South Asia Regional Integration: Benefits, Opportunities and Challenges

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Overview

- **Current situation**: South Asia is the least integrated region in the world.

- **Benefits of integration**: Policy makers tend to focus on the benefits of trade integration. Benefits of non-trade integration (e.g., energy, water, roads) may be potentially greater.

- **Sharing of benefits**: Benefits of trade integration significant for smaller economies (e.g., Bangladesh, Sri Lanka). Benefits of non-trade integration potentially large for larger economies (e.g., India, Pakistan).

- **Reasons for optimism**: High level political commitment, private sector interest, changing external and regional landscape.

- **Reform agenda**: Pick the low hanging fruit.

- **Summary**: Opportunity for a new era on integration.
Cross-border structural rigidities a constraint to medium-term development.

Major cross-border structural rigidities in South Asia:

- Weak trade integration.
- “Behind-the-Border” and non-trade barriers—e.g., customs procedures, ports systems, border crossings.
- Poor regional infrastructure—e.g., energy, water management, and transport.
- High level of uncertainty—e.g., low FDI, high military expenditure.
South Asia weak on global trade integration.
(Exports as a % of GDP, 1980-2002)

Source: United Nations COMTRADE data
South Asia weak on intra-regional trade integration.

Intra-regional trade as a share of GDP (2002)

Source: United Nations COMTRADE data and World Development Indicator.
South Asia attracts limited FDI inflows:

Global gross Foreign Direct Investment (FDI) as a Percent of GDP, 2002
South Asia weak on non-trade integration

Source: WMO database

Notes: A higher score implies better performance. Data on regulatory environment and service-sector infrastructure are not available for Pakistan.

“Ports” – the quality of infrastructure of maritime and air ports.

“Customs” – administrative efficiency and transparency of customs.

“Regulations” – domestic regulatory environment.

“Services” – domestic service infrastructure.
South Asia has fewer people-to-people contact.

Inbound global tourists (thousands).

- East Asia & Pacific
- Latin America & Carib
- Sub-Saharan Africa
- South Asia

1990
2002
Gains from integration.

- Expansion of trade in goods and services.
- Increase in FDI.
- Improvement in infrastructure and services (e.g., energy, water, transportation).
- Peace dividend.
Benefits of trade expansion.

- Potential increase in intra-regional trade from $0.5 billion to $2 billion.
- Greater trade diversification, given that SAARC countries do not trade as much with each other, as they do with the rest of the world.
- Switching of trade from informal to formal channels will increase consumer welfare, reduce efficiency losses (e.g., of Indian/Pakistan goods through Dubai) and increase Government revenue.
What will be size of total trade Gain?

Trade gain from removing trade barriers (blue) and from removing non-trade barriers (brown) as a Share of Total Trade

Note: “Actual trade” - value of trade recorded in COMTRADE data “Predicated trade” - value of trade predicted by a gravity model.
Non-trade benefits of integration.

- FDI.
- Peace dividend.
- Regional energy trade.
- Cross-border water management.
- Transportation.
Integration can boost FDI inflows: The EU experience

FDI as % of GDP in Europe: Before and After Integration

- Peace will reduce investment risk.
- Integration, by increasing the size of the market, will generate necessary scales to attract investments.
- Export, productivity, and technology spillover effects of FDI will boost growth.
Integration can boost FDI inflows: The NAFTA experience.
What will be the size of peace dividend?

Trends in Indian Stock Market Just Days after Kargil War BSE

- 5/25/1999: 4100
- 5/26/1999: 4000
- 5/27/1999: 3900
- 5/28/1999: 3800
Benefits of regional energy trade

- Significant unutilized complementarities in energy endowments -- gas, hydropower, coal -- within the region and between the region and its neighborhood.
- National energy systems are autarchic: very low trade in network energy -- electricity and gas -- in comparison with worldwide trends, both within the region and between the region and the outside world.
- Fast increasing demand, driven by economic growth and access expansion, will further increase the opportunity costs of keeping the national energy systems isolated.
Benefits of regional energy trade

- India: electricity and gas imports; trading base-load power for peak power
- Pakistan: gas imports; energy transit; reliability support
- Nepal and Bhutan: hydropower exports; base-load electricity generation imports; reliability support
- Bangladesh: gas exports (directly and/or through electricity); reliability support
- Afghanistan: electricity and gas imports and transit
- Trade with countries outside the region: Central Asia, Iran, Myanmar
Benefits of cross-Border water management.

- Improved cross-border flood warning systems
- Watershed management and storage in Nepal generating hydro and irrigation benefits in Nepal and flood control benefits in India (Bihar).
- Storage in NE India being used for hydropower and flood control in India, and for flood control and dry season water augmentation in Bangladesh.
Benefits of regional transportation

- Increased inter and intra-regional connectivity
- New transit routes to Central Asia, China and NE India
- Reduced border crossing times and costs
- Increased transport asset utilization leading to lower costs and lower tariffs
- Allowing cross-border movement without transshipment; major benefits for landlocked countries but also intra-regional trade for Pakistan, India and Bangladesh
- Improved port systems → reduced vessel delays → lower shipping costs → use of larger and more economic vessels → better shipping services
Reasons for optimism.

- Improving relations between Pakistan & India.
- Private sector is more enthusiastic about integration.
- Demise of the Soviet Union has diminished external competition for influence that divided SAR countries.
- China is seen less of a strategic threat and more of an opportunity.
- Indian regional policy shifted towards partnerships.
Reform agenda:
Views of the private sector from Bangladesh, India, Pakistan and Sri Lanka.

- “Government must ensure that economics should take precedence over the political issues”---Confederation of Indian Industries.
- Give private sector greater voice in policy making.
- Policy makers focus as much on the “non-trade” benefits of SAFTA.
- Ensure equitable sharing of benefits.
- “Win-win” reforms should be discussed at a regional workshop in 6 months.
Implementing SAFTA: making it more effective.

- SAFTA should minimize trade diversion and maximize trade creation.
- Negative list small and phase it out quickly.
- Coverage of SAFTA to include services and investment.
- Rules of origin kept simple, transparent and same for all goods.
- SAFTA has provision for non-trade integration agenda—strengthen the deeper integration agenda.
- Keep SAFTA consistent with WTO rules.
Broadening the gains from integration: India is a challenge as well as an opportunity.

- Smaller countries are concerned about more equitable sharing of the gains from trade.
- India, a rapidly growing economy, provides a huge market to the rest of South Asia. Sri Lanka, for example, has increased its exports to India in the last two years.
- Trade Compensation Fund will compensate smaller countries for the loss of trade revenue arising from the implementation of SAFTA.
Improving Connectivity

- Multiple entry visa.
- Transportation links—more flights, expansion of shipping links, more air cargo facilities.
- Better passenger air services
- Cooperation in the banking sector
- Introducing mechanisms for dispute settlement
- Developing trade infrastructure (shipping, rail and road) immediately among South Asian economies to ease flow of goods.
Improving Regional Trade Facilitation

- Improving port efficiency
- Improving customs cooperation. Harmonization of procedures; green channel treatment of imports, and selective PSI from other South Asian countries—reliance on self declaration and risk management systems.
- Improving exchange of information on market information and legal environment—information on standards; import rules; investment opportunities; opening of trade body offices
- Mutual Recognition Agreement on Standards.
- Improving regulatory environment
- Improving service sector infrastructure.
Summary

- Quantitative benefits can not capture the potential benefits of a change in mindset/paradigm.
- Great opportunity for a new era on integration.
- Focus both on trade and non-trade benefits of integration.