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**Sanguinity and aspiration toward South
Asian Regional integration: a case study
of the South Asian Free Trade Area
(SAFTA) Agreement**

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Acronyms and Abbreviations:

Asian Development Bank (ADB)

Bay of Bengal Initiative for Multi sectoral Technical and Economic
Cooperation (BIMSTEC)

Customs union (CU)

Common market (CM)

Central American Free Trade Agreement (CAFTA)

Economic union (Eu)

European Union (EU)

Free trade area (FTA)

General Agreement on Trade and Tariff (GATT)

General Agreement on Trade in Services (GATS)

Generalized System of Trade Preferences (GSTP)

Independent South Asia Commission on Poverty Alleviation (ISCAPA)

North American Free Trade Agreement (NAFTA)

Preferential trade arrangements (PTA)

Regional trade arrangements (RTAs)

South Asian Association for Regional cooperation (SAARC)

South Asian Free Trade Area (SAFTA)

South Asian Preferential Trading Arrangement (SAPTA)

The Southern Common Market (MERCOSUR)

The Association of Southeast Asian Nations (ASEAN)

United Nations Conference on Trade and Development (UNCTAD)

World Trade Organization (WTO)

Executive Summary:

The expansion of regional economic cooperation was one of the major developments in the world political economy after the Second World War. Factors that thrust countries closer were both economic and political but economic factors prevailed; the classic example was the EU and ASEAN where economic dimension have brought long time foes in the same dais. The present international economic situation characterized by stagnant growth, recessionary conditions, and protectionist tendencies in the developed countries has seriously underpinned the economic growth in developing countries.¹ The worsening terms of trade, acute balance of payment crisis and debt burden on developing countries have further crippled the potential economic growth of these countries. Therefore current world economic conditions call for a greater economic cooperation among the developing countries. Around 330 agreements are notified in World Trade Organization (WTO). Apart from Mongolia, all WTO members are involved in one or more regional trade agreements.² Unsuccessful WTO talks in Cancun increased a world-wide trend towards regional cooperation and integration, such as EU, NAFTA, CAFTA, MERCOSUR, ASEAN, SAARC etc.

1 Kanhiya Lal Chawla, Economic Cooperation among developing countries with special reference to SAARC: Jaipur, RSBA Publishers, 1991. p.1.

2 WTO website, http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm

The latest report by the World Bank, entitled *Global Economic Prospects: Managing the Next Wave of Globalization* predicts that in the next 25 years the growth in the global economy will be powered by the developing countries, whose share in global output will increase from about one-fifth of the global economy to nearly one-third. It means that some of the key drivers in the global economy will be China and some of the countries from South Asia. There are today six developing countries which have populations greater than 100 million and GDP of more than \$100 billion. By 2030, there will be 10 countries that would have reached the twin 100s threshold, and four of them will be from the vicinity of South Asia. In addition to India and China, who have already reached that level, Pakistan and Bangladesh are also likely to be part of this dynamic group.³

Increased participation in global trade was an important determinant of economic growth of the catch-up economies. This is one reason why South Asia has lagged and has not been a catch-up economy. Could the decision of the 2004 SAARC summit change South Asia's economic structure and move towards economic union? Can South Asia become a major player in the global economic and trading system? The

³ The third decade of Saarc: by Sridhar K. Khatri. Volume 2, Issue 4, May 2007, Monthly Forum, Daily Stare. <http://thedailystar.net/forum/2007/may/saarc.htm>

following report aims to come across the answer of the above issue regarding SAFTA.

Introduction:

The crumple of the WTO negotiations in late July 2006 augments the significance in regional trading arrangements in South Asia. The first step in this direction came in 1995 when SAPTA signed. SAFTA was a parallel initiative to the multilateral trade liberalization commitments of SAARC⁴ member countries which signed in 2004 with the aim of reducing tariffs for interregional trade among the SAARC members.⁵ There have been strong arguments for the creation of regional economic integration in South Asia which generate significant interregional trade and welfare gains for the South Asian countries. However, critics have pointed out that the potential benefits from the SAFTA and other regional trading arrangements in South Asia are little because there are limited complementarities in the region; major trading partners of the individual South Asian countries are located in

4 The South Asian Association for Regional Cooperation (SAARC) was established when its Charter was formally adopted on December 8, 1985 by the Heads of State or Government of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. SAARC provides a platform for the peoples of South Asia to work together in a spirit of friendship, trust and understanding. It aims to accelerate the process of economic and social development in Member States. <http://www.saarc-sec.org/main.php>

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

the West, and RTAs in South Asia will lead to substantial trade diversion than trade creation and it may work as a stumbling block to multilateral trade liberalization.⁶

Recently 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.⁷ 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.⁸ 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.⁹

In 1997 SAARC leaders had agreed to launch the SAFTA by 2001. The five-year delay was caused by deteriorating relations between India

6 Ibid

7 IMF, *The World Economic Outlook - 2005*, International Monetary Fund, Washington, D.C., April 2005, Table 1.7, P. 33.

8 Bandara and McGillivray, 1998 and Panagariya, 1999 for an overview of trade reforms in the region.

9 Supra 3

and Pakistan after nuclear tests by the two countries in May 1998, the military takeover in Pakistan in October 1999, and the near-war in 2001 and 2002 when more than a million soldiers massed along the India–Pakistan border. Tensions began ease by April 2004 when Atal Bihari Vajpayee, then prime minister of India, pledged to work toward creating a peaceful South Asian region. The move to create SAFTA, therefore, represents a major development in the region. Properly implemented, SAFTA could bring both economic development and peace to the region.

1. Motivations for the formation of RTAs:

1.1 Toning down political rivalry:

Most of the RTAs catch European integration as the template for regional integration, little realizing the uniqueness with which Europe was (and is still) blessed. Europe's overriding objective, which was brilliantly achieved, was political and military: to use economic integration to overcome the historic animosities of its chief protagonists and thus render future wars impossible.¹⁰ Indeed, the preamble to the 1951 treaty establishing the European Coal and Steel Community, out of which EU grew, states its aim as follows: "To

¹⁰ Bergsten, Fred (2000a), *the New Asian Challenge*, Working Paper 00-4, March, Institute for International Economics, Washington, D.C.

create, by establishing an economic community, the basis for broader and deeper community among peoples long divided by bloody conflicts."¹¹

Economic compulsion in the region may eventually help to bring down the political barriers, particularly between India and Pakistan, in South Asia. The best examples are India and China, where the two countries after fighting a war in 1962, have, without resolving their territorial differences, engaged each other since the late 1980s. As a result, bilateral trade has boomed from less than \$200 million in the early 1990s to nearly \$20 billion in 2005.¹² China is set to overtake the EU and the US as India's largest trading partner within a few years. And, despite some political and territorial differences, both countries agreed to set up a "strategic partnership" in April 2005, which has led to frequent high-level visits by leaders to each others' capitals. If two rivals such as India and China can put their territorial differences aside to achieve major economic gains, it is also possible for India and Pakistan to find ways and means beneficial economically, without sacrificing their stands on political and territorial issues. The important thing is for Pakistan to overcome its fear that open trading arrangements with India, bilaterally or multilaterally, will not lead to

¹¹World Bank (2000), *Trade Blocs*, Oxford University Press, Oxford.

¹² *Supra* 3

Indian products swamping its market at the cost of its own industries. For its part, India needs to be confident of its growing economic power to be able to devise ways to placate the Pakistani fears, both real and imagined.

1.2 Bargaining power:

“United we stand”, as the saying goes, and by joining hands together weak countries can become stronger. Caribbean Community and Common Market (CARICOM), the alliance of smaller Caribbean island states, is an exception among the developing countries groupings in as much as it negotiates in most of the international fora, including the WTO, in a unified manner. CARICOM is not only focused on achieving regional integration – rather its objective is common action. For example, they have taken the lead in formulating and articulating the position of the African, Caribbean, and Pacific (ACP) countries group in negotiating the Lome Convention.¹³ South Asia can shadow CARICOM and act as united manner to the world fora.

1.3 Economic motives:

The economic effects of regional agreements are of two main types. The first are removal of trade barriers and move toward integration in

¹³ Supra 11

a regional market. This allows firms to benefit from greater scale and attract Foreign Direct Investment (FDI). The second source of economic change is "trade and location" effects.

India is now the world's fourth largest economic power, and many expect it to surpass Japan to become the third largest very soon. The entrepreneurs, especially in the IT sector, are the catalyst in India's economic miracle, and have managed to fuel growth through the service sector and domestic consumption. India has managed to maintain an average of 7.5 percent growth rate for the past five years, despite archaic labour laws and "bureaucratic high modernism." India is not alone in registering a positive growth trend in the region, Bangladesh, Pakistan and Sri Lanka GDP has also shown a positive growth of around 7 percent. Roberto Zaghera did a study in 2005 which lists as "growth successes" those countries with a faster per capita GDP growth rate than the US in the 1990's, and a 1980's growth rate of at least 1 percent. His list contains one Latin American country (Chile), a couple of small African countries (Botswana, Lesotho), no Eastern European or Central Asian country, but six of the eight South Asian countries.¹⁴

¹⁴ Supra 3

The contribution of India (and one can add also China) as an engine of growth for South Asia will be substantial, since it accounts for (in 2005) about 80 percent of South Asia's GDP, trade, and regional growth. In South Asia, India's development into a regional hub would attract more foreign direct investments into India and from India to other South Asian countries, which would boost economic growth in the whole region. As the latest ADB report states: "India is not only crucial for the success of regional trade cooperation in South Asia; it could also transform the development and growth pattern of the entire region."¹⁵

2. REGIONALISM: BUILDING BLOCK OR STUMBLING BLOCK?

At the turn of the 20th Century both globalism and regionalism are coexisting in the global trading system. During the 1990's, it was widely assumed that building complementary between regional and multilateral institutions was the only way to grapple with the complexities of the fast changing global economic and trade realities. As per Larry Summers, any "ism" (bilateralism, regionalism and multilateralism) is good as long as its ultimate objective is trade liberalization. ¹⁶ Bergsten argue, "Regional arrangements promote

¹⁵ ibid

¹⁶ Winters, L. Alan (1996), "Regionalism versus Multilateralism", paper prepared for a CEPR Conference on Regional Integration, La Coruna, Spain, April 26-27, 1996.

freer trade and multilateralism in at least two senses: that trade creation has generally exceeded trade diversion, and that the RTAs contribute to both internal and international dynamics that enhance rather than reduce the prospects for global liberalization." Winter states¹⁷, "Regionalism, by allowing stronger internalization of the gains from trade de-restriction, seems likely to be able to facilitate freer trade in highly restrictive circumstances or sector."

3.1 WTO PROVISIONS FOR PTAS/RTAS:

PTAs are the agreements between two or more countries in which tariffs imposed on goods produced in the member countries are lower than on goods produced outside. This term differs from the most favored nation (MFN) trade liberalization clause which means each country lowers its trade barriers for all the trading partners regardless of the trade policies of other countries. Customs unions (CUs) are also PTAs in which all members adopt a common external tariff structure.¹⁸ Since RTAs represent a fundamental departure from the core WTO principles, it has provided its members a large degree of flexibility in entering RTAs. They may join agreements by meeting the requirements of the GATT Article XXIV covering the information of

17 Winters Alan L. (1996), *Regionalism vs. Multilateralism*, World Bank, November 1996, Washington, D.C.

18 *The Process of Economic Integration in South Asia* International Finance Division, Research Department. April 27, 2005

customs unions and free trade areas in merchandise trade; the General Agreement on Trade in Services (GATS) Article V on agreements in services; or the Enabling Clause of dealing with trade in goods between developing countries.¹⁹

4. Economic Development: Trends and Comparative Statistics:

In 2002, the South Asian region's estimated population was 1.4 billion and its combined gross domestic product was \$640 billion, measured at market exchange rates, or \$3.4 trillion in terms of purchasing power parity (PPP)²⁰. This is a relatively poor region with average per capita income of only \$467 in conventional terms and of \$3,560 in PPP terms.²¹ By way of comparison, China in 2002 had a population of 1.280 billion, while its GDP in both conventional and PPP terms were considerably \$1.234 trillion and \$5.792 trillion, respectively. Its GDP per capita, estimated at \$960 at market exchange rates, was more than twice as high as that of South Asia.²²

¹⁹ *ibid.*

²⁰ It is the method of using the long-run equilibrium exchange rate of two currencies to equalize the currencies' purchasing power. It is based on the law of one price, the idea that, in an efficient market, identical goods must have only one price. It is the method of using the long-run equilibrium exchange rate of two currencies to equalize the currencies' purchasing power. It is based on the law of one price, the idea that, in an efficient market, identical goods must have only one price. http://en.wikipedia.org/wiki/Purchasing_power_parity

²¹ SOURCE: World Development Indicators 2004, the World Bank Group.

²² Potential of the South Asian Free Trade Area, Shahid Javed Burki the Senior Economic Advisor to USAID's Bureau of Asia and the Near East (USAID/ANE) U.S. Agency for International Development (USAID). <http://www.lafollette.wisc.edu/publications/workshops/2003-2004/pa869/2004-SAFTA.pdf>.

South Asian intraregional trade volume is currently around \$4–6 billion per year²³. India's dominance in regional trade is very much apparent; there is no clear secondary competitor. Between 1992 and 2002 India's exports go up to the region from \$710 million to \$2.8 billion. By contrast, its imports were quite low: \$166 million in 1992 and \$531 million in 2002.²⁴ While less than 1 percent of India's total imports came from South Asia, and 4 to 5 percent of its exports went to the region. Throughout the 1990's, Bangladesh was the second largest contributor to trade within South Asia. Data and estimates for 2002, however, indicate that Sri Lanka likely surpassed Bangladesh. Pakistan's economy is the region's second largest, but its annual contributions to intraregional trade declined between 1998 and 2002.²⁵

The global production system now encompasses a number of East Asian countries other than those in the developed world. South Asia, in contrast, did less well. Although the region's GDP growth in 1980–2000 and the share of exports in output increased. Non-oil export shares of the East Asia and Pacific region increased from 18 percent in

23 Malik, Nadeem. 2004. "New Dawn for South Asian Trade," Asia Times Online, January 13.

Available at http://www.atimes.com/atimes/South_Asia/FA13Df04.html, accessed May 13, 2004.

24 Impacts of the South Asia Free Trade Agreement, Elizabeth Krueger Rossana Cecilia Bastos Pintom Policy Analysis Workshop, Public Affairs 869 Spring 2004. La Follette School of Public Affairs University of Wisconsin–Madison.

25 *ibid*

1980, to 34 percent in 2000. The corresponding shares for the South Asia region were 8 and 14 percent, respectively.²⁶

Robin Cook²⁷, former Foreign Minister of Britain, said of the signing of the European Constitution, "Pause for a while to contemplate the remarkable transformation of European politics which made this event possible. Most of the countries sitting together in the same council chamber have been at war with each other in living memory and in the century that preceded it." But progress toward increasing economic and political association among the countries of Europe was not always easy: "[T]heir appeal to past millennium betrays what drives their resistance to European integration—a misplaced nostalgia for the outdated world of free standing nations. It is an era that has vanished. We are all interdependent now" overview of economic development in the South Asian region underscores Robin Cook's point: a great deal of historical baggage has to be cast off before countries in the region can begin to work together.

5. Historical Context for Regional Integration:

²⁶ Supra 22

²⁷ Cook, Robin. 2004. A Strong Europe—or Bush's Feral US Capitalism. *The Guardian*, October 29.

Under colonial rule this region was known as the Indian sub continent. According to historian Niall Ferguson, "1783 famine killed more than a fifth of the population of the India; this was followed by severe scarcities in 1791, 1801, and 1805"²⁸. Blue-ribbon Royal Famine Commissions were established to devise a long-term solution to persistent food scarcities. British planners saw that the vast tracts of virgin land in Punjab and Sindh could be cultivated by irrigating them with water from the Indus river system. The strategy worked and within a few decades, Punjab and Sindh were producing surplus food grains. But this surplus had to be transported to the northeast, especially the heavily populated province of Bengal. To do this, the British invested heavily in transport infrastructure, a system of roads linked with the fabled Grand Trunk Road that linked Kabul with Calcutta, railways, and the port of Karachi. These investments formed the basis for close economic integration of the British Indian Empire and are now parts of the independent states of Bangladesh, India, and Pakistan.

Moreover water dispute surfaced in the early 1950's and almost brought India and Pakistan to war.²⁹ Intense international diplomacy

28 Ferguson, Niall. 2003. *Empire: How Britain Made the Modern World*, London: Allen Lane.

29 International Rivers linking project by India, elucidation from international water law: anticipated potential environment threats on Bangladesh. By A. S. M Shahriar kabir, *South Asian journal*, 2007 March.

and the involvement of a consortium led by the World Bank salvaged the situation.³⁰ Furthermore after partition in 1947 from British rule, Pakistan refused to follow other countries of the "Sterling Area"³¹ in devaluing its currency with respect to the U.S. dollar; India, in return, refused to recognize the new exchange rate of 144 of its rupees to 100 Pakistani rupees and halted all trade with its neighbor. Pakistan, starved of most manufactured goods of daily consumption launched a program of industrialization to achieve a measure of self-sufficiency. Had this trade war not occurred, Pakistan would not have industrialized as rapidly as it did and would not have forsaken its comparative advantage in agriculture.³²

All countries in the region pursued import-substitution approaches to economic development for nearly 40 years and trade among the countries fell from about 19 percent of total trade in 1948, to about 4 percent by the end of the 1950s, and to 2 percent by 1967³³. The share of intraregional trade in total trade began to increase only after the countries abandoned import substitution in favor of general trade

30 For a detailed account of the development of the dispute and its ultimate resolution see Aloys Mitchell, *The Indus River*, Yale University Press (1969).

31 The Sterling Area was made up of the countries of British colonies that had linked their currencies to the "sterling" or the British pound. The Sterling Area is roughly equivalent today's Commonwealth.

32 Shahid Javed Burki, *Pakistan: A Nation in the Making*, West view Press (1980).

33 World Bank. 2004d. *Trade Policies in South Asia: An Overview, 2004*. Report #29949. Washington, D.C.

liberalization. Still, this increase is insignificant compared to trade among countries in other regions.³⁴

The economic policies adopted by all countries in the region are another legacy. Jawaharlal Nehru, India's first prime minister brought socialist economic management to his country and launched the "license raj"³⁵. Over three decades this system left Indian economy untouched.³⁶ The Licence Raj is considered to have been dismantled in 1990, when a macroeconomic crisis forced India to usher in economic reforms. The government of India finally initiated liberalization under the Prime Ministership of PV Narasimha Rao, which resulted in substantial growth in the Indian economy, which continues today. The efforts of the current Prime Minister and ex Finance Minister Manmohan Singh of PV Narasimha Rao were eventually recognized.

34 Ibid. Intraregional trade accounted for 67 percent of the total for the European Union; 62 percent of NAFTA; and 26 percent for members of ASEAN.

35 India had a highly developed bureaucratic system before partition and they ran an elaborate system of rationing and price controls to prevent price gouging. The architect of the system of Licence Raj was Jawaharlal Nehru, India's first Prime Minister. Inspired by the economy in the Soviet Union, he was determined to implement the model in India. The Licence Raj was a result of India's decision to have a planned economy, where all aspects of the economy are controlled by the state and licences were given to a select few. The Licence Raj was a result of India's decision to have a planned economy, where all aspects of the economy are controlled by the state and licences were given to a select few. http://en.wikipedia.org/wiki/Licence_Raj

36 An excellent description of the license raj and the damage it did to the Indian economy is in Gurcharan Das, *India Unbound*. New Delhi: Penguin (2003).

For a decade and half, Pakistan followed a different route, encouraging the private sector to help meet the enormous shortages of consumer goods created by the 1948 trade war with India. While encouraging private entrepreneurship, the state was generous in building a high wall of protection around it. It also established state-owned financial institutions to provide the private sector cheap and long-term capital. And, for a time, Pakistan operated a dual exchange rate system that gave rich incentives to those who set up import-substituting industries while punishing those who wanted to sell their products in the international market. In the two-year period between 1972 and 1974 Zulfikar Ali Bhutto, an avowed socialist, took Pakistan in a sharply different direction. He undertook a program of extensive nationalization of private assets soon after assuming office and took control of 31 large-scale industries, virtually all financial institutions, all large-scale trading companies and eventually even small agro-production enterprises. By the middle of the 1970's, the grip of the Pakistani state on the economy was as tight as the hold of the state in India.³⁷

³⁷ South Asian free trade area, opportunities and challenges: U.S. Agency for International Development USAID, 2004.

Mujibur Rahman, the first President of Bangladesh nationalized all industries and brought bureaucratic socialism. Thus, by about the mid-1970s, South Asia had closed itself off to the outside world.

In 1980 the late President of Bangladesh Ziaur Rahman first proposed regional cooperation in South Asia.³⁸ Several factors influenced President Ziaur Rahman's thinking about establishing regional organization in South Asia³⁹. The smaller countries of the region (Nepal, Bhutan, Maldives and Sri Lanka) promptly accepted the proposal of regional cooperation however India and Pakistan were skeptical initially. Indian policy makers apprehension that regional organization might prove an opportunity for the small neighbours to regionalize all bilateral issues and to join with each other to 'gang up'

38 Kishore C Dash, *The Political economy of Regional Cooperation in South Asia*, Pacific Affairs, (Vol. 69, No.2, summer 1996), p.186.

39 Firstly change in the political leadership in the South Asian countries and demonstration of accommodative diplomacy by the new leaders; secondly Ziaur Rahman's need for Indian support to legitimise his coup d'etat regime; thirdly, an acute balance of payment crisis of almost all the South Asian countries, which was further aggravated by the second oil crisis in 1979; fourthly failure of the North-South dialogues and increasing protectionism by the developed countries; fifthly publication of an extremely useful background report by the Committee on Studies for Cooperation in Development in South Asia (CSCD), identifying many feasible areas of cooperation; sixthly assurance of economic assistance of multilateral cooperative projects on sharing water resources of Ganges and Brahmaputra by the United States President Jimmy Carter and British Prime Minister James Callaghan during their visit to South Asia in 1978 and seventh the soviet military intervention in Afghanistan in late December 1979 resulting in rapid deterioration of the South Asian security situation (S D Muni and Anuradha Muni, *Regional Cooperation in South Asia* (New Delhi: National Publishing House, 1984), pp. 29-31)

against India.⁴⁰ Pakistan also feared that it might be an Indian strategy to organize other South Asian countries against Pakistan and ensure a regional market for Indian products, thereby consolidating and further strengthening India's economic dominance in the region.⁴¹ Nevertheless SAARC was finally established in 1985 comprising Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.⁴² Former President Bill Clinton described South Asia as the most dangerous place on earth on the eve of two emerging antagonistic nuclear powers.⁴³

Fortunately, this has begun to change. Larger countries in the region are now reasonably open to international trade. In 2000, Sri Lanka was the most open, with trade-to-GDP ratio of 77 percent⁴⁴. The corresponding ratio for Nepal was 44 percent; for Bangladesh and Pakistan, 33 percent; and for India 19 percent⁴⁵. India's greater openness was prompted by the foreign exchange crisis in 1991 and

40 Dash, *The Political economy of Regional Cooperation in South Asia*, p. 187.

41 W. Howard Wiggins with F. Gregory Gause, III, Terrence P. Lyonss, and Evelyn Colbert, *Dynamics of Regional Politics: Four Systems on the Indian Ocean Rim* (New York: Columbia University Press, 1992), p.132; Thomas Perry Thornton, 'Regional Organisation in Conflict Management', *The Journals of the American Academy of Political and Social Science*, Vol. 518 (November, 1991), p. 136.

42 First Declarations of the South Asian Association of Regional Cooperation: 7-8 December 1985, Dhaka, Bangladesh. <http://www.saarc-sec.org/>

43 Maleeha Lodhi, 'Viewpoint: Security Challenges in South Asia' *The Non-proliferation Review*, Summer 2001, p. 118.

44 ADB, *Asian Development Outlook - 2004*, Asian Development Bank, Manila, April 28, 2004, P. 32.

45 Ibid.

the prodding of the IMF, which had developed a new approach, subsumed by most commentators under the term “the Washington Consensus.”⁴⁶

According to Joseph Stiglitz, “the Washington Consensus policies were designed to respond to the very real problems in Latin America, and made considerable sense...When trade liberalization—the lowering of tariffs and elimination of other protectionist measures—is done the right way and at the right pace, so that new jobs are created as inefficient jobs are destroyed, there can be significant efficiency gains”⁴⁷. Unlike some Latin America countries, South Asian countries did not rush to implement these policies. In the 1950’s trade optimists were export pessimists and did not anticipate that Korea’s exports would grow four times as fast as world trade during the next thirty years⁴⁸. In 1970, Korea’s trade-to-GDP ratio was 0.32; it increased to 0.66 in 1988. For Malaysia, another miracle economy, the ratio in the same period increased from 0.89 to 1.09⁴⁹. The East Asian economic

46 The Washington consensus is a phrase initially coined in 1987-88 by John Williamson to describe a relatively specific set of ten economic policy prescriptions that he considered to constitute a “standard” reform package promoted for crisis- wracked countries by Washington-based institutions such as the IMF, WB and U.S. treasury Department. http://en.wikipedia.org/wiki/Washington_Consensus

47 Stiglitz, Joseph. 2003. *Globalization and Its Discontents*. Norton: New York.2003, p145.

48 Ibid.

49 *ibid.*

miracle had a profound impact on the thinking of policymakers in South Asia.

According to a recent World Bank study⁵⁰ Pakistan and Sri Lanka are now the least protected markets in the region with average customs duty of 18.8 percent for Pakistan; Bangladesh is the region's most protected economy with a total protection rate of 26.5 percent. The total value of regional trade increased rapidly in the late 1980s and most of 1990s but not the share of regional trade in totals trade. The United States was the major importer of South Asian goods and commodities; it accounted for 36 percent of Bangladesh's total exports, 29 percent of Pakistan's, and 21 percent of India's. There was a different pattern for the points of origin for South Asian imports. For both Bangladesh and Pakistan, the single most important source of imports is China. For India, the United States is the largest single supplier.⁵¹

It would appear from the structure of South Asian trade that the "gravity model"⁵² has not worked for the region. Among the three approaches to increasing trade among countries, purists prefer unilateral action not contingent on the granting of reciprocity by

50 World Bank. 2004b. *Global Economic Prospects: Trade, Regionalism and Development*. Washington D.C.

51 *Supra* 37

52 The gravity model of trade predicts bilateral trade flows based on the economic sizes of (often using GDP measurements) and distance between two units. The model was first used by Jan Tinbergen in 1962. www.wikipedia.org

trading partners.⁵³ The second-best approach is to conduct negotiations on removing barriers to cross-border trade in the context of multilateral discussions. According to this line of thinking, the least satisfactory approach is to start with regional integration as the first step in easing constraints on global trade. If SAFTA succeeds in its aims, the economic and trading system that existed in British India could very well be restored. But it was politics that severed these links; it will take politics to restore them.⁵⁴

6. Regional Economic Integration Attempts:

Compared to other regional blocs, the performance of SAARC is gloomy. Steps towards formal economic cooperation were made with the signing of the SAPTA in 1993. 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% (\$1.59 billion) in 1990 to 4.56% (\$6.53 billion) in 2001 and marginally improved to 4.7% by 2003. This slight increase has been mostly attributed to rapid liberalization under bilateral trade agreements and WTO regimes, rather than to SAPTA. The failure of SAPTA is also reflected in the skewed pattern of trade in the region,

⁵³ The economist Jagdish Bhagwati is one of the most articulate exponents of this view. For his approach to international trade see his recent, *In Defense of Globalization*, New York: Oxford, 2004.

⁵⁴ *Supra* 37

since India has not fully integrated into the region. But for the first time India is pushing SAFTA which was mooted in 2002, and culminated into an agreement in January 2004 and expected to come into force from January 1, 2006 upon completion of all formalities.⁵⁵

BIMSTEC ⁵⁶covers a population of approximately 1.3 billion and combined GDP of about \$1.3 trillion. Broad sectors for cooperation identified at the First Summit level meeting held in July 2004 covered trade and investment, technology, tourism, transport and communication, energy, and fisheries. For India, BIMSTEC resolves the problem of slow movement in South Asian cooperation by eliminating Pakistan and including Myanmar and Thailand. In 2004, BIMSTEC member countries agreed to establish the BIMSTEC Free Trade Area Framework Agreement for a free trade area in goods, services and investments.

There are also sub-regional and bilateral initiatives aimed at liberalizing trade among SAARC countries and promoting trade and investment facilitation efforts. Among the important sub-regional

55 South Asian Regional Trade Agreements: Perspectives, Issues and Options, Jayanta Roy. Principal Advisor, Confederation of Indian Industry, India June 20, 2005.

56 This agreement includes Bangladesh, India, Sri Lanka, Thailand, Myanmar, Bhutan and Thailand. www.bimstec.org

initiatives are Bangladesh-Bhutan-India-Nepal Growth Quadrangle Initiative (BBIN-GQ) and Bangladesh-India-Sri Lanka –Thailand Economic Cooperation (BIST-EC).⁵⁷

7. Trade Facilitation:

Trade facilitation includes port reform, modernization, streamlining regulatory requirements and harmonizing standards, as well as customs regimes, expanding the use of information technology to lower trade transactions costs.⁵⁸ Security is also an important part of trade facilitation in modern commerce. The International Maritime Organization (IMO) developed the International Ship and Port Security Code (ISPS) which was adopted by more than 100 countries, and went into effect on 1 July, 2004. On July 31, 2004, WTO members reached consensus to launch negotiations on trade facilitation. The negotiations will focus specifically on three articles⁵⁹ of GATT.⁶⁰

57 Research and Information System for the Non-Aligned and Other Developing Countries (RIS) (2004). South Asia Development and Cooperation Report 2004. New Delhi, India.

58 World Bank (2004a). Global Economic Prospects – Realizing the Development Promise of the Doha Agenda 2004. Washington, D.C.: World Bank.

59 This includes Article V (freedom of transit) which relates to conditions in which the transit of goods is free from barriers to transport and discrimination among suppliers, firms, and traders. GATT Article VIII (fees and formalities on imports and exports) addresses customs clearance procedures and a commitment of non-discrimination and transparency in fees and rules applied to goods crossing borders. GATT Article X (publication and administration of trade regulations) includes commitments to assist in ensuring timely publication of regulations on imports, including fees, customs valuation procedures, and other rules. It also includes obligations to maintain transparent administrative procedures for disputes in customs.

7.1 Measuring the Impact of Trade Facilitation:

Walkenhorst and Yasui⁶¹ (2003) point out that the degree of potential benefits of trade facilitation varies across countries, sectors, and types of traders.⁶² A study by APEC (1999) finds that “shock” reduction in trade costs from trade facilitation efforts vary from 1 percent of import prices for industrial countries and the newly industrializing countries of Korea, Chinese Taipei and Singapore, to 2 percent for other developing countries.⁶³ The study estimates that effects of APEC trade liberalization and facilitation would increase the volume of APEC merchandise exports in 1996 by 3.3 percent.

Maskus, Wilson, and Otsuki⁶⁴ evaluated that the gains to trade facilitation related to harmonized regulations and standards. According

60 Trade Facilitation and Regional Integration in South Asia: Accelerating the Gains to Trade with Capacity Building, The World Bank/ International Monetary Fund, 2004 Annual Meetings, Program of Seminars, October 1, 2004, Washington, D.C.

61 Walkenhorst, Peter and Tadashi Yasui (2003). “Quantitative Assessment of the Benefits of Trade Facilitation.” TD/TC/WP2003(31)/FINAL. (13 November). Paris: OECD.
[http://www.oalis.oecd.org/oalis/2003doc.nsf/43bb6130e5e86e5fc12569fa005d004c/ec8dd2cee8fca29ac1256ddd0055e57b/\\$FILE/JT00153655.PDF](http://www.oalis.oecd.org/oalis/2003doc.nsf/43bb6130e5e86e5fc12569fa005d004c/ec8dd2cee8fca29ac1256ddd0055e57b/$FILE/JT00153655.PDF)

62 For instance, the authors mention that trade transaction costs (TTCs) range from 1-15 percent of traded goods depending on country's pre-trade facilitation condition. Furthermore, border costs for agro-food products are 50 percent higher than those for manufacturing products, and that TTCs for small medium enterprises are 50 percent higher than those for big enterprises.

63 A Review of Cross-border Mergers and Acquisitions in APEC, by Chunlai Chen and Christopher Findlay. www.blackwell-synergy.com/doi/pdf/10.1046/j.1467-8411.2003.00129.x

64 Maskus, Keith E., John S. Wilson and Tsunehiro Otsuki (2001). “An Empirical Framework for Analyzing Technical Regulations and Trade,” in Quantifying the impact of technical barriers to trade: Can it be done? Keith Maskus and John S. Wilson eds., University of Michigan Press, 2001.

to Moenius⁶⁵ bilaterally shared standards raise trade volume, and therefore, harmonization of standards promotes trades. Baier and Bergstrand⁶⁶ find that 8-9 percent of the average growth in real bilateral trade flows among 16 OECD countries increased because of transport-cost reductions. UNCTAD shown that 1 percent reduction in the cost of maritime and air transport services could increase Asian GDP by some US \$3.3 billion, 1 percent improvement in wholesale and retail trade services would lead to an additional gain of US\$3.6 billion.⁶⁷ Hummels concluded that each day saved in shipping time in part due to a faster customs clearance is worth 0.5 percent reduction of tariff.⁶⁸ The Australian Department of Foreign Affairs and Trade and Chinese Ministry of Foreign Trade and Economic Cooperation (2001) suggested that moving to electronic documentation for trade would result in a cost savings of some "1.5 to 15 percent of the landed cost of an imported item."⁶⁹ If a simple average of a 3 percent reduction in landed costs were applied to intra-Asia-Pacific Economic Cooperation

65 Moenius, Johannes (2004). "Information versus Product Adaptation: The Role of Standards in Trade." Kellogg School of Management Northwestern University.

66 Baier, S.L. and J.H. Bergstrand (2001). "The Growth of World Trade: Tariffs, Transport Costs, and Income Similarity." *Journal of International Economics*, February 53(1): 1-27.

67 United Nations Conference on Trade and Development (2001). *E-Commerce and Development Report*. UNCTAD: Geneva.

68 Hummels, David L. (2001). "Time as a Trade Barrier." (mimeo). Department of Economics. Purdue University, Lafayette, Ind. <http://www.eiit.org/ConfInfo/2000Papers/hummels.pdf>

69 www.yearbook.org.cn/english/yearbook_view/1999/1999contents.htm

(APEC) merchandise trade, the gross savings from electronic documentation could be US\$60 billion.⁷⁰

Wilson, Mann, and Otsuki found that enhanced capacity in global trade facilitation would increase world trade of manufacturing goods by approximately \$377 billion dollars – an increase of about 9.7 percent.⁷¹ They found that the improvement in customs environment results in about \$107 billion (0.8 percent) gain. The gain from the improvement in regulatory environment is \$83 billion. The largest gain comes from improvements in services sector infrastructure and e-business usage (\$154 billion or 4.0 percent).

7.2 Overview the Conditions in South Asia:

Article 3 of SAFTA included plans to integrate transport systems and harmonize standards in the region. India has specifically indicated interest in providing the “main technical support and other trade facilitation steps in the field of harmonization of customs procedures and standards for products of trade interest to the region”⁷². Some experts expect the SAFTA to be “a step towards better physical, industrial and communication infrastructure development in the

70 Supra 55.

71 Wilson, John S., Catherine Mann, and Tsunehiro Otsuki (2004) “Assessing the Potential Benefit of Trade Facilitation: A Global Perspective” World Bank Working Paper 3224.

72 Hindu Business Line, May 11, 2000.

region"⁷³. In order to highlight conditions in South Asia it is useful to compare the region's performance.

(1) Port Infrastructure and Efficiency

Air and maritime ports in South Asia are generally considered less competitive than those in East Asia. It takes only a couple of hours at the port of Singapore or Laem Chaband in Thailand to clear a vessel Whereas 2 to 3 days in chittagong ports in Bangladesh.⁷⁴ 30-35 days need for goods shipped via container from U.S. to Pakistan. At Jawaharlal Nehru port in India about 75 percent of calls are direct, for example, averages \$20,000 for a call by a 4000 TEU ship. Cargo dwell time at the Dehli airport averages 2.5 days where the norm is 12 hours.⁷⁵ At Nhava Sheva port in India, exporters are "estimated to lose around Rs 800 core a month because of delayed shipments."⁷⁶ Due to congestion an exporter had to send his consignment by air, which cost "40 per cent of the value of the product"⁷⁷. Regional seaports do not operate on a fixed day-of-the-week schedule which can cause delays

73 Nayar, Lola (2004). "SAFTA a Step Forward for Regional Development: Experts." South Asia Monitor. (August 5).

74 Ibid.

75 Roy, Jayanta (2004) "Consequences and Benefits of Implementing a Multilateral Approach to Trade Facilitation,": World Bank Seminar, Dakar.

76 August 6, 2004, Business Standard, India.

77 Business Standard (2004). "Nhava Sheva Port in Jam." Business Standard. (August 6). Mumbai.

<http://www.businessstandard.com/common/storypage.php?hpFlag=Y&chklogin=N&autono=163402&leftn m=lmnu2&lselect=0&leftidx=2>

and uncertainty. Subramanian and Arnold⁷⁸ highlighted the problem of excessive delays in moving cargo through the ports of Calcutta and Chittagong in Bangladesh and the associated impact on trade.

(2) Land Transportation

The lack of cross border transit points and road connections across the region are significant hindrances to intra-regional trade.⁷⁹ Goods moving between India and Pakistan are often transshipped through a third country. Lack of integrated transport networks in the region clearly raised cargo shipping costs. This is a critical problem particularly for landlocked countries, including Afghanistan, Bhutan, and Nepal. In addition, labor strikes cause delayed in transit and congestion in land transport networks. Inland roads are a major means of moving goods across South Asia and India has "an extensive 3.3 million km road network making it one of the largest in the world"⁸⁰. A number of road corridors in the region were not maintained and are of limited capacity.⁸¹ This makes it expensive to move commodities across long distances with countries imposing load limits. For example, in India the percentage of paved roads at 56 percent is lower than

78 Subramanian, Uma and John Arnold (2001). "Forging Subregional Links in Transportation and Logistics in South Asia." (January). Washington, D.C.: World Bank.

79 World Bank (2004b). "Trade and Regional Cooperation between Afghanistan and Its Neighbours." Report No. 26769. (February 18). Washington, D.C.

80 Supra 60

81 Supra 66

in countries of East Asia which averages 88 percent. The average transport costs on the Kolkata-Petrapole route between Bangladesh and India is Rs 2543 which is about 40 percent higher than other highways⁸². A carpet manufacture in Kathnabdu reported that because of the poor quality of the local roads, it must "repair one of its vehicles every week and spends NRs 100,000 a year on maintenance"⁸³. Other restrictions are based in licensing restrictions, for example foreign trucks are not permitted to enter Bangladesh.

India railway network has moved to electrify tracks and convert from meter gauge to broad gauge to harmonize its system infrastructure.⁸⁴ Freight accounts for 41% of traffic units on India's railway system, however, 76% of traffic on China's.⁸⁵ The railways in India and Bangladesh suffer from "over-staffing, poor maintenance, and old rolling stock"⁸⁶.

(3) Border Crossings and Customs

82 Das and Pohit, 2004.

83 Biggs, Tyler et al. (2000). "Pilot Investment Climate Assessment: The Business Environment and Manufacturing Performance in Nepal." World Bank Regional Program for Enterprise Development and Federation of Nepalese Chambers of Commerce and Industry.

84 United Nations Economic and Social Commission in Asia and the Pacific (UNESCAP) (2001). "Part Five: Logistics, Transport Facilitation and Multimodal Transport." Review of Developments in Transport and Communications in the ESCAP Region 1996-2001 Asia and the Pacific. New York: United Nations. <http://www.unescap.org/tctd/pubs/review2001toc.htm>

85 Supra 64

86 ibid

Some border crossings do not have customs facilities⁸⁷. Problems arise when customs clearance centers are located far away from border crossing. For instance, the sanitary and phytosanitary testing laboratory in Calcutta is located one thousand kilometers from the customs facility at Birgunj, Nepal. Exporters have to pay additional fees for vehicle detention charges for weeks while waiting for test results⁸⁸.

Poor management at customs is another issue. At the India-Bangladesh border a consignment needs at least 22 documentations, more than 55 signatures, and minimum 116 copies for the final approval⁸⁹. Furthermore, the region uses different product classification systems for commodities: the Standard International Trade Classification is used by Pakistan and the Harmonization System (HS) by other countries⁹⁰. There are other administrative problems with customs that includes limitations on staff working hours, lack of uniformly applied import duty rates, etc. India launched a modernization project in customs which includes leveraging Electronic Data Interchange (EDI) technology, which allowed exchanging

87 *ibid*

88 Karmacharya, Binod K.(2002). "Facilitating Trade in SASEC Region in the Perspective of Recent Developments: A Case Study of India and Nepal." Paper presented for Asian Development Bank: South Asia Business Forum (SABF), South Asia Sub-regional Economic Cooperation (SASEC), 12-13 August 2002, New Delhi, India.

89 *Supra* 60

90 *Supra* 22

documents and forms electronically, to streamline clearances. With assistance from the World Bank, Pakistan started reforms in the Central Board of Revenue including customs offices and is expected to have a revenue increase by Rs.65 billion of in the fiscal year 2004-5⁹¹. Pakistan also introduced electronic filing system at Port Qasim.⁹² In Bangladesh, the steps required for import and export clearance of fiber, fabric, and garments have been reduced by 75 percent⁹³. Afghanistan is working on customs modernization in a new \$31 million World Bank project. Nepal is currently undertaking reforms under a Three Year Customs Reform and Modernization Action Plan. The reforms resulted in a revenue increase by Rs.900 million in the first six months of 2004 from the same period in the previous year⁹⁴.

South Asia can learn from experiences in East Asia, like Philippines' modernization of customs. It was reported that customs clearance involved 10 separate documents in multiple copies, with over 90 steps, and more than 40 signatures.⁹⁵ Implementing the ASYCUDA⁹⁶ system

91 Rizvi, Shamim Ahmed (2004). "Reforms in the CBR." *Pakistan Economist*. (June 7-13). Islamabad.

92 World Bank (2004a). *Global Economic Prospects – Realizing the Development Promise of the Doha Agenda 2004*. Washington, D.C.: World Bank.

93 Ibid

94 Gorkhapatra Daily (2004). "Reform in Customs Boosts Revenue." *Gorkhapatra Daily*. January 24.
<http://www.gorkhapatra.org.np/pageloader.php?file=2004/01/26/topstories/main3>

95 World Bank (2001). "E Government: Philippine Customs Reform." (January 3).
<http://www1.worldbank.org/publicsector/egov/philippinecustomscs.htm>

can reduce paper transactions. Another example is the customs administration reform in China in October 2003 at Shanghai port to reduce congestion and accelerate trade.⁹⁷

(4) Information Technology and Services Sector Infrastructure

Progress in information technology is as important as development of physical infrastructure. Biggs examine that in Nepal phone lines usually did not work well outside of the cities and Services did not available all day, and when available, voice quality is often poor.⁹⁸ Asia Pacific Economic Cooperation (APEC)⁹⁹ has targeted achieving paperless trading among all member countries by 2010. This is being advanced by computerizing custom procedures through United Nations Rules for Electronic Data Interchange for Administration Commerce and Transport (UN/EDIFACT) and reducing the number of documents required for sea, air and land transport. Vietnam marked a new progress in the process of modernization, simplification and

96 The Automated System for Customs Data (ASYCUDA) has been a major driving force in the development of customs procedures and for foreign trade procedures. ASYCUDA has directed programs that are reforming the customs clearance process developed by UNCTAD.

97 Shanghai WTO Affairs Consultation Center (2003): "Chapter Seven Pudong's Economic and Social development After China's Accession to the WTO."

http://www.sccwto.net:7001/wto/english/shanghai2003_8.htm

98 Biggs, Tyler et al. (2000). "Pilot Investment Climate Assessment: The Business Environment and Manufacturing Performance in Nepal." World Bank Regional Program for Enterprise Development and Federation of Nepalese Chambers of Commerce and Industry.

99 www.apec.org

harmonization of customs procedures.¹⁰⁰ The overall savings from this paperless trading initiative is expected to be “between 1.5 to 15 per cent of the landed cost of an imported item.”¹⁰¹ World Bank Trade and Transport Facilitation in Southeast Europe (TTFSE)¹⁰² project on customs and border reform could also be considered as one model of reform for South Asia.¹⁰³

7.3 Peace and economic integration: an analysis:

The spontaneous Indo-Pakistan tensions have put a damper on any kind of activities to increase the pace of economic integration and bring about peace in the region. But the "composite dialogue" between India and Pakistan over the past two years has led to the opening of bus and railway services, and dialogue over strategic issues on Siachen, Sir Creek and the future of divided Kashmir considered key areas of cooperation more openly than before.

100 Asia Pacific Economic Co-operation (APEC) (2003). "Vietnam Individual Action Plan: Customs Procedures." <http://www.apec-iap.org>

101 Australian Department of Foreign Affairs and Trade and Chinese Ministry of Foreign Trade and Economic Cooperation (2001). "Paperless Trading: Benefits to APEC." Commonwealth of Australia. www.dfat.gov.au/publications/paperless/paperless_trading.pdf.

102 www.ttfse.org

103 The Trade and Transport Facilitation in Southeast Europe Program initiated in 2000 by the national governments in Southeast Europe, the World Bank, and the United States in collaboration with the European Union. The project is aimed at reducing transport costs, eliminating corruption, and providing European Union-compatible customs standards, and some progress have been made. For details, see <http://www.seerecon.org/ttfse/>.

History shows that regional economic integration can be successful only if the countries concerned establish a commonality of political purpose. France and Germany who fought three wars between 1871 and 1945 was able to thaw differences through EEC. The Cold War gave western European nations another urgent reason to bind economically together to gain strategic strength. The same pattern is evident in the ASEAN, which was formed as a political grouping to oppose threat of Communist expansion from Vietnam and China.

It is a common phenomenon in international relations that a small neighbour had to live under fear when its large neighbour has 'expansionist' policy and there are unresolved and complicating factors in their relations. This is particularly true in the case of South Asia as India continuously showed her hegemony towards her small neighbours rather than being regarded as 'Big Brother'. Bhutan and Nepal are continuously living under this threat of becoming next Sikkim¹⁰⁴. To create a sense of 'easiness' among her neighbour, the former Indian Prime Minister I K Gujral adopted a doctrine called 'Gujral Doctrine'¹⁰⁵ as a tool of conflict management in the region.¹⁰⁶

104 Sikkim used to be a small state in North eastern part of India, which was ceded into it by force.

105 The Gujral Doctrine is a set of five principles to guide the conduct of foreign relations with India's immediate neighbours These principles are: first, with neighbours like Bangladesh, Bhutan, Maldives, Nepal and Sri Lanka, India does not ask for reciprocity, but gives and accommodates what it can in good faith and trust; second, no South Asian country should allow its territory to be used against the interest of another country of the region; third, no country should interfere in the internal affairs of another; fourth,

But in reality growing political strife and bureaucratic obstacles indicates that non-tariff barriers in the form of political disputes, bureaucratic delays and interference by the intelligence agencies have been obstructing trade between India and Pakistan. There are growing concern that regionalism in South Asia might end up as Pandora's box if concerned efforts are not made beyond the turmoil of political exigencies.

SAARC members will have to agree on a common import policy, either formally or informally and no country will retain sovereignty over the import policy. However, it felt that unless countries of a region enjoy considerable political harmony, they cannot possibly agree on concessions like surrendering sovereignty over their import policy. This is particularly true in South Asia where Indian economy dominated overall regional outcomes.¹⁰⁷ So, although economic cooperation and even integration is very desirable in South Asia there is a call for creating a politically harmonious subcontinent, which is an extremely formidable task.

all South Asian countries must respect each other's territorial integrity and sovereignty; and, finally, they should settle all their disputes through peaceful bilateral negotiations.

106 Padma Murthy, *The Gujral Doctrine and Beyond*, Strategic Analysis; A monthly Journal of the IDSA, July 1999 (Vol. XXIII No. 4).

107 Ghanshyam N. Singh (ed), *The Economy of the SAARC Nations*, (New Delhi: Anmol Publications, 1993).

After 2006 so many things changed and now South Asia begins to think immense about itself as a region. The proposal to set up a South Asian University is the best example, since it would require nothing short of \$1 billion to do so.¹⁰⁸ The business community is thinking even further ahead of the governments in the region. In anticipation of SAFTA, the TATA group of India has already proposed a \$3 billion investment in Bangladesh in gas-based fertilizer, power and steel plants. The reconstituted Independent South Asia Commission on Poverty Alleviation (ISCAPA) has adopted a more reasonable approach by suggesting a 24-point approach for halving poverty in South Asia by 2010, as opposed to MDG of the UNDP that requires South Asia to do so by 2015.¹⁰⁹ After years of discussion, and, to some extent, a large degree of negligence, the South Asian Development Fund is also making some headway, with assets amounting to around \$300,000,000.¹¹⁰ South Asia receives around \$32 billion annually in remittances, by exporting labour to the Gulf region and the East and Southeast Asian countries.¹¹¹ In Pakistan, remittance increased four-fold, from just over \$1 billion in 2001 to over \$4 billion in 2003; in Bangladesh, it increased from \$1.9 to \$3.3 billion; in India, it

108 Supra 3

109 ibid

110 ibid

111 World Bank's Global Economic Prospect report for 2006.

increased from \$12 to \$21.7 billion, and Nepal receives \$1.5 billion.¹¹²

From 12 June India Bangladesh railway service will be restored, though bus services exist between the countries from 1996.

8. Necessary conditions for a successful PTA:

Economic trade theory indicates a number of criteria likely to increase the probability that a FTAs will result in welfare gains and economic growth. Key criteria include the following seven¹¹³:

1. Geographical proximity.
2. High pre-FTAs tariffs.
3. High intraregional trade levels.
4. Trade complementarities.
5. Low political tensions.
6. Streamlined market access for goods produced.
7. Low non-tariff barriers (NTB).¹¹⁴

8.1 South Asian position:

Proximity has not worked in South Asia; intraregional trade is an insignificant component of total trade. This "inverse" regionalism is not necessarily the result of political problems between India and

112 Supra 3

113 How desirable is the South Asian free trade area? A quantitative assessment: Jayatilleke S Bandara and Wusheng Yu, NJF Seminar No. 325, August 17-18, 2001, Helsinki.

114 Supra 78

Pakistan¹¹⁵. In the three large countries in the region (Bangladesh, India and Pakistan), tariffs is still higher than Southeast Asian countries¹¹⁶.

Because of illegal across-border trade intra-regional trade in South Asia is insignificant. The share of intra-regional trade in South Asia's total trade declined from 3.5 per cent to 2.4 between 1970 and 1990, it showed a moderate rise from 2.4 per cent in 1990 to 4.6 in 1999.¹¹⁷

The other important trend is India's growing trade surplus with other SAARC countries. The share of India's exports to the region increased from 3.9 per cent in 1970 to 5.5 per cent in 1999; its import share from the region declined from 1.4 per cent to 0.9 per cent during the same period.¹¹⁸ This will also be a major concern for other member countries and certainly is not a good sign of promoting overall intra-regional trade in South Asia.¹¹⁹

115 Lahiri, S. (1998) "Controversy: Regionalism Versus Multilateralism", *The Economic Journal*, Vol 108, 1126-1127.

116 Panagariya, A. (1999) Trade Liberalisation in South Asia: Recent Liberalisation and Future Agenda, *The World Economy*, Vol. 22, No. 3, pp.353-378.

117 Zimba, Lyonpo Yeshey, A South Asian Panorama for the Twenty-First Century, in 'South Asian Survey', Sage. Publication, New Delhi, Vol. 9.

118 Ibid.

119 Supra 113

Despite some limitations, trade complementarity indices developed by Drysdale¹²⁰ can be used to check the existence of trade complementarity in South Asia. There was a lack of strong trade complementarity in the bilateral trade structures of South Asia. This point is supported by an early study of Aggarwal and Pandey¹²¹ (1992) and a recent study of Samaratunga¹²² (1999).

South Asian countries are producing and trading similar commodities. To identify different country's competitiveness among different commodity groups, the Export Revealed Comparative Advantage indices (XRCA) have been estimated by two recent studies for commodities at the three-digit level using recent UN trade data¹²³. The results of the above two studies indicate that countries in South Asia have an almost identical pattern of comparative advantage in a relatively narrow band of commodities and that these countries do not have comparative advantages in a wide range of capital goods and advanced manufactured products.

120 Drysdale, P. D. (1969) "Japan and Australia: The Prospect for Closer Economic Integration", *Economic Papers*, Vol. 30, pp. 12-28.

121 Aggarwal, M. and Pandey, P. (1992) "Prospects of Trade Expansion in the SAARC Region", *The Developing Economies*, Vol. 30, No. 1, pp.

122 Samaratunga, R. H. S. (1999) *Essays in Trade Policy and Economic Integration with Special Reference to South Asia*, Unpublished PhD Thesis, La Trobe University, Melbourne

123 *ibid.*

9. INTERNATIONAL TRADE FACILITATION INDICATORS:

International comparisons of economic and commercial conditions from the World Economic Forum's Global Competitiveness Report 2004-2005 (GCR)¹²⁴ provides detailed figures for 104 countries, four of them SAFTA members—India, Pakistan, Bangladesh, and Sri Lanka. The GCR's figures give not only a sense of the range of conditions among SAFTA countries, but also how these countries compare with the rest of the world.

9.1 Hidden Trade Barriers:

The GCR¹²⁵ survey asked respondents to rank hidden trade barriers on a scale of 1 to 7, with 1 important and 7 not important. The SAFTA countries' ranks are as follows in 2006:

i. Global Competitiveness Index rankings:

Country	point	Rank
India	4.44	43
Sri Lanka	3.87	79
Pakistan	3.66	91
Bangladesh	3.46	99

ii. Country hidden trade barriers Index Rank:¹²⁶

124 World Economic Forum. 2002. Global Competitiveness Report. Geneva.

www.us.oup.com/us/pdf/reports/gcrexecutivesummary.pdf

www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm

125 <http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>

Sri Lanka	4.9	35
India	4.7	42
Pakistan	3.8	75
Bangladesh	3.8	76

India's and Sri Lanka's scores reflect views on the extent of hidden trade barriers that are slightly better than the global mean, while Pakistan and Bangladesh fall below the mean.

iii. Business Impact of Customs Procedures¹²⁷

Country Index Rank

Sri Lanka	3.9	54
India	3.6	68
Pakistan	2.9	92
Bangladesh	2.8	96

The South Asian countries score below the global mean, indicating negative impacts on business from customs operations. Customs in Pakistan and Bangladesh have among the strongest negative impacts on business in the world.

iv. Efficiency of Custom Procedures:

Country Index Rank¹²⁸

Sri Lanka	3.4	54
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126 Global Competitiveness Report 2004-2005 (GCR)

127 ibid

128 ibid

India	3.4	55
Pakistan	2.5	88
Bangladesh	2.2	100

The highest score was 6.7 and the lowest 1.8; the standard was 3.7. Once again, Sri Lanka and India are just slightly below the global mean while Pakistan and Bangladesh are near the bottom of global rankings.

v. Business Impact of Rules on Foreign Direct Investment:

Country Index Rank¹²⁹

India	5.1	28
Pakistan	5.0	33
Sri Lanka	5.0	36
Bangladesh	4.8	53

The highest score was 6.4 and the worst, 2.8; the mean was 4.8. All South Asian countries scored at or above the global mean in this area, reflecting the efforts of the past decade to reform the environment for foreign investment. India, Pakistan, and Sri Lanka are in the top third of all countries.

vi. Infrastructure Quality Overall:

Country Index Rank¹³⁰

India	2.7	63
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¹²⁹ ibid

¹³⁰ ibid

Pakistan	2.8	77
Sri Lanka	2.7	79
Bangladesh	2.4	99

The best score was 6.8 and the worst, 1.5; the mean was 4.0. In this case, all four countries score well below the global mean, reflecting the substantial shortcomings in the general quality of infrastructure throughout the region.

vii. Port Infrastructure:

Country Index Rank¹³¹

Sri Lanka	3.5	60
India	3.3	65
Bangladesh	2.5	86
Pakistan	2.4	88

The highest score was 6.8 and the worst, 1.5; the mean was 4.0. The below average scores for port infrastructure are consistent with the negative findings for infrastructure generally. The quality of port services determines a great deal of trade transaction costs because all the countries in the region depend primarily on sea transport for foreign trade.¹³²

10. Review of selected studies:

¹³¹ *ibid.*

¹³² Facilitating Regional Trade under SAFTA, James W. Robertson

Jayaraman¹³³ examined that gains from a South Asian PTA would be insignificant for small nations. Rahman concluded that small countries like Nepal and Sri Lanka would lose welfare as a result of the custom union. DeRosa and Govindan¹³⁴ suggest that welfare gains may increase significantly as a result of much broader trade liberalization with other parts of the world. Srinivasan and Canonero¹³⁵ recommend that the unilateral trade liberalization would yield much more gains for the region compared to gains from preferential trade liberalization. Small economies in the region gain much more from preferential trade liberalization than larger economies. Pigato¹³⁶ used the global CGE model¹³⁷ and found that SAPTA would create some welfare gains for its member countries. However, unilateral trade liberalization would create larger gains for the region. The creation of SAFTA “would be highly desirable” and “economic gains would be significant, especially for the smaller countries and reduce political and border tension in the region”.

133 Jayaraman, T. K. (1978) *Economic Cooperation in the Indian Sub-continent - A Customs Union Approach*, Orient Longman, New Delhi.

134 DeRosa, D.A. and K. Govindan (1996) “Agriculture, Trade, and Regionalism in South Asia”, *Journal of Asian Economics*, Vol. 7. No.2, pp.293-316

135 Srinivasan, T.N. and G. Canonero (1993) “Preferential Agreements in South Asia: Theory, Empirics and Policy”, Yale Growth Centre, Yale University (mimeographed) (as cited in Pigato, et al, 1997).

136 Pigato, M., Farah, C., Itakura, K., Jun, K., Martin, W., Murrell, K. and T.G. Srinivasan (1997) *South Asia's Integration into the World Economy*, World Bank, Washington, D.C.

137 Hertel, T.W. (ed) (1997) *Global Trade Analysis: Modeling and Applications*. Cambridge University Press.

In contrast to the above studies some observers have a much more negative view on SAFTA. Panagariya¹³⁸ rejects the idea that forming SAFTA is beneficial for the region and argues that "it is in the region's interest to push ahead with its non-discriminatory liberalization rather than promote trade preferences". Panagariya¹³⁹ points out that this is a misguided argument and SAFTA is "likely to become a binding constraint on true, nondiscriminatory liberalization". He uses examples of Mexico and Brazil joining the Southern American Common Market (MERCOSUR) and states that these two countries have reviewed in this section have contributed valuable inputs to the debate on the desirability of SAFTA.

Three different viewpoints on SAFTA can be summarized as follows:

(a) Optimistic View: This group believes that the SAFTA would be "highly desirable" and economic gains would be significant, especially for small economies in the region. South Asian politicians and many bureaucrats hold this view.

138 Panagariya, A. (2000). "Preferential Trade Liberalization: The Traditional Theory and New Development", *Journal of Economic Literature*, XXXVIII (2): 287-331.

139 Panagariya, A. (1999) Trade Liberalisation in South Asia: Recent Liberalisation and Future Agenda, *The World Economy*, Vol. 22, No. 3, pp.353-378.

(b) Pessimistic View: This group believes that the SAFTA is "highly undesirable" and it will lead to trade diversion and slow down of unilateral trade liberalization.

(c) Moderate or Intermediate View: This group believes that potential gains from SAFTA, though less than those from unilateral liberalization, are significant for small countries in the region and preferential trade liberalization is good as part of a coordinated liberalization in countries in the region, and it will lead to unilateral trade liberalization.

11. SAFTA:

The SAFTA agreement covers tariff reductions, rules of origin, safeguards, institutional structures, and dispute settlement. It also calls for the adoption of various trade facilitation measures. The SAFTA tariff reduction program stipulates average weighted tariffs of no more than 20 percent by the region's more developed economies—India, Pakistan, and Sri Lanka—within two years of the entry into force of the agreement. Within five years after the completion of the first phase, India and Pakistan will adjust their tariffs to the 0 to 5 percent range. The region's least developed countries (LDC) Bangladesh, Bhutan, Maldives, and Nepal are required to have average weighted tariffs of no more than 30 percent within two years, but would be allowed longer periods for the second downward adjustment: Sri Lanka in six

years and Bangladesh, Bhutan, Maldives and Nepal in eight years. India, Pakistan, and Sri Lanka will reduce their tariffs to the agreed low levels on imports from other countries no later than January 1, 2009. The agreement also calls for eliminating quantitative restrictions for products on the tariff liberalization list.

While member states have been allowed to develop lists of sensitive items that would not be subjected fully to the stipulated tariff cuts, the number of products to be included in the country lists would be subject to review every four years. A Ministerial Council will be the highest decision-making authority while a Committee of Experts (COE) will monitor implementation of the agreement and resolve disputes. The COE will report to the ministers every six months on the progress of the agreement. The agreement is to be fully implemented by 2015.¹⁴⁰

11.1 TRADE FACILITATION PROVISIONS IN THE SAFTA TREATY:

SAFTA seeks to change the emphasis of SAARC economic regional cooperation from a policy of sustenance¹⁴¹ to actively enhancing¹⁴² it. SAFTA's ambitions extend to increasing the scope of the South Asian

¹⁴⁰ Details are from the SAARC Ministerial Declaration, January 2004.

¹⁴¹ Article 2(1) SAPTA

¹⁴² Article 2 of SAFTA

regional trade dialogue to include issues of competition¹⁴³; trade and transport¹⁴⁴ facilitation through progressive harmonization of legislation¹⁴⁵; banking procedures¹⁴⁶; macroeconomic consultations¹⁴⁷; communications¹⁴⁸; foreign exchange regulations¹⁴⁹; and immigration (currently SAFTA is only concerned with the facilitation of business visas).¹⁵⁰ SAFTA also introduces a specific Trade Liberalization Programme¹⁵¹ that phases down tariffs and eliminates quantitative restrictions in consonance with the obligations imposed by the WTO¹⁵². Article 20 of SAFTA also provides for a detailed dispute settlement mechanism under the auspices of a Council of Experts analogous to the Dispute Settlement Body (DSB) of the WTO. SAFTA member countries agreed concerning trade facilitation in Article 3 of the SAFTA agreement.

11.2 Drawback of the Treaty:

A major drawback of the Treaty is the long time period that it envisages for establishing the Free Trade Area. Going by the past

143 Art 3(1) (b) & 8(j)

144 Art 8(g) & (k)

145 Art 3(2) (e) & 8(a)-(e)

146 Art 8(f), Article 8(j) specifically mentions venture capital as being an issue for liberalization.

147 Art 8(i)

148 Art 8(k)

149 Art 8(l)

150 Art 8(m)

151 Art 7

152 Art 7(5)

experience, the process can be derailed by any adverse development in the political relationship between the countries of the region. Moreover, the long SAFTA process envisaged in the Treaty is likely to be overtaken by events at both bilateral and multilateral levels. Series of bilateral free trade agreements will make the SAFTA process redundant and same outcome can be expected because of the expected lowering of tariffs by further trade liberalization through negotiations under the WTO.

Another major deficiency and element of uncertainty in the SAFTA Agreement is the "sensitive" or negative lists of products. No datelines have been fixed for concluding the negotiations on these items. It does not subscribe categorically to the phasing out of the sensitive list. The Agreement only provides that the sensitive list "shall be reviewed after every 4 years --- with a view to reducing the number of items". Moreover if the list 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".

SAFTA Treaty does not include provisions for the liberalization of trade in Services which is a major lacuna. Services have become an important driver of the economies of SAARC countries accounting for nearly 50 percent of the GDP of most of these countries. It also leaves

out liberalization of investment in the region. It is a severe shortcoming because it is not possible to take full advantage of the enlargement of the market brought about by trade liberalization, without freer movement of capital.

The SAFTA Treaty contains no specific provisions for deeper integration. The measures for deeper integration may come within the scope of its Article 8, under the title "Additional Measures". However, this Article is couched in very general terms and implies no commitments on the part of the member states to pursue any of the special measures listed under this Article and set up a mechanism for pursuing the additional measures.

11.3 SAARC FINANCE:

The 24th Session of the SAARC Council of Ministers held in Islamabad during January 2-3, 2004 recommended SAARC FINANCE to examine the concept of a South Asian Development Bank (SADB) and to study and make recommendations on early and eventual realization of a South Asian Economic Union (SAEU).¹⁵³

11.4 Measure Economic Benefits from SAFTA:

¹⁵³ SAPTA, SAFTA and Beyond, Hem Prasad Neupane

“A consensus has emerged among researchers that RTAs are trade creating”¹⁵⁴. For instance, the share of NAFTA trade among the signatories’ total trade increased from less than 35 percent in the late 1980s to almost 50 percent in 1999. Over the same period, the share of trade between members of MERCOSUR, compared to the parties’ total trade, doubled from 10 to 20 percent. In South Asia, if tariffs remain high on imports from outside the region than SAFTA would divert total trade. FDI has played a very important role in successful RTAs. South Asia needs more resources for investment than it can mobilize domestically. The corporate sector in South Asia has remained unaffected by developments in the global production system. According to a review of the changes in industrial processes by Alan Winters¹⁵⁵, production chains and finer division of the production processes across countries, including developing countries, allows producers to exploit potential gains from (1) local increasing returns to scale in the production of intermediate inputs, (2) regional differences in factor costs for different components of the production process, (3) increasing competition arising from widening market, and (4) technology transfer from developed countries embedded in

154 Ghosh, S. and S. Yamraik. Are Regional Trading Arrangements Trade Creating? An Analysis of Extreme Bounds Analysis: *Journal of International Economics*, 63, 369-95.

155 Winters, L. Alan. 2004. Trade Liberalization and Economic Performance: An Overview. *The Economic Journal*, 114 (February), pp. F4-F.

intermediate inputs and backward linkages through exports.¹⁵⁶ In most cases trade integration has allowed developing countries to specialize in their production systems.

11.5 SAFTA's Future:

RTAs often follow rather than determine changes in regional trading patterns. This does not augur well for South Asia since relatively little trade exists among the countries of the region. One can argue, however, that the region's focus on developed markets resulted from political problems that marred relations between India and Pakistan. If the recent easing of tensions between the two countries gains momentum, some trading patterns may change in favor of intraregional trade. The conclusion of free trade arrangements between Sri Lanka and India and Sri Lanka and Pakistan might have created a sense of dynamism that would move the entire region towards an RTA.

When implemented in highly restrictive economic and trading environment, RTAs are usually inconsequential. SAPTA did not succeed because the South Asian countries had highly protective trade regimes. This has changed; external tariffs on trade and other trade-

¹⁵⁶ *ibid.*

restricting practices have been reduced considerably in all countries of the region¹⁵⁷.

Minimize excluded products expand the scope for positive net benefits through competition and trade creation. The temptation to use lists of sensitive items is not as great when overall tariffs are low. According to one review of South Asia's experience with regional arrangements, the 1993 SAPTA "was stillborn, given high levels of protection, a lack of meaningful concessions, domestic political problems, hostility between India and Pakistan, India's ban on imports of all consumer goods and India's control over major primary goods"¹⁵⁸.

Services bring more benefits to regional economies. India now has a highly developed information technology sector that could benefit other populous countries, such as Bangladesh and Pakistan, which also have a large number of well-educated and well-trained people. At the same time, Pakistan has made advances in commercial banking from which the regional banking industry could benefit. India, with a much larger pool of savings than other countries in the region and with a more developed capital market, could help fill the region's savings and investment gap.

157 World Bank. 2004c. South Asia Free Trade Area: Promise and Pitfalls of Preferential Trade Arrangements. Washington D.C.

158 Baysan, T. 2004. South Asia: Lessons and the Way Forward. Mimeo. Washington: World Bank.

Trade facilitation measures are critical for reducing the cost of trade. While the SAFTA declaration incorporates these measures, they have to be interpreted much more broadly than seems to be the inclination among trade officials working on the modalities of the arrangement.

A SIX-POINT FOR SAFTA:

1. Establish strong political support. It is necessary to establish strong political support to ensure the impetus needed to reach the goals of the SAFTA agreement.
2. Establish a regional trade facilitation council. A trade facilitation council should be charged with providing an annual report to senior political leaders, perhaps at an annual summit, that presents the current agenda and describes progress.
3. Establish national trade facilitation working groups. Recognizing that each member country faces different challenges in making changes and meeting standards, each country should establish standing national working groups for trade facilitation. These working groups should also invite substantial participation by the private sector and trade experts and have access to the technical assistance necessary to assume their responsibilities.
4. Establish a regional customs committee. A committee comprising of the heads of customs agencies in each SAFTA country

should be established to work with the trade facilitation council and should be represented on the council.

5. Undertake a regional communications program. A regional communications program should be undertaken to improve public understanding of the importance of aggressively pursuing measures to reduce the costs of trade. Improvements in international rankings, such as the GCR, should be publicized.

6. Establish response mechanisms. Public sector mechanisms should be put in place to respond rapidly to private sector reports of measurable trade transaction costs or delays. Typical bureaucratic responses to such shortcomings are not effective.

Conclusion:

British India was divided on two nation theory¹⁵⁹. On the foundation of religious conviction India and Pakistan created. Sri Lanka faces civil war from the last three decades which is hammered by the cast system. Until and unless the people of south Asia heartily believe and dream about south Asian union nothing can be achieved. The religious partition in 1947 still is a gigantic weapon against any sort of union. It

159 The Two-Nation Theory was the basis for the Partition of India in 1947. It stated that Muslims and Hindus were two separate nations by every definition, and therefore Muslims should have an autonomous homeland in the Muslim majority areas of British India for the safeguard of their political, cultural and social rights, within or without a United India. http://en.wikipedia.org/wiki/Two-Nation_Theory.

is we the people of South Asia who need to change our outlook about economic enrichment rather than religious fantasy and drive our national leader for greater unification. World Bank (WB) country director Xian Zhu argues that although some of the same phenomena are present to some degree in South Asia, there has nevertheless been a turn for the better in the region due to a number of exceptional factors.¹⁶⁰

¹⁶⁰ <http://thedailystar.net/2007/05/16/d70516011410.htm>

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