free trade, with free competition and no trade barriers. Free trade is treated as an idealistic option, and although realized within certain developed states, economic integration has been thought of as the "second best" option for global trade where barriers to full free trade exist.

Most of SAARC countries had adopted highly interventionist trade regimes in the initial phases of their growth. But this started to change in the late 1970s. From 1977, Sri Lanka began to liberalize gradually. It was followed by others in the 1980s. But this environment began opening up as a whole from the early 1990s (Jayasuriya and Weerakoon 2001, Sahoo 2006, RIS 2004, Dutta 2000). The process of economic liberalization manifested itself in considerable reduction

in investment and trade barriers. Alongside multilateral trade liberalization, these countries also activated the process of economic integration through regional, sub-regional and bilateral approaches. The South Asian countries with the exception of Afghanistan formed the South Asian Association for Regional Cooperation (SAARC) in 1985 as a political consultation entity.

In December 1991, SAARC approved the establishment of an Inter-Governmental Group (IGG) at the Sixth Summit held in Colombo to formulate an agreement to establish a “SAARC Preferential Arrangement” (SAPTA) by 1997. Given the consensus within SAARC, the Agreement of SAPTA was signed on April 11, 1993, (much ahead of the schedule) and entered into force on December 7, 1995. SAPTA was envisaged primarily as the first step towards the transition to a South Asian Free Trade Area (SAFTA) leading subsequently towards a Customs Union, Common Market and Economic Union., The process of economic integration in South Asia gathered momentum with the implementation of the agreement.

The Agreement on South Asian Free Trade Area (SAFTA) was signed on January 6, 2004, during the Twelfth SAARC Summit in Islamabad. The deal entered into force on January 1, 2006, and was formally launched on July 1, 2006. The special needs of the Least Developed Contracting States are recognized by adopting concrete preferential measures in their favour on a non-reciprocal basis. The arrangement is a traditional trade barriers reducing exercise. Its major objective is to eliminate obstacles to trade, both tariff and non-tariff, and facilitate the cross-border movement of goods between the territories of the Contracting States.

In addition to SAFTA, there have been three bilateral free trade agreements between South Asian countries : India- Bhutan, India-Sri Lanka, Pakistan-Sri Lanka; one sub regional preferential arrangement: Asia Pacific Trade Agreement (India, Bangladesh, Sri Lanka, Philippines, Lao PDR and Korea) and seven trade agreements: India-Nepal, India-Bangladesh, India-Maldives, Bangladesh-Nepal, Bangladesh-Pakistan, Pakistan-Nepal and Sri Lanka-Nepal. Others are under process. A comprehensive Economic Partnership Agreement between India and Sri Lanka is under way. The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation i.e. BIMSTEC (Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand)-FTA aims to achieve its own free trade area by 2017. Finally, four RTAs are under

negotiation: India-Pakistan, India-Bangladesh, Sri Lanka-Maldives and Pakistan-Bangladesh (Chaturvedi 2007).

A distinguishing feature of these agreements is that with the exception of BIMSTEC, all others are traditional RTAs which aim at reducing/ eliminating only trade barriers. The current status of trade liberalization measures in major SAARC countries has been shown in the table.

Table 1

Status of Trade Liberalization Measures in Major SAARC Countries

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

Source: Samaratunga (1999); Weerakoon (1998)

Trade in SAARC and Other Regions

Regional integration typically reduces trade barriers and this resulted in the increased volume of intra regional trade as well as promotion of trade with other part of the world. SAARC is one of the region in which most of the countries are either developing or underdeveloped. And because of this, trade in this region has not increased rapidly. It is only after inception of SAFTA trade in South Asia has increased. In 1990 the exports of SAARC was US \$47033 million which got up to US \$92724 million in 2004 and further to US \$331968 in 2008. The growth of exports in SAARC region, in the year 2004 and thereafter was relatively more than Asia and Eastern Asia. India accounts largest share which was US \$17969 in 1990, US \$42379 in 2004 and US \$176858 million in 2008. Similarly, imports of SAARC region rise faster than exports. It was US \$57416 in 1990 which rose to US \$96072 million in 2004 and US \$445309 million in 2008. (Appendix Table 2 and Table 3).

The share, however, of SAARC's total exports and imports in the world is relatively very low in comparison to other major trade groupings of world. This can be seen in the table 4.

Table 4

Exports and Imports share of Major Trade Groups (in percent)

Year/Trade Groups		APTA	ASEAN	SAARC	EU	APEC	NAFTA
1990	Exports	4.27	4.17	0.80	44.41	38.25	16.13
	Imports	4.26	4.51	1.09	44.67	39.08	19.02
2000	Exports	7.38	6.70	1.00	37.95	48.30	18.99
	Imports	6.80	5.66	1.21	37.64	50.13	25.32
2004	Exports	10.21	6.19	1.15	40.85	44.16	14.27
	Imports	9.56	5.23	1.51	39.59	47.05	21.24

2005	Exports	11.08	6.22	1.27	38.75	44.70	14.12
	Imports	10.08	5.50	1.82	38.28	47.60	21.27
2006	Exports	11.83	6.35	1.31	37.82	45.07	13.84
	Imports	10.52	5.55	1.92	38.21	47.19	20.55
2007	Exports	12.58	6.20	1.33	38.20	44.48	13.27
	Imports	10.95	5.45	2.0	38.64	45.69	18.99
2008	Exports	12.81	6.26	1.39	36.65	44.21	12.76
	Imports	11.63	5.80	2.31	37.42	45.51	17.69

Source: UNCTAD, 2009

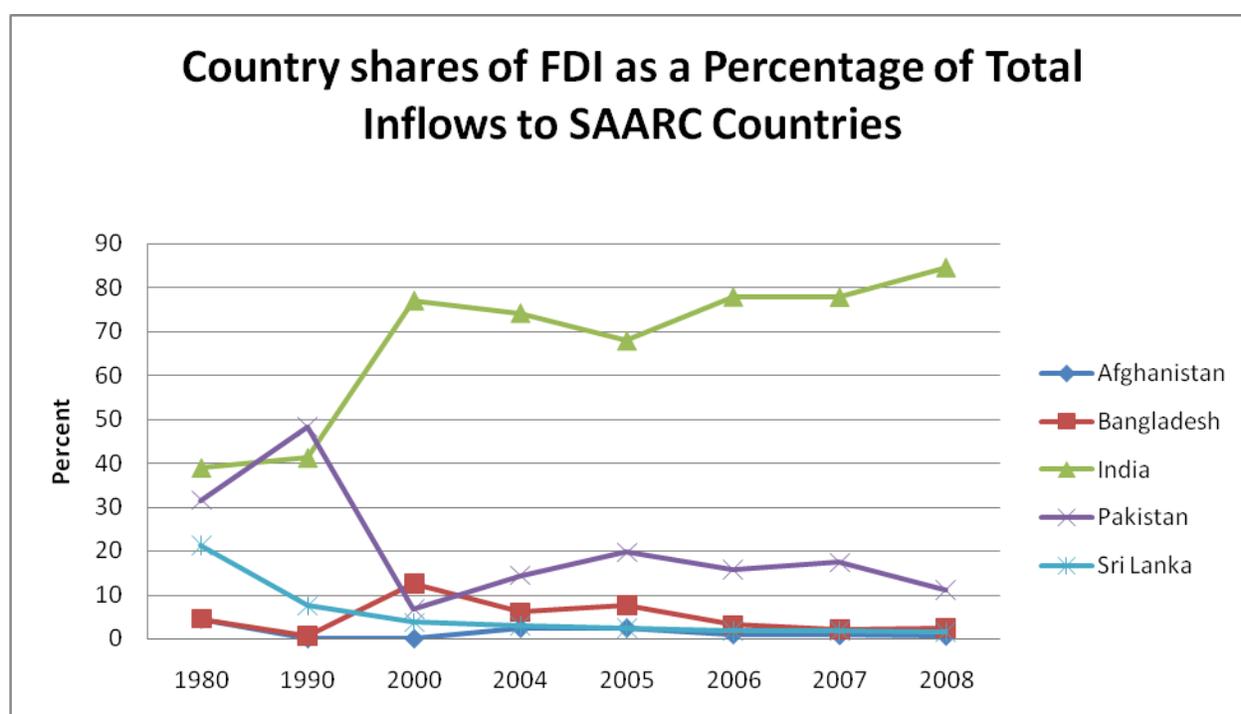
From above table it is clear that SAARC is nowhere to other major trade groups. In 1990 EU accounts 44.41 percent of world exports and 44.67 percent of world imports. The other Asian trade group, i.e., ASEAN accounts 4.17 percent of exports and 4.51 percent of imports. In the same year SAARC accounts a meager 0.80 percent of exports and 1.09 percent of imports which rose to 1.39 percent and 2.31 percent exports and imports respectively in 2008. Thus there is need for to increase the share of SAARC in the world trade.

FDI Flow in SAARC Countries:

Until recently, most countries in South Asia were not seen by international investors as attractive investment destinations. In any case, these countries themselves had a restrictive attitude towards foreign investments. FDI flows were therefore quite minimal. In the early 1990s, most of them began opening up their economies. This was also the period when schemes for regional cooperation were accelerated. FDI flows to the region started to pick up in the 1990s and have gathered further momentum in the past few years. All the countries of the region (with the only exception of Bhutan and Nepal) have gained in terms of FDI flows. In fact, they grew faster than either the rest of the developing world or the world at large. South Asia has improved its share in

terms of total FDI inflows to the world, developing countries and Asia over the period 1980 - 2008. Nevertheless, the magnitude of inflows attracted by the region remains relatively meager. In 2000, it was only US \$ 4658 million, a mere 0.33 percent of global flows. In contrast, China received more than 10 per cent of all global inflows. The inflows to SAARC rose to US \$49177 million in 2008 which was 2.89 percent of global flows. The bulk of FDI to the SAARC region has come to India. However, Bhutan, Nepal, Afghanistan and Maldives have not received significant inflows.

Figure 1



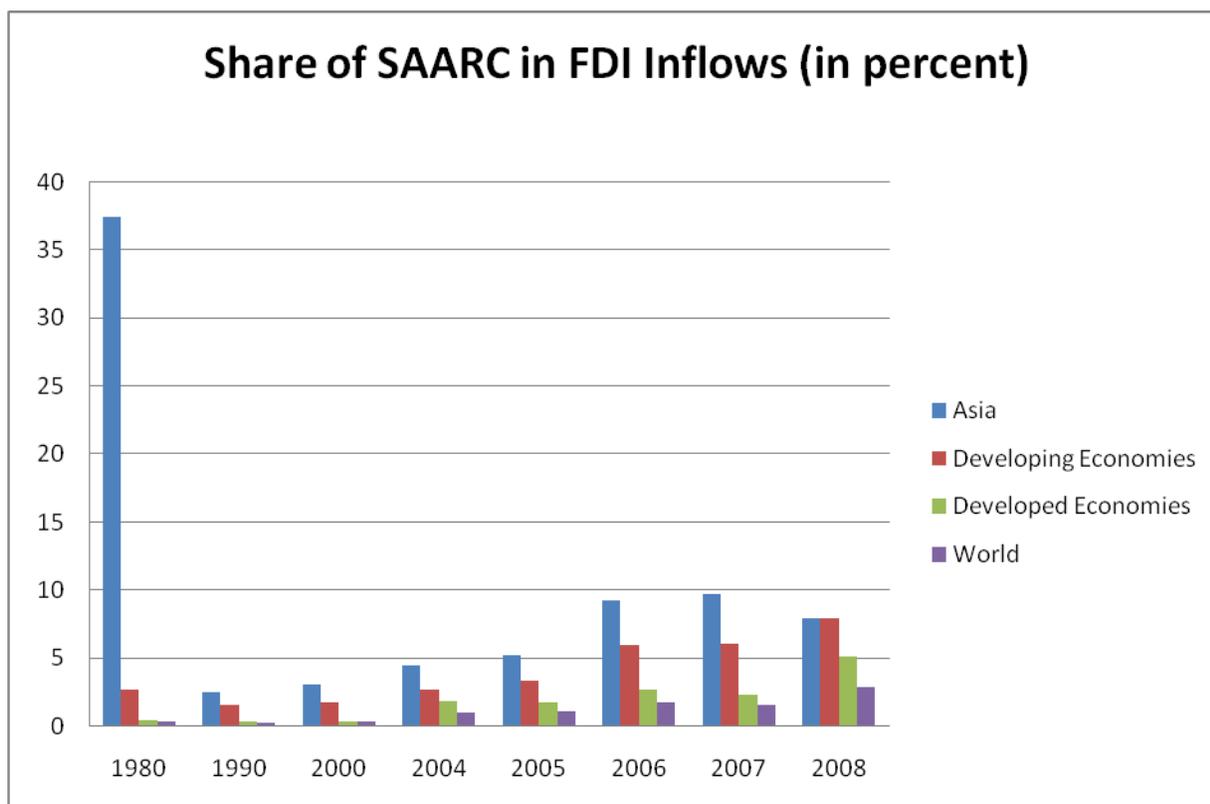
Source: Calculated from UNCTAD Handbook of Statistics Database, 2009

From the above figure it is clear that India is a major recipient of FDI inflows. In 1990, India's share in total SAARC inflows was 41.2 percent. It rose to 74.11 percent in 2004 and further to 84.49 percent in 2008. Pakistan and Sri Lanka also accounts a major portion of FDI inflows in 1990 which was 48.34 percent and 7.47 percent respectively. But their share in total SAARC inflows declined significantly in 2008 they accounts only 11.05percent and 1.52 percent respectively. Similarly the share of Bangladesh is also declining. Despite this growth, FDI as a

proportion of the GDP of SAARC countries remains very low. For example, in the mid-1990s, the share of FDI in GDP for Pakistan and Sri Lanka was approximately 1 per cent, while the corresponding figure for India was in the region of 0.5 per cent.

Though SAARC is not a major group in terms of trade share in the world but it has significant share in terms of FDI inflows in Asia, developing countries, developed countries and the world. In 2008, SAARC share in Asia was 7.92 percent which was 3.13 percent in 2000. SAARC share in developing countries total FDI inflows in 1990 was 1.63 percent which rose to 7.92 percent in 2008.

Figure 2



Source: Calculated from UNCTAD Handbook of Statistics Database, 2009

From the above figure it is evident that SAARC has a significant share in Asia and developing countries FDI inflows. But its share in developed countries and world as a whole is not significant. It was only 0.43 percent of developed countries inflows in 2000, rose to 5.11 percent

in 2008. The growth rate of FDI inflows in SAARC is quite impressive over the years. This growth rate is better than the major trade groups of the world. In 2008, ASEAN and EU registered a negative growth rates in FDI inflows. But SAARC registered a growth rate of 52.13 percent in the same year. The growth rates have been calculated from the FDI inflows in these trade groups in the period 2005-08.

Table 8

Growth rates of FDI in Trade groups

	2005	2006	2007	2008
APTA	15.99	12.67401	13.56045	41.34402
ASEAN	11.73452	38.70048	26.40493	-13.7577
SAARC	44.03493	132.9975	23.69035	52.13773
EU	123.1744	18.4305	42.69081	-40.2296
APEC	-19.0662	89.42952	34.41337	3.262879
NAFTA	-4.17505	107.4582	28.66856	-5.92182

Source: Calculated from UNCTAD Handbook of Statistics Databse, 2009

This can be stated that there is enough potential exist in the region to attract more FDI from across the world. Only because of this many developed countries in the recent years have shown great interest to in invest in South Asia.

Conclusion

The above analysis indicates that regional integration has the potential to promote economic development in member countries irrespective of size and the level of growth. This potential can be exploited only through deeper cooperation. However, there are a number of challenges which restrict this region to tap its potential. In spite of the various challenges, SAARC has achieved

remarkable position in attracting FDI. And increased investment will increase the competitiveness of regional firms in global markets. Though its share in the world trade has not gone too much but there is scope for improvement. The concept of SAARC for regional cooperation will only be materialized when political autonomy and mutual trust will prevail. While intra-regional trade is not a novel concept for the region, the ideas of regionalism and regionalization is new for the economies of South Asia. There are several factors combine to make a negative case for a viable free trade agreement in the short-term. Even so, a reasonable case exists for the creation and gradual strengthening of SAFTA, as there are few benefits to dwelling on historical ill will. As these economies grow and economic complementarities begin to develop, the countries of South Asia may find that SAFTA can offer a potentially significant contribution to their progress.

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Appendix:

Table 2
Exports of SAARC countries and other regions

Regions and Countries	Exports (f.o.b.) Millions of dollars						
	1990	2000	2004	2005	2006	2007	2008
Asia	590417	1087167	1535122	2900745	3475868	4050687	4750767
Eastern Asia	280565	562608	774898	1538367	1846744	2186288	2475315
SAARC	47033	64980	92724	192993	235376	268710	331968
Afghanistan	235	166	137	384	408	497	580
Bangladesh	1671	3501	6389	9297	11802	12453	15369
Bhutan	70	103	103	258	414	674	521
India	17969	30630	42379	99620	120861	145393	176858
Maldives	78	85	109	162	225	228	328
Nepal	204	345	803	863	838	888	1100
Pakistan	5589	7992	9028	16051	16930	17838	20289
Sri Lanka	1912	3798	5430	6347	6886	7740	8450

Source: UNCTAD, 2009

Table 3

Imports of SAARC countries and other regions

Regions and Countries	Imports (c.i.f.), Millions of dollars						
	1990	2000	2004	2005	2006	2007	2008
Asia	570895	1119239	1388726	2615179	3062153	3586444	4285907
Eastern Asia	265896	567473	742868	1411111	1647693	1910483	2210617
SAARC	57416	72921	96072	237775	287799	341655	445309
Afghanistan	936	387	1176	2470	2582	2819	2514
Bangladesh	3618	6694	8883	13889	16034	18595	23861
Bhutan	81	112	175	386	420	526	543
India	23580	34707	51523	142842	175242	215241	292701
Maldives	137	268	389	745	927	1096	1388
Nepal	672	1333	1574	2283	2492	2904	1100
Pakistan	7376	11461	10864	25357	29825	32590	42328
Sri Lanka	2685	5185	6281	8834	10258	11301	13629

Source: UNCTAD, 2009

Table 5

FDI Trends in SAARC Region (\$US mn)

Region country or territory	Inward flows, Millions of Dollars							
	1980	1990	2000	2004	2005	2006	2007	2008
Afghanistan	9	--	0	187	271	238	243	300
Bangladesh	9	3	579	460	845	793	666	1086
Bhutan	--	2	0	3	9	6	73	30
India	79	237	3 585	5 771	7 606	20 336	25 127	41554
Maldives	0	6	13	15	9	14	15	15
Nepal	0	6	0	0	2	-7	6	1
Pakistan	64	278	309	1 118	2 201	4 273	5 590	5438
Sri Lanka	43	43	173	233	272	480	603	752
SAARC	203	575	4658	7787	11216	26133	32324	49177
Asia	543	22660	148561	172910	213751	282127	331425	387828
Developing Economies	7477	35087	256883	29037	32922	433764	529344	620733
Developed Economies	4656	172115	1117795	414186	613089	972762	1358628	962259
World	54076	207273	1381675	734892	973329	1461074	1978838	1697353

Source: UNCTAD, 2009

Table 6

Country shares of FDI as a Percentage of Total Inflows to SAARC Countries

	1980	1990	2000	2004	2005	2006	2007	2008
Afghanistan	4.43	--	0	2.40	2.41	0.91	0.75	0.61
Bangladesh	4.43	0.52	12.43	5.90	7.53	3.03	2.06	2.20
Bhutan	--	0.34	0	0.03	0.08	0.02	0.22	0.06
India	38.91	41.21	76.96	74.11	67.81	77.81	77.73	84.49
Maldives	0	1.04	0.27	0.19	0.08	0.05	0.04	0.03
Nepal	0	1.04	0	0	0.01	-0.02	0.01	0.002
Pakistan	31.52	48.34	6.63	14.35	19.62	15.74	17.29	11.05
Sri Lanka	21.18	7.47	3.71	2.99	2.42	1.83	1.86	1.52

Source: Computed from Above Table 5

Table 7

Share of SAARC in FDI Inflows (in percent)

	1980	1990	2000	2004	2005	2006	2007	2008
Asia	37.38	2.53	3.13	4.50	5.24	9.26	9.75	7.92
Developing Economies	2.71	1.63	1.81	2.68	3.40	6.02	6.10	7.92
Developed Economies	0.43	0.33	0.41	1.88	1.82	2.68	2.37	5.11
World	0.37	0.27	0.33	1.05	1.15	1.78	1.63	2.89

Source: Computed from Above Table 5