

South Asia Regional Integration

India Country Note

South Asia Regional Economic Cooperation: Private Sector Perspectives



**The World Bank/ International Monetary Fund
2004 Annual Meetings
Program of Seminars, October 1, 2004
Washington, D.C.**

South Asia Region
The World Bank
Washington, D.C.

India Country Note

South Asia Regional Economic Cooperation: Private Sector Perspectives

This paper on regional economic co-operation in South Asia was commissioned by the World Bank to CII. It is based on a survey of the private sector through the administration of a questionnaire as well as detailed interviews, culminating in a meeting of private sector participants to discuss the desired initiatives. This paper was prepared by Sonu Jain under the guidance of Rajiv Kumar, Chief Economist and N. Srinivasan, Director General of CII.



Confederation of Indian Industry

Disclaimer: All rights reserved. The findings, interpretations and conclusions expressed herein are those of the author(s) and do not necessarily reflect the views of the Board of Executive Directors of the World Bank or the governments they represent. Copying and/or transmitting portions of all of this work without prior permission may be violation of applicable law. The World Bank encourages dissemination of its work and will normally grant permission promptly. Any queries in this regard should be addressed to the Office of the Publisher, World Bank, 1818 H Street NW, Washington DC 20433, USA, fax 202-522-2422, email: pubrights@worldbank.org

Introduction¹

The South Asian region comprising eight countries (Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) is one of the most densely populated and poorest regions in the world. It has 23 per cent of the world's population and accounts for a mere 2 per cent of world output. The region has 40 per cent of the poorest people in the world and its relatively young population is one of the least literate and the most malnourished in the world. Out of these eight countries seven (excluding Afghanistan) are members of the South Asian Association for Regional Cooperation (SAARC), which was established in 1985.

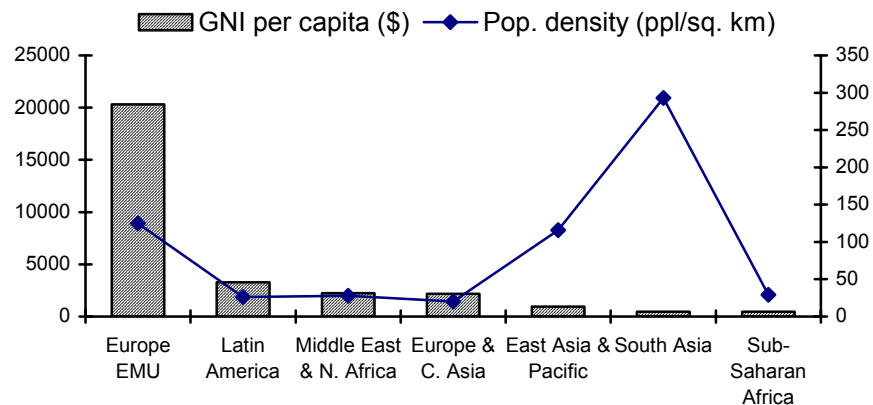


Table 1: Indicators of Poverty and Mortality

	Share of people living on less than \$1 a day (2001)	Child Mortality Rate per 1,000 live births (2002)	Maternal Mortality Ratio per 1,00,000 live births (2000)
East Asia and Pacific	15.6%	42	115
Europe & Central Asia	3.7%	37	58
Latin America	9.5%	34	193
Middle East & N. Africa	2.4%	54	165
South Asia	31.1%	95	566
Sub-Saharan Africa	46.5%	174	917
Europe EMU	-	6	10

Source: World Development Indicators, 2004

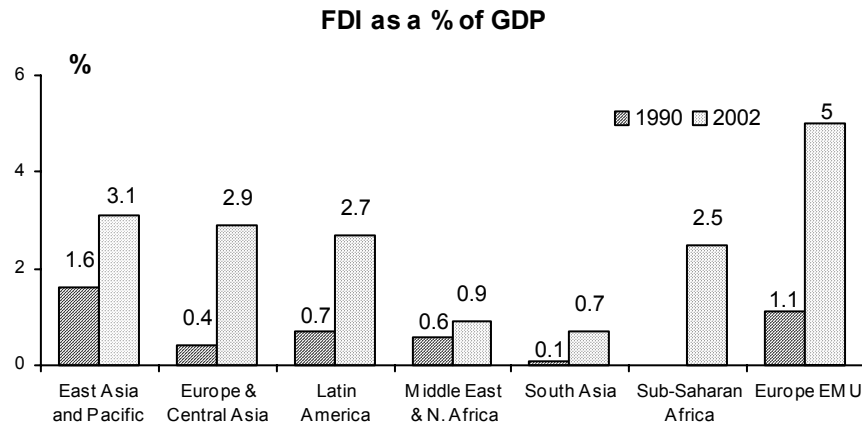
Section I

Rationale for Regional Integration

Regional cooperation and its more advanced form of regional economic integration would enable SAARC countries to integrate more efficiently with the rest of the world and take fuller advantage of global flows of investment and technology and trade opportunities. Regional integration also permits diversification of individual economies, and promotes development in their peripheral regions.

¹ Draft incorporates inputs from SAARC Chamber of Commerce, RIS, CII, responses from questionnaire and interviews with industry people

Regional economic cooperation permits countries to overcome constraints posed by the relatively small size of their individual markets and the low purchasing power in their economies. *Integrating smaller economies into larger regional economic space expands the size of the market and facilitates cost reductions through economies of scale and scope.* Regional cooperation and economic integration result in the threshold scales necessary to attract larger volumes of foreign direct investment². Chart below shows that FDI as a per cent of GDP in South Asia is among the lowest in all regions and regional integration will help to improve South Asia's performance in attracting FDI.



Source: World Development Indicators, 2004

Regional cooperation in South Asia will also help to increase the level of intra-regional trade among South Asian economies. At present this is at a low level of 4.2 percent and has actually been declining over the years having been 4.8 per cent in 1980³. Freer trade and lowering of trade barriers will help these countries to take the fullest advantage of their mutual comparative advantage.

Apart from the strong economic rationale for regional cooperation and integration, it also enables the member countries to minimize negative externalities and conflicts. Trans-boundary challenges like trafficking in women and children, smuggling of drugs, wild-life trade and cross-border terrorism can be overcome only through regional initiatives. Successful economic cooperation would also yield a substantial peace dividend with direct welfare raising impact for the entire region.

Initiatives for South Asian Regional Cooperation

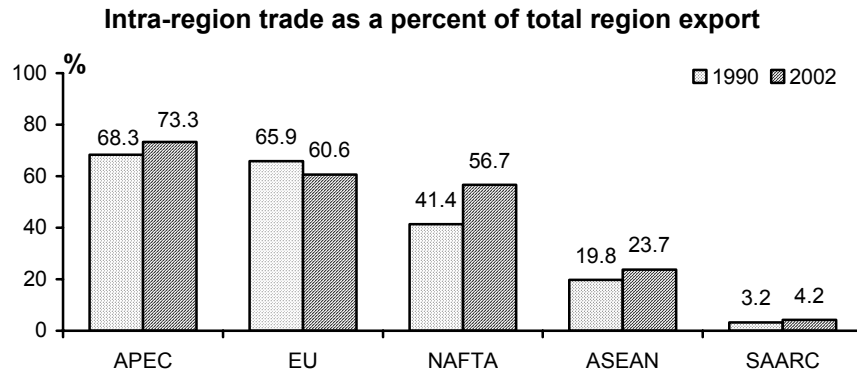
Regional Level: The initiative of South Asian regional cooperation was launched in 1985 with the establishment of SAARC. Initially the focus was essentially on non-economic areas, and economic cooperation formally entered the SAARC agenda only in 1995 with the operationalization of the SAPTA Agreement. So far, four rounds of trade negotiations have been concluded under SAPTA covering over 5500 commodities. Even though each round has contributed to an incremental trend in the product coverage and the deepening of tariff

² The formation of the European Economic Community (EEC) in 1960s was accompanied by a surge of foreign direct investment into Europe from the US

³ World Development Indicators, 2004

concessions over previous rounds, the intra-region trade continues to remain almost stagnant, at a mere 4%. This is because either the tariff concessions offered under SAPTA were too insignificant or commodities covered under SAPTA do not form a significant part of the existing or potential trade basket of the SAARC countries.

The chart below displays that at present, intra-regional trade (as a per cent of total region export) among SAARC countries is less than 5 per cent, while it is 73 per cent in APEC, 61 per cent in the European Union, 57 per cent in the North American Free Trade Area and 23 per cent in the Association of South-East Asian Nations.



Source: World Development Indicators, 2004

So far the progress in this region has clearly been modest. But *a major breakthrough has been made early this year, with the signing of South Asia Free Trade Area (SAFTA) agreement. It is expected to come in to force on 1 January 2006.*

Focus of the SAFTA agreement is primarily on tariff reduction and trade in goods. Vital areas like trade in services are left untouched. Many critical items that are important for success of SAFTA like formulation of rules of origin, preparation of the negative list, creation of a fund for compensating LDCs for loss of revenue from the elimination of customs duties, and the identification of areas for providing technical assistance to the relatively weaker countries are left untouched. Moreover no datelines have been fixed for concluding the negotiations on these items, except for the compensation fund that must be in place before the commencement of the SAFTA. The agreement does not subscribe to phasing out of negative list rather it just provides for the list to be reviewed after every four years. The agreement provides for elimination of QRs (quantity restrictions) as soon as 0-5 per cent tariff level is achieved, however it does not prescribe elimination of other non-tariff and para-tariff restrictions. Some of the important measures missing from the agreement are finalization of the pending draft investment agreement, creation of a SAARC Investment Area, South Asian Development Fund, South Asian Development Bank, South Asian Energy Grid, vertical industrial integration, and the harmonization of fiscal and monetary policies. These are significant omissions and point to the weak political will for pursuing regional cooperation.

Bilateral level: With regional cooperation making only modest progress, bilateral free trade agreements are gaining momentum in this region. While some bilateral initiatives are in place, between India and Sri Lanka, India and Nepal, India and Bhutan some others are under negotiations like between Pakistan and Sri Lanka and the India and Bangladesh FTA. Some sub-regional economic cooperation programs have also been launched to bring together the four countries in the eastern part of South Asia. These four countries have joined together under the

Growth Quadrangle (India, Nepal, Bangladesh, Bhutan) and another possible sub regional initiative in the offing is between (South India, Sri Lanka, Maldives).

Indo-Sri Lanka Free Trade Agreement (FTA), which came into effect in 2000, has boosted bilateral trade between the two countries. Sri Lanka's export to India increased from \$71 million in 2001 to \$168 million in 2002 while India's export to Sri Lanka were up from \$604 million in 2001 to \$831 million in 2002⁴. Besides this, FTA has made Sri Lanka a hot destination for FDI since many foreign investors consider it as a window to access the vast Indian market. Indo-Sri Lanka BFTA has now been advanced to an Indo-Lanka Comprehensive Economic Partnership Agreement where liberalization of services (in addition to investment) has been included. Indo-Sri Lanka case ought to be a model for similar agreements in South Asia.

Under the Indo-Bhutan relationship, Bhutan has built hydro-electricity ventures by collaborating with India with buy-back facility. Hydroelectricity export from Bhutan to India provided over 45 per cent of the government's revenues and accounted for 30 per of GDP in 2003.

Long existing *Indo-Nepal treaties* were formalized as Indo-Nepal Trade and Transit Treaty in 1996. The duty free provision of the agreement induced Indian JVs to operate from Nepal. The volume of exports from Nepal has consequently increased considerably; specifically few items were exported to India in bulk quantity. The need for value addition norms was introduced in 2002 to protect the Indian domestic industries and producers. As a consequence, rules of origin procedures were introduced in the renewed Treaty of Trade in 2002. Specific modifications comprising value addition requirements of 30 percent, quantitative restrictions on export for vegetable ghee, acrylic yarn, copper and zinc oxide, and existence of negative list were introduced in the renewed treaty. These developments have not only seen a degree of retrogression in Indo-Nepal bilateral trade but also affected attempts at economic diversification in Nepal.

South Asian Growth Quadrangle was launched in 1997 involving four countries of this region namely Bhutan, Bangladesh, India and Nepal (BBIN) primarily aimed at creating an enabling environment for rapid economic development through the identification and implementation of specific projects. At the request of BBIN, Asian Development Bank launched assistance for sub-regional cooperation under the *South Asia Sub-regional Economic Cooperation (SASEC) Program in 2001*. Technical assistance was provided to identify and prioritize sub-regional projects in 5 major sectors: transport and communication; energy and power; environment; tourism; trade, investment and private sector cooperation. SASEC program is one of the most successful among all the initiatives taken in the past. Last year, ADB has approved a \$450,000 technical assistance grant to develop a tourism plan for the four countries belonging to SASEC, with ecotourism and Buddhist circuits as the common themes.

In addition to the activities under SASEC program, ADB has provided support for several stand alone investment projects having significant sub-regional implications. These projects include West Bengal Corridor Development Project⁵, Road Network Development Project⁶. In addition,

⁴ UNCTAD report

⁵ A north-south road corridor from Raiganji, near Siliguri, to Barasat, the north of Kolkata in West Bengal, India with links to border points in Bangladesh

⁶ Nepal's East West Highway, which links to India and Bangladesh through Kakarbita.

ADB's Private Sector Group has invested in Lafarge Surma Cement, the first sub-regional private sector project, which will transport limestone from Meghalaya, India, to a cement plant in Bangladesh through a cross border conveyor system.

World Bank has been actively involved in various poverty alleviation, health, infrastructure, social and environmental projects in this region. Following Sub-Saharan Africa, South Asia is the largest regional recipient of concessional lending from the International Development Association (IDA), the World Bank affiliate that provides interest-free loans to the world's poorest countries. *In FY03, new World Bank lending commitments to South Asian countries was \$2.9 billion for 31 projects.*

Section II- Prospects and Problems for South Asian Regional Cooperation: A Private Sector Perspective

The private sector looked seriously at SAARC sometime in 1994 with the establishment of SAARC Chamber of Commerce and Industry (SCCI). The objective of SCCI was to represent the private sector and promote regional trade and investment in this region. It has played a significant role by bringing together the national chambers of commerce and industry of the seven SAARC countries under one umbrella. FICCI is a nodal point and Indian representative of SCCI. SCCI has undertaken a number of positive initiatives since its inception through commissioning of studies and reports, publication of books, convening of seminars, workshops and trade fairs, and in fostering a closer dialogue with the Governments on trade and economic matters. SCCI has done outstanding work in forging a consensus in the private sector to facilitate regional cooperation.

Confederation of Indian Industry has also taken some initiatives in the past for regional cooperation in South Asia. It is working actively with Chamber of Commerce of Bangladesh, Nepal and Sri Lanka through Joint Economic Councils to resolve bilateral issues since growth at regional level was very modest. At regional level, it has brought together the private sector through CEO's Forum, audio-video conferencing, trade fairs, missions, publications etc.

Prospective areas of regional cooperation in South Asia

Questionnaires sent out by CII to a select group of its members active in the region, reveal that a significant chunk (95%) of respondents would benefit substantially from greater regional cooperation in South Asia. The potential areas highlighted below are taken from the responses of the questionnaire and interviews conducted for the study (except for Harmonization of standards, non-tariff barriers, and common currency which don not emerge from the survey of private sector but are CII's own views on promoting regional economic cooperation in South Asia).

Harmonizing Standards: There is a need to accelerate adoption of best practices and international voluntary standards to have a stronger voice for the region in debates at WTO and international standard setting bodies. *The lack of standardization in South Asia wastes efforts to export local products because they do not meet regulations in other markets.* In addition to this, harmonization of standards has played a critical role in development of regional blocks and global marketplace. Eighty percent of world merchandise trade is impacted by standards and regulations that embody standards. They are a means to ensure satisfactory compliance with health, safety

and environmental requirements. *Standards were the principal element of EU's Single Market Program as they provide a common language and framework for commerce and economic development worldwide.* Movement toward SAFTA and standardization must be coordinated.

Non-tariff barriers: In the current scenario, as tariffs continue to decline, there has been emergence of non-tariff barriers as a measure of protection. *Given the extremely low negotiating power of the individual member states at WTO, there is a strong need for a collective strategy to this issue.* European Union, USA and Japan are the principal export destinations for the four South Asian countries, Bangladesh, India, Pakistan and Sri Lanka, with share of exports in these markets to the total exports over 50 percent. In 1998, up to 94 per cent of the South Asian exports to these countries were facing NTMs.

SAARC exports are severely impacted by NTMs in major markets. Also, for successful regional integration within SAARC, it is crucial to reduce technical and regulatory barriers to trade by countries within the region.

Enhancing trade through negative list approach: For successful regional cooperation it is important to change the current approach, which involves lengthy negotiations for each sector/product. Instead, a negative list approach can be adopted, by which products not identified in this list can be immediately subjected to tariff reduction. This is a more transparent approach and appropriate towards trade liberalization. *However, it is important that negative list should be limited in scope and should be reviewed after every two years with a view to reducing the number of items.*

Trade Facilitation: According to a study by Rohit and Taneja (2000), the main sources of transaction costs in Indo-Nepal and Indo-Bangladesh trade are delays caused by complex customs and transit procedures. Delay in custom clearances happen on account of verification of HS classification, chemical tests, customs valuation, labeling requirement for carrying description (in order to enjoy tariff preferences). Due to this, informal trade has surged and government is losing on revenue. *It is thus essential to work out harmonization arrangements* in areas such as customs procedures, arbitration, double-taxation, proper channels to access market information & legal systems and electronic data exchange leading to paperless trade, which would help reduce transaction costs and make intra-SAARC trade more efficient and prosperous for business.

Transport Infrastructure: Availability of transport infrastructure is crucial in providing impetus to economic activities especially international trade. The transport infrastructure has immensely helped EU to grow fast. Over the years a number of initiatives have been taken by South Asian countries at bilateral, sub-regional and regional level but trade is yet to grow at the expected rate. There is a need to strengthen trade instruments such as transport linkages among the members. The current level of trade can be doubled if appropriate regional agreements on roads, rail, shipping and air are put in place enabling seamless movement. To attain competitiveness, countries have to cooperate with each other in building and operating infrastructure facilities. Our region is strategically situated at the crossroads of Asia between the oil-rich countries in West and Central Asia and the dynamic economies of South East Asia. We should make full use of this geographical advantage.

Common Currency for the region: A common currency is a characteristic of strong regional economic integration. *Currency unification promotes inter-country trade and investment by reducing transaction costs arising from currency conversions and by eliminating exchange risk and uncertainty.* However, the objective of common currency can be achieved only in a phased manner. The first and immediate step in this regard should be introduction of a parallel currency. The region can create a reserve fund that can provide funding to regional public goods like

transport, energy, IT etc to promote trade and investment. Provision of regional public goods and concessional assistance for the lagging regions will help build mutual trust and confidence in the region.

Development of Financial Sector: There is an acute need of adequate financial infrastructure including, banking, insurance, clearance mechanism and capital market for facilitating trade and investment. This sector is not fully developed in this region and existing network is both insufficient and fragile. The banking sector is saddled with huge NPAs indicating serious need for banking sector reforms. A well-developed banking sector will help in simplification of procedures for import financing as well. The state of development of the capital market is yet another area of concern. Most of the member states have a long way to go for appropriate development and modernization of capital market institutions. Since India has a relatively well-developed capital market, it may help smaller economies to develop stock exchanges, train stockbrokers and other intermediaries. Till date, Sri Lanka is the only country with which India has executed a Memorandum of Understanding (MoU) for securities markets, although discussions are also underway with Pakistan, in addition to Nepal⁷. In as much as this is a low cost step towards market integration, it would be a straightforward recommendation that SEBI enter into MoU with all the SAARC countries.

Vertical integration within the region and increasing value addition in traditional exports: Trade complementarities did not develop within the region due to lack of vertical specialization through production sharing arrangement. Vertical specialization allows the countries to reap economies of scale by concentrating on a specific production process in the value addition chain. For example, trade can take place if one country specialized in yarn and fabrics while another in finished garment products. In case of primary commodity exports, regional cooperation will allow greater value addition since South Asia is exporting these commodities in bulk, and value addition takes place in importing countries thereby resulting in lower value realization. A good example of such cooperation and joint venture was the jute industry when Bangladesh produced jute and West Bengal had processing mills. JVs are an effective way of expanding and diversifying the production base and trade structure of the economy.

Electricity: Electricity demand in most of South Asia is currently outstripping supply. Despite having diversity of energy resources among South Asian countries, there is little energy/electricity trade in the region. The potential of cooperation in improving energy supply in South Asia is enormous. Hence development of regional energy resources by exploiting complementarities will result in greater welfare of the region as a whole.

a. Hydroelectricity- Nepal and Bhutan have substantial untapped hydroelectricity potential, estimated at 43,000 MW and 30,000 MW⁸ respectively which could be developed both for domestic consumption as well as for exports. The beneficial outcome for both India and Bhutan arising from cooperation between these two countries on Chuka hydroelectricity project is an eye opener. More recently in October 2002, Australia's Snowy Mountains Engineering Corporation (SMEC) signed an agreement with the Nepal government for the development of the 750-MW

⁷ In the last fiscal year, World Bank sponsored an exploratory mission of staff from SEBI to Nepal to review the capital markets and meet with Securities Board of Nepal (SEBO) officials with a view to executing a MoU between the two regulatory bodies and extending cooperation and training in the field of securities market regulation (particularly relating to supervision, surveillance and enforcement).

⁸Energy Cooperation in South Asia: Potential and Prospects

West Seti hydroelectric dam in one of the poorest provinces in Nepal. This plant will primarily export power to India. Presently, however, only a very small proportion (11%) of this potential has been exploited.

b. Natural Gas Exploitation: There is likely to be a sizeable shortfall of gas in and around this region unless some major exploration happens or the shortfall is met through imports either via pipelines or LNG. Bangladesh is endowed with natural gas reserves but gas trade is constrained by the region's inadequate domestic infrastructure. Pakistan and Afghanistan also have an important role to play as transit states, as they provide the best route for access to Central Asia's energy. According to one study, Pakistan alone stands to benefit by at least US\$ 1.5 billion a year if trade in this sector is galvanized.

c. Non-conventional Energy: India has proven capability in the field of wind energy, with its installed capacity of 900 MW, second only to the United States. This capability needs to be shared with other countries in the region where there is potential for tapping wind energy. For instance, Sindh province (in Pakistan) could make use of the wind power by cooperating with India.

d. Thermal Power: Thermal power is the dominant source of energy in this region and accounts for about 92 per cent of the installed capacity in Bangladesh, 73 per cent in India and 69 per cent in Pakistan. India has a large reserve of coal (206 billion tonnes) accounting for about 7 per cent of world reserves. Since energy demand in these countries is likely to record higher growth in the years to come, there is scope for cooperation among countries for their mutual benefit. For example Bangladesh could import coal from Raniganj (West Bengal, India) and reap the benefit of proximity because coal can be transported at minimum cost by rail. There is also potential for cooperation between India and Pakistan in electricity generation using coal.

Water Resources: Economic cooperation initiatives can help the countries to better harness and utilize the available natural resources. For example, South Asia while being endowed by ample water resources, continue to suffer annually by both floods and droughts and faces increasing shortage of potable and irrigation water. Greater regional cooperation in the utilization and harnessing of trans-boundary rivers (the Ganges, the Brahmaputra and the Meghna) and a cooperative approach towards river basin development is needed to effectively address the water problems and other issues that cannot be addressed satisfactorily by countries acting independently.

Trade in Services: A free trade area in services in South Asia will complement the achievement of SAFTA, which is currently a free trade area in goods. One of the objectives of SAFTA is to increase the competitiveness of South Asian industries thereby promoting growth in the region. A more liberal trading regime in services will increase the degree of competition among service suppliers in the region and make them more cost efficient thereby benefiting people of this region. Plethora of business opportunities is available in service sector which has been untouched so far. These include health services, educational services, rural banking services, environmental services, entertainment etc. *As mentioned before, the region has 40 per cent of the poorest people in the world and its relatively young population is one of the least literate in the world, liberalization of education and health services will surely help in improving the life of people in this region.* For rural development, Grameen Bank model⁹ of Bangladesh should be replicated in other countries of South Asia.

Tourism: South Asia's diversity in offerings of tourism products is well known. The main tourism activities in this region involve pleasure/sight seeing, trekking, mountaineering, rafting, wildlife and cultural tourism. However, according to one study about 75 per cent of tourists coming to this

⁹ It helped in alleviating poverty and generating employment in Bangladesh

region are conventional tourists coming for pleasure and sightseeing and hence large potential is still untapped. This sector has wide ranging multiplier effects as it cuts across several other sectors and generates new employment opportunities. If it is well managed, tourism development will also contribute to the preservation of the culture and conservation of the ecology of the region. In order to exploit this sector's potential, tourism development is one of the priority areas under ADB's SASEC program. Since 2002, for the South Asia region, ADB has provided \$3 million Technical Assistance grants and about \$20 million concessional loans annually for regional and subregional cooperation projects for the tourism sector.

Information, communication and technology (ICT): Across the globe there has been continued growth of information technology. At this juncture, South Asian countries are at a crossroads: either these countries could ride the surging information wave or be swamped by it to be further marginalized in the global economy. South Asian Regional Cooperation for ICT is necessary because their combined resources, and shared gateways, will allow for more traffic to flow to the region and from the region. The electronic commerce within the region will help develop the skills, expertise, essential institutions (banking, arbitrage, logistics) and unique solutions that will allow merchants of South Asia to access the world market for their goods and services. It will help in simplifying complex documentation procedures. Further it is desirable that all South Asian countries develop roaming facilities. Such an agreement can be the driving force in increasing intra and inter-regional trade. ICT is being used to promote people-to-people contact among SAARC member countries through the audio-visual exchange of culture and ideas for promoting awareness on literacy, health, participatory governance and other socio-economic issues.

Traditional Medicine and Pharmaceuticals: South Asian countries possess a competitive advantage in the field of traditional systems. Since ancient times, it has been a supplier of herbal, Ayurvedic and Unani medicines through out the world. The production and exports of pharmaceuticals have become more and more knowledge based all over the world. According to one study, medicinal plants related trade is estimated at US \$ 60 billion per year, and growing at about 7 percent annually. There is considerable potential to further expand the market as well as the market share of South Asia in the future. Among the South Asian countries India has emerged as a leading producer of pharmaceutical products. Due to the lower manufacturing costs and the R&D expertise Indian companies are able to produce and export drugs at extremely competitive prices. The progress of the Indian pharmaceutical sector is a positive reflection on South Asia as a whole and other countries can gain substantially by this.

Agro-Food Processing: Agro-food processing is one of the priorities of most of the South Asian countries. However, food processing as a business concept is yet to gain ground in the region. India has made considerable progress in this regard compared to its neighbors. But only 7 per cent of the food produced in India is being value-added despite the fact that it is the second largest producer of food in the world. India should exploit its IT knowledge to enhance the productivity of the food-processing sector and to create more knowledge based food-processing activities. In Sri Lanka most of the food processing comes under SME category, especially those making RTS beverages, squash, jam, chutney, pickles and sauce. The industry by and large is into processing fruits and vegetables, cereals, milk, confectionery, oilseeds (coconut) and spices. Pakistan is doing well in fresh and dry fruits trade and made considerable advances in food processing. It is suggested to set up modern food machinery design and development centres in India and Pakistan with facilities for design R&D, pilot plant, fabrication workshops and consultancy facilities. Thus, as a whole, South Asia has immense untapped business potential in this sector.

Issues in Regional Cooperation in South Asia:

Hydroelectricity: In spite of the fact that Nepal has huge hydro-electricity potential, investments are not happening. This is primarily due to the lack of political will and non-conducive investment climate. Such projects require huge investments, gestation period is long and involve high risks. There are other policy issues such as sharing of cost and benefits of the projects, determination of power tariff, cost of transmission line and its sharing mechanism, environmental issues, funding arrangement etc. The Chukha model of power trading between India and Bhutan has worked very well, however. Any power trading arrangement in the region should work on similar lines.

Natural Gas Exploitation: Projects having cross-border implications are more often treated on political lines rather than on commercial considerations. Due to lack of political will of Bangladesh government and strained relation between India and Pakistan, potential in this area has not been tapped till now.

Tourism: Due to indifferent policy initiatives, the real potential is not realized in this sector. Each country is trying to carve out a niche without really taking advantage of synergies that may arise. Infrastructure connectivity, internal conflicts and other bottlenecks continue to dog this region from attracting high profile tourists.

ICT: Many countries are unable to take full advantage of space technologies to enhance the use of ICT because of high costs. Wider application of the technology and rural penetration will reduce the cost significantly as economies of scale are high and marginal costs are minimized. Private sector should take the lead in setting up required infrastructure in the region.

Water management: Water management between India and Bangladesh is on high priority but progress has been held back due to mistrust.

Common issues:

Lack of connectivity: No SAARC country has a common border other than India and intra-regional transportation and communication links remain weak. Improvements in these sectors are critical to derive the full benefits of geographical proximity. In the absence of road connectivity between Nepal-India-Bangladesh, Nepal cannot access ports in Bangladesh. Likewise, India cannot use Bangladesh roads to access its Northeastern states, thereby resulting in increase in transportation costs. No container trains are running between India and Pakistan and similarly between India and Bangladesh, though passenger trains are running among these countries. Infrastructure requires up-gradation and development.

Geo-political Issues: Indo-Pakistan conflict over Kashmir, conflicts between Sri Lankan government and Liberation Tigers of Tamil Eelam (LTTE), Maoist rebels in Nepal, rise of global terrorism in Afghanistan (where Usama bin Laden and other terrorists have refuge) have threatened peace in this region and have made this region a less preferred option for the investor abroad. Presently, South-Asian countries are spending a high proportion of their GDP¹⁰ (2.7 per cent) on military expenditures and on handling local uprisings.

¹⁰ World Development Indicators, 2004

Trade relations between these countries will play a crucial role in subsiding tensions as countries realize the economic benefits from trade and co-operation. According to the India-Pakistan Chamber of Commerce and Industry bilateral trade between India and Pakistan through formal channels is worth \$230 million annually, but trade through illegal channels has flourished and is now estimated at about \$1.5 billion annually. Experts believe official trade between the two neighbours could go up to \$4 billion in two to three years if trade relations are normalised.

Asymmetry between countries: There is a fear that India being a large nation accounting for 70% of the region's GDP will eat up the share of other countries. However, there are many experiences within the region that demonstrate that advantages outweigh initial misgivings. Since India and Sri Lanka entered into bilateral agreement (in 1998), trade gap between these two countries has reduced by two-third. Hydroelectricity export from Bhutan to India provided over 45 per cent of the government's revenues and accounted for 30 per of GDP in 2003.

Free movement of people: Visa regulations and inability of businessmen to visit freely within the region has hindered trade, investment and tourism in the region. In order to facilitate trade, visa for business purposes should allow multiple entries, be for a minimum duration of 5 years and should not contain any city wise permissions. However, for tourism promotion, one time visa can be given without delays. Work permits should be given to professionals especially in some key sectors like IT, Healthcare etc.

Lack of information: Lack of knowledge about country's trade and economic policies have hindered trade in this region. For instance there is a strong feeling in Pakistan that Indian agriculture is highly subsidized at the production and export stages. However, estimates of the aggregate measure of support (AMS) put the AMS at between 5 and 7 per cent. This is much lower than the 10 per cent that is allowed under the WTO. Other estimates have even gone to the extent of saying that Indian agriculture is negatively subsidized and therefore can never be suspected of being protected. Another example of lack of information is that custom officials are not always aware of FTAs, resulting in delayed clearances.

Section III- Priority Sectors for Cooperation: Steps Forward

While the prospects of the regional cooperation and the issues are discussed in the previous section, this section will shed some light on how to address the roadblock in some priority sectors.

Tourism: The appropriate approach will be to create a tourism product that makes travelling to various places a pleasant experience through an environment of peace, stability, security and an integrated physical infrastructure that does not fail. Effective coordination of public and private efforts will achieve synergy in development of this sector. A common marketing strategy and fund, human resource development through cross intra-regional investments in hotel management, common policy related to fleet and charter flights will help in achieving the desired results.

Trade Facilitation: Although a technical committee on transport was established in 1983, and seventeen meetings have been held so far, the policies are yet to be implemented. There is a need to develop regional transportation and transit system that offers efficient transport options and low transaction costs. Identify additional routes by road and rail, augmenting shipping links and increasing flights and air cargo facilities for the seamless movement of goods. There should be an

open sky policy in South Asia, which will foster ‘people to people’ contact in the region. There should be harmonization of procedures and green channel treatment of imports within the region. There should be harmonization of technical standards such as truck size, weight regulations, railway gauge and rolling stocks across South Asia. Modernization of land customs stations including warehousing, parking facilities and simplification of clearance procedures on a priority basis is strongly recommended. There is a need to develop a common transport policy for South Asia resulting in free movement of goods vehicles in South Asian countries.

Hydroelectricity: Regional energy grids have to become a reality for growth in this region. This would entail setting up of power projects and then linking the transmission grids of all the countries of the region. SAARC grid is a way out for assuring quality power at low cost, besides ensuring mutual support during contingencies. Cooperation among South Asian countries should steer towards setting up a data bank for preventing duplication of R&D in the field of renewable energy. Countries like Nepal and Bhutan should invite World Bank or ADB and thus initiate regional cooperation for the exploitation of its water resources.

Natural Gas exploitation: Arrangements should be made on multilateral basis to enable and facilitate exchanges in natural gas. A Trans-SAARC Gas pipeline should be constructed across this region. By sharing pipelines, countries would be able to share the operating costs of the projects and will be able to reap benefits of economies of scale. It is crucial to promote cooperation within SAARC and between SAARC and ECO (Afghanistan, Pakistan, Central Asian Republics).

Healthcare: In India public healthcare system is at a low level and in other SAARC countries it is even worse. However, India has seen a meteoric level in science and health and has developed various centres of excellence without any grand plan, by individual efforts. SAARC countries can benefit a lot with India’s experience. Indian hospitals are training doctors and building state-of-the-art hospitals in other SAARC countries. Though some progress has been witnessed in the area of cardiology, much needs to be done in other fields also. Since people residing in South Asia have common gene pool, countries can benefit from collaborative research. Developing health care systems by building hospitals through joint ventures will lower the cost of medication and will provide better healthcare facilities to all individuals.

Conclusion

Despite the trade barriers, informal trade has flourished across the South Asian frontiers. In 2002, this region’s share in world output was merely 2 per cent and its share in FDI inflow in developing countries was just 2.8 per cent. South Asia faces the danger of marginalisation in the global economy. Regional cooperation is an effective modality that can help put South Asia firmly on the global map and improve its access to financial and technology flows. Lot of theoretical work has been done so far on prospective areas where countries in this region will gain and impediments have been identified, however no action has been taken to address them. Nearer to us, countries of South East Asia have been able to achieve commendable success in development with regional cooperation with ASEAN playing a key role in this process. Both NAFTA and EU are success stories for regional grouping. There is a need to speed up our arrangements for trade facilitation and meaningful initiatives need to be taken by SAARC in this direction. The private sector’s interest is directly and substantially involved in the creation of a regional economic space. To achieve this, it expects the governments to take a longer-term view of benefits arising from regional cooperation. *Governments must ensure that economic progress takes precedence over political issues. This will help in building confidence and trust.*



Confederation of Indian Industry

The World Bank

1818 H Street N.W.
Washington, D.C. 20433, U.S.A

Telephone: 202 473 1000

Facsimile: 202 477 6391

Internet: www.worldbank.org