The South Asian Century: Progressing Towards Regional Integration - A Study

January 2014



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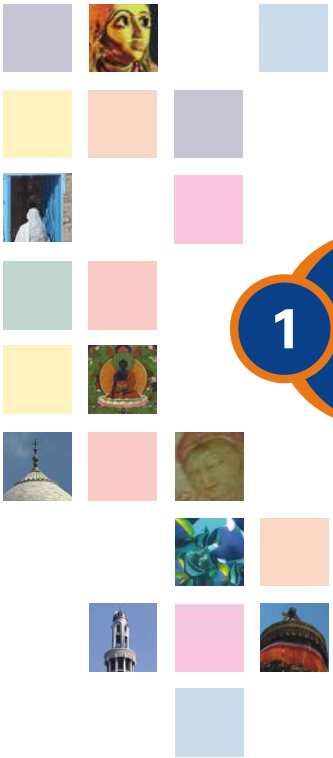
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1. INTRODUCTION







1 INTRODUCTION

The South Asian Association for Regional Cooperation (SAARC) was founded in 1985 by seven South Asian countries - Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. It emerged from the pressing need for intra-regional engagement to promote the welfare of the people of South Asia. The avowed aim was to strive towards common socio-economic goals drawing upon a shared history and culture. An equally important goal was to reverse the sense of alienation and conflict which had been engendered in the post independence era. The progressive move was initiated by Bangladesh, conceptualised in a joint 'Working Paper', which was then shared by all the other South Asian heads of states. This initiative was taken forward by leaders in all SAARC countries. Since then, the member states, later joined by Afghanistan[1], have continued numerous dialogues through various seminars, ministerial meetings and annual SAARC summits to move ahead with regional engagement and to work for the economic integration of South Asia.

SAARC, which has just completed 28 years of its formation, has over the years become an important player in the global development strategy. Linking Central and West Asia with Southeast and East Asia, the region is home to the world's largest working-age population and a quarter of the world's middle-class consumers. The region has experienced a long period of robust economic growth, averaging 6 percent a year over the past 20 years. This strong growth has translated into declining poverty and impressive improvement in human development[2].

In fact, the region as a whole has evolved through the process of strategic partnerships and joint agreements in areas of mutual interest and has made landmark achievements including the South Asian Free Trade Agreement (SAFTA) in 2006, SAARC Development Fund (2008), SAARC Food Bank (2009), South Asian University (2010), and SAARC Agreement on Trade in Services (SATIS). These serve to reinforce the need for greater engagement among the member states for common good. At the same time it is also vital to highlight the enormous potential in the region, which largely remains untapped.

[1] The SAARC membership was expanded to eight SAARC member states with the participation of Afghanistan in the year 2005 as an active Member State

[2] World Bank, 2013. Regaining Momentum. South Asia Economic Focus. Spring 2013.



Despite a centuries old common heritage shared by the member countries, South Asia today continues to be the least integrated and one of the more unstable regions in the world. The intra-regional trade in SAARC lingers around 5.7 percent as compared to European Union (EU)'s 61.8 percent and Association of South East Asian Nations (ASEAN)'s 25.9 percent approximately. Moreover, cross-border investment flows are extremely low, rather negligible.

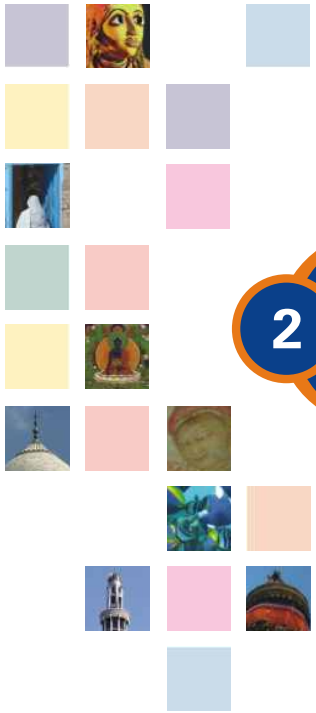
This calls for concerted efforts to deepen trade and investment linkages in the region. A close assessment and early conclusion of South Asia Free Trade Agreement (SAFTA), diversification of trade basket, implementation of SAARC Agreement on Trade in Services (SATIS), signing of regional transit agreement as well as gradual removal of non-tariff barriers (NTBs) that restrict cross border trade and investments, are the need of the hour. At the same time pending declarations and agreements endorsed and signed during the past SAARC summits should be brought into suitable action while keeping a close watch over the desired results.

Two noteworthy developments were witnessed over the past couple of years, which has given a fresh impetus to the goal of regional integration. One pertains to the breakthrough achieved in India-Pakistan bilateral trade relations with the recent signing of agreements to address the issue of NTBs and Pakistan's consent to grant Most Favoured Nation (MFN) status to India. Second, India's recent efforts to improve her bilateral relations with the Least Developed Countries (LDCs) such as the signing of strategic agreements with Afghanistan and Nepal, reduction of the number of items in India's sensitive list for LDCs, under SAFTA, to just 25 items and grant of duty free and quota free access to all commodities (barring liquor and tobacco), are remarkable.

Thus, at a time when the South Asian economies are making bold strides, it is time to adopt a collaborative approach, co-opting the private sector and capitalizing on the huge potential of the region. Active involvement of all stakeholders in decision making may render the much needed support to make SAARC a viable and vibrant organisation responsible to the aspirations of its people.

2. INTRA-REGIONAL TRADE & INVESTMENT



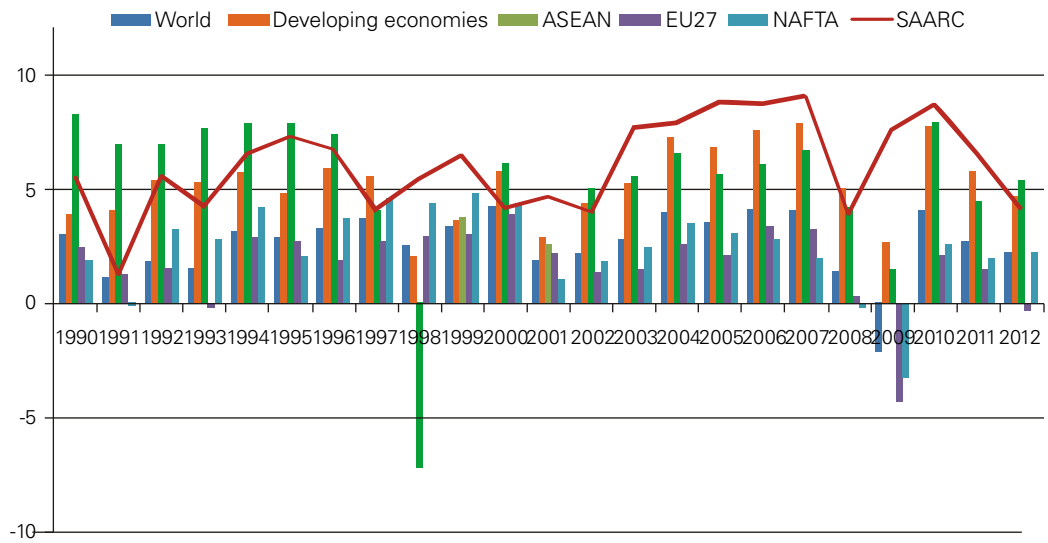


2 INTRA-REGIONAL TRADE & INVESTMENT

Economic Growth

SAARC region has experienced a long period of robust economic growth, averaging around 6 percent a year over the past 20 years. This strong growth has translated into declining poverty and impressive improvements in human development. South Asia's 7.46 percent average annual growth rate for the period 2002-2012 was the second highest in the world.

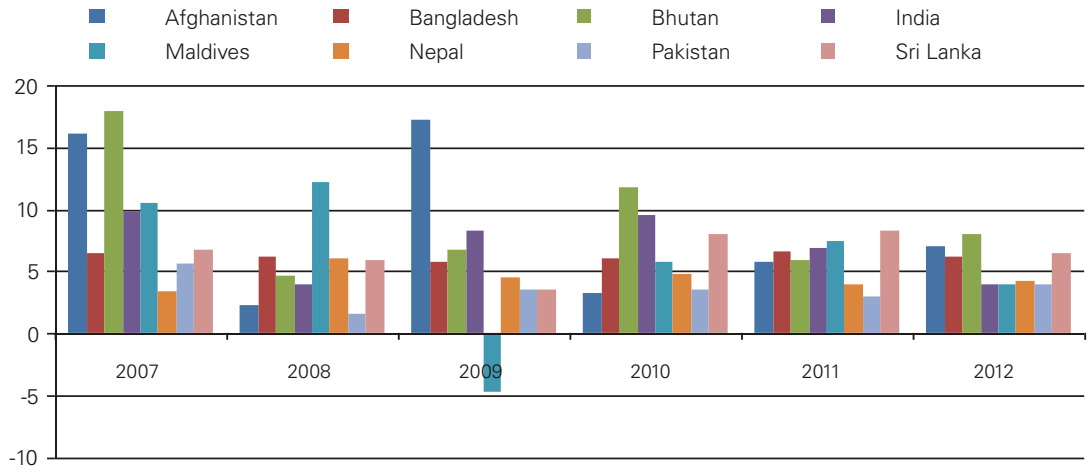
Fig 1: Real GDP Growth Rate (%)



Source: UNCTAD Statistics

South Asian economies managed the turbulence of the financial and economic crisis reasonably well. However, as can be seen in the above figure, post-crisis real GDP growth rates have moderated and remain well below pre-crisis rates. In fact, growth rates in South Asia have been showing a declining trend in the recent past. South Asia's annual GDP growth rate weakened to an estimated 4.18 percent in 2012 from 6.5 percent in 2011. Weak global demand, coupled with supply side constraints, policy uncertainties, macroeconomic imbalances and flight of capital have triggered the recent downturn in the South Asian growth story.

Fig 2: South Asia Annual Real GDP Growth Rate 2007-2012 (%)



Source: UNCTAD Statistics

Capital has been leaving South Asia in the months since May 2013. The rebalancing of global portfolios has been triggered by global investors reassessing risk and return in emerging markets relative to advanced economies. Overall, regional gross capital inflows declined by 70 percent between May and August, 2013, with bank loans, as well as equity and bond issues all dipping. Financing current account deficits has become more difficult across South Asia and above all in India, where greater reliance on portfolio inflows increased exposure to sudden changes in investor sentiment. While foreign direct investments (FDI) represented 91 percent of total capital inflows to the region in 2008, by 2012 the share had declined to 31.9 percent, the rest corresponding to more volatile portfolio investments[3].

Global capital flows have highlighted structural weakness and vulnerability in South Asia, acting as a wake-up call for policy makers. Meanwhile, supply-side constraints and macro-economic imbalances remain to be tackled in most South Asian countries. But the depreciation of regional currencies offers the opportunity to accelerate exports, and provides the incentive to re-engage with reforms.

According to the World Bank's latest forecast, regional GDP is projected to grow by 4.4 percent in the 2013 and 5.7 percent in 2014; driven by possible improvement in export demand due to depreciated regional currencies and strengthening of global demand and possible acceleration in investments.

Thus, there is a need to look for innovative ways to create new avenues and provenance of growth and investment in South Asia. Moreover, it is important to reap the full potential of intra-regional trade.

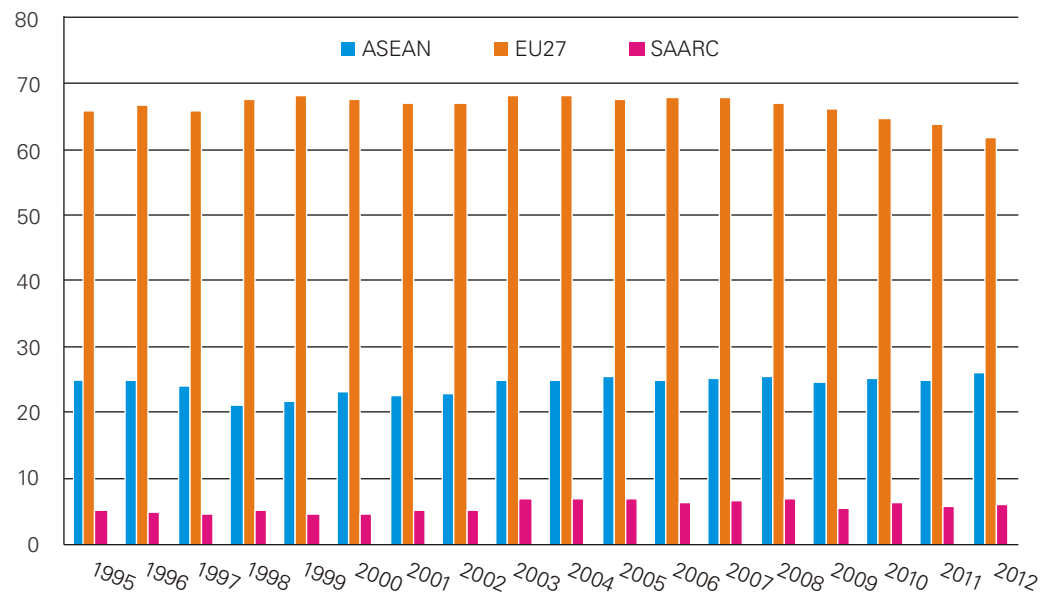
[3] *World Bank, 2013.Wake Up Call. South Asia Economic Focus.Fall 2013.*

Intra-regional Trade

Intra-regional trade data on South Asia shows that there is a lot of untapped economic opportunity within the region and a high dependence on extra-regional trade and investment. The intra-regional trade (extending from Kabul to Chittagong) was as high as 19 percent in 1948 which declined to a mere 2 percent by 1967. Over the years, trade within the region has increased slightly to 5.7 percent in 2012. This compares to European Union (EU)'s 61.8 percent and Association of South East Asian Nations (ASEAN)'s 25.9 percent.

In 2012, the total value of merchandise trade reported by the South Asian countries was US$ 355 billion, of which only US$ 20 billion was destined for regional partners[4].

Fig 3: Intra Regional Trade (US$ Millions)



Source: UNCTAD Statistics

Country Pattern of Intra-Regional Merchandise Trade

The South Asian bloc is distinct from other regional blocks in the world, since it is dominated by a few large countries (India, Pakistan, Bangladesh and Sri Lanka in terms of total value of external trade) which have had bilateral political conflicts, and which trade largely with the rest of the world rather than their neighbours. The smaller countries like Nepal and Bhutan are more integrated with the regional economy.

[4] *ITC Trade Map states the intra-regional SAARC Trade as US$ 16.6 billion.*

India is by far the largest trading country in South Asia, but virtually all of its formal trade is with the rest of the world. Even for Pakistan and Bangladesh, intra-regional trade is not as important as it is for the smaller countries of the region. In 2012, intra-regional trade in South Asia was estimated to be US$ 16.6 billion, of which US$ 15.5 billion was reported from India, i.e. a share of 93 percent of the total intra-regional trade. However, for India, trade with other SAARC members constituted barely 2 percent of its total external trade. India's intra-regional merchandise exports constituted 4.6 percent of its total exports to the world, while imports from the region accounted for only 0.5 percent of its total imports from the world.

Table 1: South Asia's total trade within the Subregion and with the World 2012 (US$ Millions)

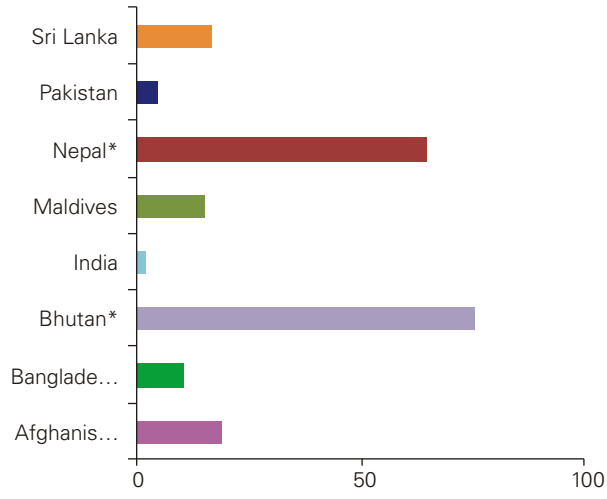
Country	Trade with SAARC	Trade with World	Trade with SAARC as a % of Trade with the World
Afghanistan	1272.261	6633.887	19.1782
Bangladesh	N.A	N.A.	10.52**
Bhutan*	1137.946	1504.71	75.6256
India	15480.03	778541.1	1.98834
Maldives	260.162	1716.109	15.16
Nepal*	4425.333	6823.557	64.8538
Pakistan	3069.242	68426.94	4.48543
Sri Lanka	4725.855	27254.71	17.3396

**Data for Nepal and Bhutan is for 2011 and for the rest is for 2012.*

*** Source: ARIC, ADB*

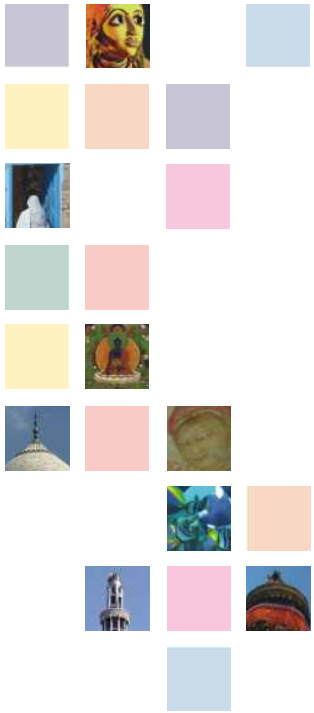
Source: ITC Trade Map

Fig 4: Trade with SAARC as a % of Trade with the World



Source: ITC Trade Map

Similarly, for Pakistan, the second largest country in the region, trade is biased towards the rest of the world, where trade with its SAARC partners constituted only 4.5 percent of its total external trade in 2012. Intra-regional exports constituted 5.5 percent of Pakistan's total exports to the world, while intra-regional imports constituted only 3.9 percent of its total imports from the world. Trade in Bangladesh too is biased towards the rest of the world. Sri Lanka's commerce is relatively more integrated with the region, with intra-regional trade constituting 17.3 percent of its total external trade.



In contrast, for a small country like Nepal and Bhutan, intra-regional trade constituted about 64.9 percent (almost two-third) and 75.6 percent (almost three-forth), respectively, of their total external trade in 2011. According to a study, South Asia has succeeded so far in achieving only 43 percent of its intra-regional trade potential, where the unrealization rate (of trade potential) varies from the highest 83 percent (Maldives) to the lowest 42 percent (Pakistan)[5].

This calls for coordinated and effective steps by the member countries to remove the impediments towards intra-regional trade.

Composition of Trade

The composition of intra-regional trade is concentrated in few commodities such as textiles, agricultural products, iron and steel and products made of, plastics, rubber and products made of, light electrical (see Table 2).The top 10 products accounted for whopping 59.4 percent of the total trade while the top 20 commodities accounted for 78.3 percent in 2012.

Table 2: South Asia Top 20 Traded Commodities (Value in US$ Millions)

HS Code	Commodity	SAARC's exports to SAARC			SAARC's exports to world		
		2010	2011	2012	2010	2011	2012
TOTAL	All products	14015.4	16445.6	16577.5	271884	364948	351564
52	Cotton	2089.95	2264.36	2679.62	10949.4	12963.7	13874.8
27	Mineral fuels, oils, distillation products, etc	1468.5	2009.27	1930.92	39472.6	58012.9	54884.3
87	Vehicles other than railway, tramway	1219.72	1387.9	1196.1	9510.5	10487.1	12407.3
72	Iron and steel	732.248	708	810.074	7342.41	8309.77	7925.61
10	Cereals	380.025	727.894	639.082	5217.73	8194.74	10813.4
84	Machinery, nuclear reactors, boilers, etc	386.206	545.998	627.641	8497.77	11123	11449.6
23	Residues, wastes of food industry, animal fodder	459.029	549.068	589.735	2195.24	2875.59	2808.41
17	Sugars and sugar confectionery	685.554	559.229	484.535	1129.89	2144.97	2441.56
39	Plastics and articles thereof	309.223	382.823	455.042	4166.39	6171.64	5647.67
29	Organic chemicals	393.82	454.369	438.061	8635.91	11223.2	12584.6
25	Salt, sulphur, earth, stone, plaster, lime and cement	334.643	497.864	388.237	1768.58	2298.04	2496.99

[5] *De, Prabir 2013.Connectivity, Trade Facilitation and Regional Cooperation in South Asia. Commonwealth Secretariat, April 2013.*

	Commodity	SAARC's exports to SAARC			SAARC's exports to world		
		2010	2011	2012	2010	2011	2012
85	Electrical, electronic equipment	287.914	360.222	358.688	9157.69	12209.2	11136.4
30	Pharmaceutical products	251.205	326.629	358.227	6286.38	8475.39	9962.97
9	Coffee, tea, mate and spices	353.925	427.178	349.726	3687.1	4797.96	4451.9
73	Articles of iron or steel	218.635	216.768	307.926	6565.88	6741.52	7997.84
40	Rubber and articles thereof	213.911	311.82	284.145	2431.11	3705.18	3753.19
89	Ships, boats and other floating structures	137.859	252.024	284.092	4396.15	7271.24	4250.09
55	Manmade staple fibres	199.696	248.028	275.587	2225.56	2958.39	2537.07
8	Edible fruit, nuts, peel of citrus fruit, melons	164.634	247.183	266.612	1469.28	1992.49	1901.52
7	Edible vegetables and certain roots and tubers	474.288	395.616	263.446	1195.99	1361.52	1095.15

Source: ITC Trade Map

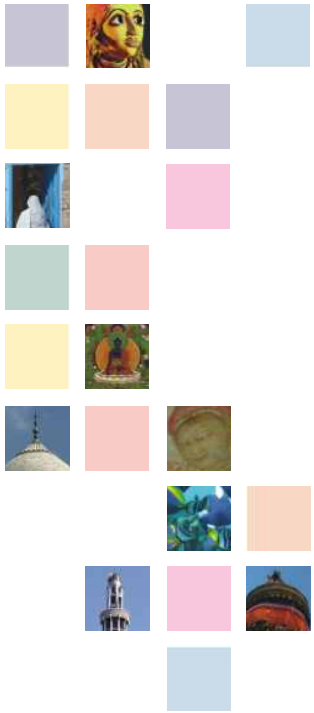
The narrow concentration is largely due a host of tariff and non-tariff barriers (which would be discussed in detail in subsequent sections).

South Asia Free Trade Agreement (SAFTA)

To promote trade and economic cooperation among SAARC nations, a South Asia Free Trade Agreement (SAFTA) was signed in 2004, replacing the earlier South Asia Preferential Agreement (SAPTA). The SAFTA agreement came into force on January 1, 2006. Under this agreement, India, Pakistan and Sri Lanka are categorized as Non-Least Developed Contracting States (NLDCs) and Afghanistan, Bangladesh, Bhutan, Maldives and Nepal are categorized as Least Developed Contracting States (LDCs).

Article 7 of the SAFTA Agreement provides for a phased Tariff Liberalization Programme (TLP) which requires the NLDCs and LDCs to bring their duties down to 20 percent and 30 percent respectively within a time frame of 2 years, from the date of coming into force of the Agreement. Starting from the third year, NLDCs and LDCs will have to further reduce the duties to 0-5 percent within a time frame of five[6] and eight years respectively. The NLDCs will reduce their tariffs for LDCs to 0-5 percent in 3 years.

[6] *However, the period of subsequent tariff reduction by Sri Lanka is six years.*



However, the success achieved under SAFTA has been limited due to large sensitive lists[7] and restrictive rules of origin and destination.

According to the TLP under SAFTA, member countries are required to review the sensitive list for reduction every four years or earlier, as established by the SAFTA Ministerial Council (SMC)[8] but there is no formal or binding commitment. Hence, the reduction of sensitive lists becomes a voluntary decision by each member country.

India has, in the recent past, steered the trade liberalisation process under the Agreement, so as to accelerate the pace of economic integration. In November 2011, India unilaterally reduced its sensitive list for the LDCs to 25 items while allowing all other imports at zero basic customs duty. This move was followed by India's decision to reduce the list of sensitive items by 30 percent for NLDCs in August 2012. Maldives also reduced its sensitive list from 681 items to 154 items (78 percent reduction). The number of products covered in the sensitive lists of member states before and after first round of reduction is as follows:

Table 3: No of Products in the Sensitive Lists of SAARC Countries

Country	Number of Products in the earlier Sensitive Lists	Number of Products in the Revised Sensitive Lists (Phase-II) w.e.f. 1 January 2012
Afghanistan	1072	858
Bangladesh	1233 (LDCs) 1241 (NLDCs)	987 (LDCs) 993 (NLDCs)
Bhutan	150	156
India	480 (LDCs) 868 (NLDCs)	25 (LDCs) 614 (NLDCs)
Maldives	681	154
Nepal	1257 (LDCs) 1295 (NLDCs)	998 (LDCs) 1036 (NLDCs)
Pakistan	1169	936
Sri Lanka	1042	845 (LDCs) 906 (NLDCs)

Source: SAARC Secretariat

[7] *A sensitive list is a list with every country which does not include tariff concession.*

[8] *SAARC Ministerial Council (SMC) consisting of Ministers of Commerce/Trade of the SAARC countries is the highest decision making body of SAFTA and is responsible for the administration and implementation of this Agreement and all decisions and arrangements made within its legal framework. Each SAARC contracting state chairs the SMC for a period of one year on rotational basis in alphabetical order. The SMC is supported by a Committee of Experts (COE), with one nominee from each Contracting State at the level of a Senior Economic Official, with expertise in trade matters. The COE monitors, reviews and facilitate implementation of the provisions of this Agreement.*

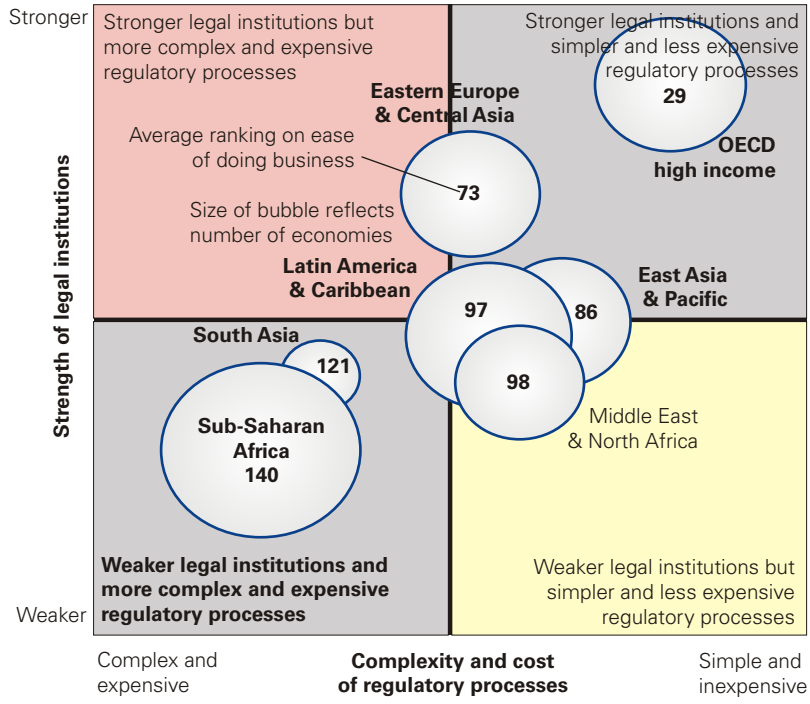
Non-Tariff Barriers[9]

Non-tariff policy barriers have gained importance as tariff-based barriers to economic cooperation have generally declined. High transportation costs, poor institutions, inadequate cross-border infrastructure, disparate custom procedures and absence of a regional transport and transit agreement are some major factors penalising the region's trade and integration. Development of cross-border infrastructure, especially transportation linkages and energy pipelines, across the region, will contribute to regional integration by reducing transportation costs and facilitating intra-regional trade.

a). Ease of Doing Business in South Asia

South Asia ranks among one of the lowest regions across the world in terms of ease of doing business (see Fig 5).

Fig 5: Ease of Doing Business [10]

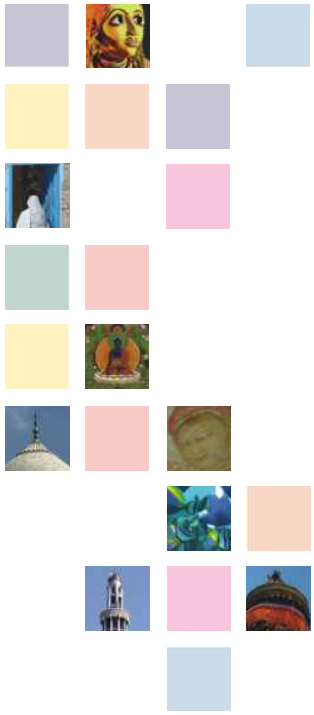


Source: Doing Business database, Doing Business Report 2013 (World Bank)

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[9] *This section is based on De 2013; De, Prabir 2013. Connectivity, Trade Facilitation and Regional Cooperation in South Asia. Commonwealth Secretariat, April 2013.*

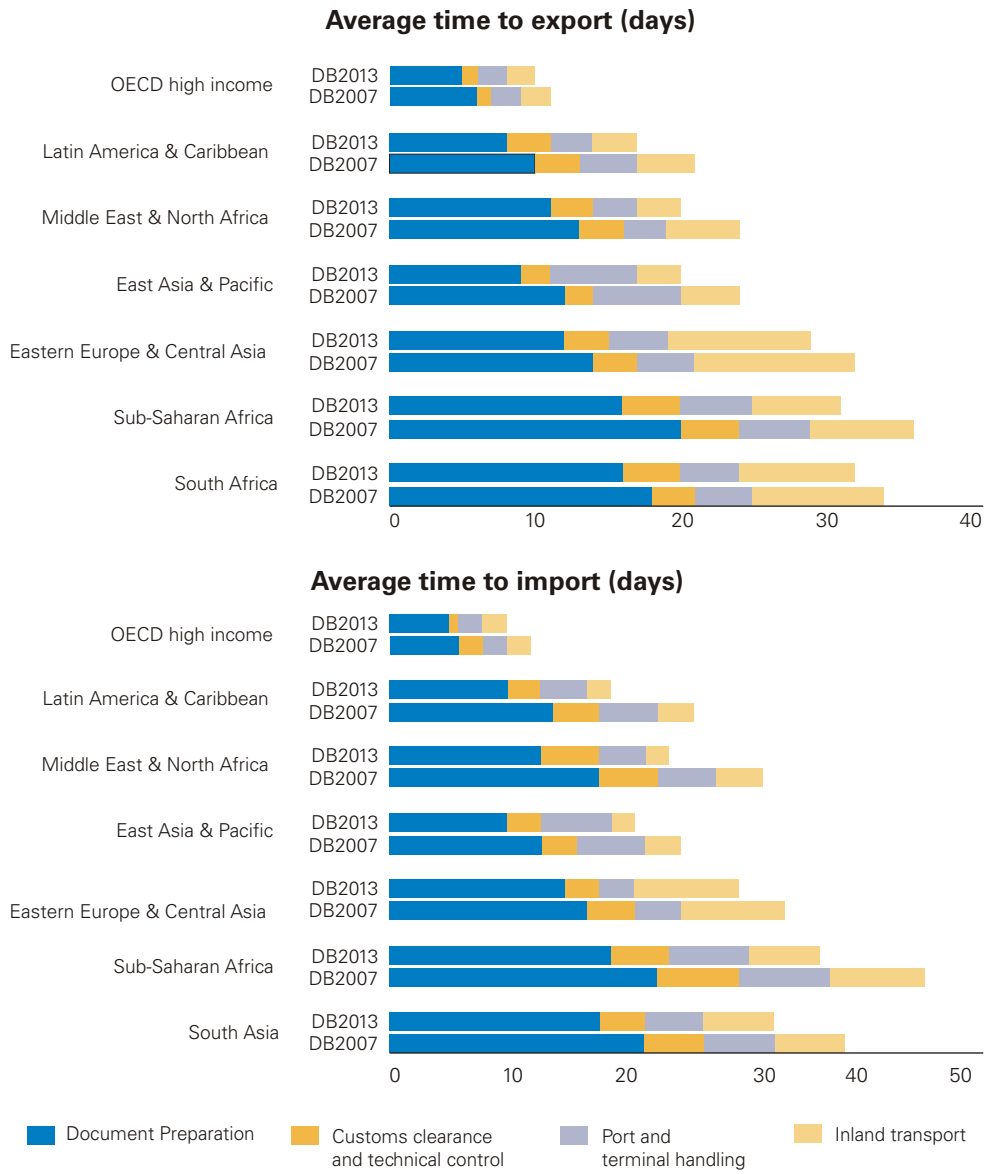
[10] *Strength of legal institutions refers to the average ranking on getting credit, protecting investors, enforcing contracts and resolving insolvency. Complexity and cost of regulatory processes refers to the average ranking on starting a business, dealing with construction permits, getting electricity, registering property, paying taxes and trading across borders.*



b). Non-Tariff Costs

South Asia suffers from outdated and inefficient border procedures, inadequate infrastructure (for example, lack of modern warehouse or container handling facility at border), lack of reliable logistics services, and absence of a regional transport and transit agreement. This has led to high transactions costs and long delays, which in turn adversely impact trade. South Asia is among the regions which require maximum time to trade across borders (see Fig 6).

Fig 6: Average Time to Export and Import



Source: Doing Business database, Doing Business Report 2013 (World Bank)

Across South Asia, there is a high variation in the time required to export and import. While Afghanistan takes 81 days to export, Sri Lanka takes only 5 days (see Table 4). Preparation of export documents and in land transport time are the major components of delay in export in the region. In general, import takes more time than export in South Asian region.

According to the World Bank's Doing Business Report 2013, a country can increase its per capita growth rate by 0.1 percent, if it reduces the time required to import or export by 4 days. Therefore, the region can achieve substantial productivity gains and cost reductions by reducing policy-related non-tariff trade cost.

Table 4: Documents, Cost and Time to Export & Import 2013

Country	Trading Across borders	Documents to export (number)	Time to export (days)	Cost to export (US$ per container)	Documents to import (number)	Time to import (days)	Cost to import (US$ per container)
Afghanistan	184	10	81	4645	10	85	5180
Bangladesh	130	6	25	1075	8	35	1470
Bhutan	172	9	38	2230	12	38	2330
India	132	9	16	1170	11	20	1250
Maldives	1387	7	21	1625	9	22	1610
Nepal	177	11	42	2295	11	39	2400
Pakistan	91	8	21	660	8	18	725
Sri Lanka	51	5	20	595	7	17	775

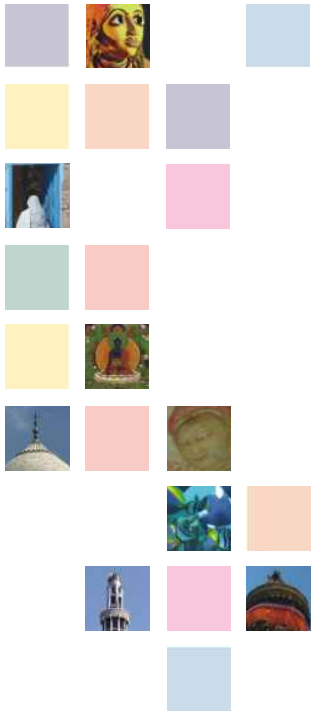
Source: Doing Business database, Doing Business Report 2014 (World Bank)

d). Land Custom Stations

The efficiency of border corridors and land custom stations (LCSs) is an important factor for South Asia's competitiveness and its trade prospects. An efficient border corridor is very important in order to maximize the benefits of regional connectivity.

Most of the LCSs suffer from limited warehouse capacity and lack of banking and foreign exchange facilities. In some cases, banks are located several kilometres from the border. Adequate foreign exchange facilities are also not available at some borders. Some LCSs do not even have a foreign exchange facility. Thus, in order to facilitate a smooth flow of trade, there is an urgent need to upgrade the LCSs.

In order to facilitate trade among contiguous countries, the Indian Government has planned Integrated Check Posts (ICPs) to serve as a single window facility covering customs, immigration and warehousing, health facilities, shopping complex and parking facilities under one roof. This would help to simplify, control and accelerate



procedures in the border customs points. The Land Ports Authority of India (LPAI) oversees the construction, management and maintenance of ICPs, which are being developed as public funded projects. About 13 ICPs – one on India-Pakistan border at Attari, four on the India-Nepal border, one on India-Myanmar border and seven on the India-Bangladesh border are being planned. Already the ICP at the Attari border between India and Pakistan border has been operational since April 2012. The cost of setting up 13 ICPs has been estimated at Rs 7.34 billion. Of these, four ICPs at Petrapole, Moreh, Raxual and Wagah are proposed to be set up in Phase I at a cost of Rs 3.42 billion. In Phase II the other nine ICPs at Hili, Chandrabangha (both in West Bengal) Sutarkhandi (Assam), Dawki (Meghalaya), Akaura, (Tripura) Kawarpuchiah (Mizoram), Jobgani (Bihar), Sunauli (UP) and Rupaidiha/Nepalganj (UP) would be set up at a cost of Rs 3.94 billion.

d). Regional Transit Agreements

Regional transit agreements in South Asia are long overdue. Mistrust among South Asian countries along with lack of institutional capacity have caused long delays in overall acceptance of transit. Despite WTO memberships, countries in South Asia do not extend MFN transit (see Table 5).

Table 5: Trade and Transit Agreements in Eastern South Asia

Agreement	Type	MFN Trade	MFN Transit	WTO signatories
India-Bangladesh	Bilateral	Yes	No	Yes
India-Nepal	Bilateral	Yes	Yes	Yes
India-Bhutan	Bilateral	Yes	Yes	India member; Bhutan observer
India-Pakistan	Bilateral	Yes*	No	Yes
Pakistan-Afghanistan	Bilateral	Yes	Yes	Pakistan member; Afghanistan observer
Bangladesh-Nepal	Bilateral	Yes	Yes	Yes
Bangladesh-Bhutan	Bilateral	Yes	Yes	Bangladesh member, Bhutan observer
Bhutan-Nepal	Bilateral	Yes	No	Nepal member, Bhutan observer

**India has granted Pakistan MFN status, but Pakistan is yet to reciprocate.*
Source: Prabir De 2013

The econometric evidences support the existing linkage of trade costs, transit and trade flows: higher the transaction costs between each pair of partners, less they trade. In a study, it was estimated that a 10 percent fall in transaction costs at borders in South Asia has the effect of increasing a country's exports by about 3 percent[11]. Moreover, a regional transit agreement will not only bring in steady

[11] *De, Prabir 2011.Why is Trade at Borders a Costly Affair in South Asia? An Empirical Investigation.Contemporary South Asia. 2011.*

revenue but will also help develop industry and service enterprises in the border areas. Once the transit between India and Bangladesh is allowed, Bangladesh can earn substantial transit fees from Indian vehicles plying to and from India's North-Eastern Region to the rest of India using Bangladesh territory. Similarly, transit arrangements between India, Pakistan and Afghanistan will fetch a hefty royalty to Pakistan from movement of vehicles between India and Afghanistan using Pakistani territory[12].

Thus, an agreement on a regional transit arrangement would mean a "win-win" situation for all countries in the South Asian region. It is therefore only apt that 2010-2020 is being observed as the 'Decade of Intra-Regional Connectivity in SAARC' to highlight the transit woes and the need to put in place ameliorative measures. As a next step, there is a need to put in place a regional multi-modal transport agreement.

Trade in Services

With the services sector now accounting for more than half of the GDP in South Asia, intra-regional trade in services, which was absent under SAFTA, is now being considered. Contrary to a longstanding development theory, new evidence, including that pertaining to South Asia, suggests that services, rather than manufacturing, are particularly effective in leading to sustainable growth (Ghani 2010).

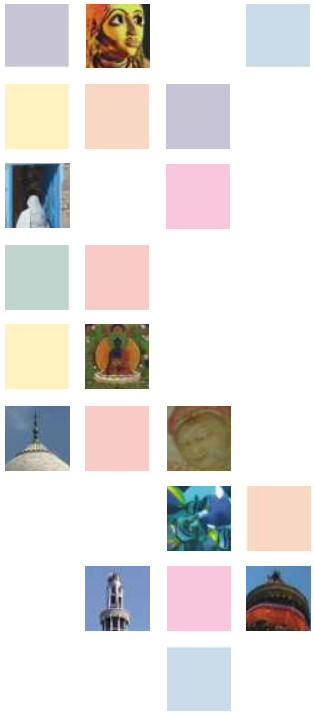
In order to expand cooperation in trade and further deepen the integration of the regional economies, the SAARC Agreement on Trade in Services (SATIS) was signed at the 16th SAARC Summit held in Thimphu in April 2010. The Agreement entered into force on November, 29 2012, after ratification by all SAARC member states with the issuance of a notification by the secretary-general of SAARC.

Multilateral donor agencies including the World Bank have observed that cross-border gas and electricity trade could significantly contribute to meeting regional demand, which is expected to grow annually in the range of 6.6-11.5 percent during the next 15-20 years. In this regard, the signing of SATIS is a noteworthy development.

Different studies have[13] analysed the nature of intra-regional services trade that carries immense potential in South Asia. The Research and Information System on

[12] *Afghanistan-Pakistan Transit Trade Agreement (APTTA) allows only goods coming from Afghanistan via Pakistan to India and not the other way round.*

[13] *A study undertaken by the National Council of Applied Economic Research (NCAER) –'Trade in Services and Investment Flows in South Asia' by Chadha and Nataraj (2008) indicates South Asia's revealed comparative advantage in commercial services and IT & IT enabled services.*



Developing Countries (a research-oriented body) in its 2010 study on "Potential for Trade in Services under SAFTA Agreement" has discussed the relevance of liberalisation of trade in services in terms of benefits and costs of liberalisation. It lists some of the high priority trade sectors including tourism, transport, IT, ITeS and telecom, energy, education, health and financial services and also proposes adherence to a positive lists approach to enable progressive, sequential liberalization, including some special and differential treatment for LDCs as recognized in SAFTA.

A Report by UNDP (2011)[14] identifies four mutually inter-dependent factors that influence the degree and pace of integration of services in South Asia: infrastructure gaps, presence of a dynamic private sector; social, cultural and historical tiesand institutional and human resource requirements of different countries in the region.

Investments[15]

Although enhanced export earnings and increased foreign investment inflows can be regarded as having similar impact on a country's external resource balance, economic activities and employment generation, evidence seems to suggest that FDI is associated with certain features that often cannot be substituted by trade alone (Bloström and Kokko, 1997 and Caves, 1996). The intangible assets of foreign companies include technological know-how, marketing expertise, improvement management practices that can have far greater positive spillover effects. Under an integrated regional market, FDI from member countries could target each other's market with a view to taking advantage of low tariff barriers and/or any other preferential schemes.

Despite the advantages of an integrated market, all locations within a region may not attract intra- and extra-regional investments at the same level; e.g., countries with locational advantages could attract more FDI. In other words, investment flows between member countries may be differentiated by differences in size of economies, variation in economic policies, poor physical and non-physical infrastructure facilities, lack of cross-border facilities and political factors (Sobhan, 2004). Overall, an integrated regional market could facilitate 'investment creation' at a large scale both by intra-regional and extra-regional FDI. Promotion of FDI in South Asia should take that perspective into account in its initiative for regional cooperation for investment.

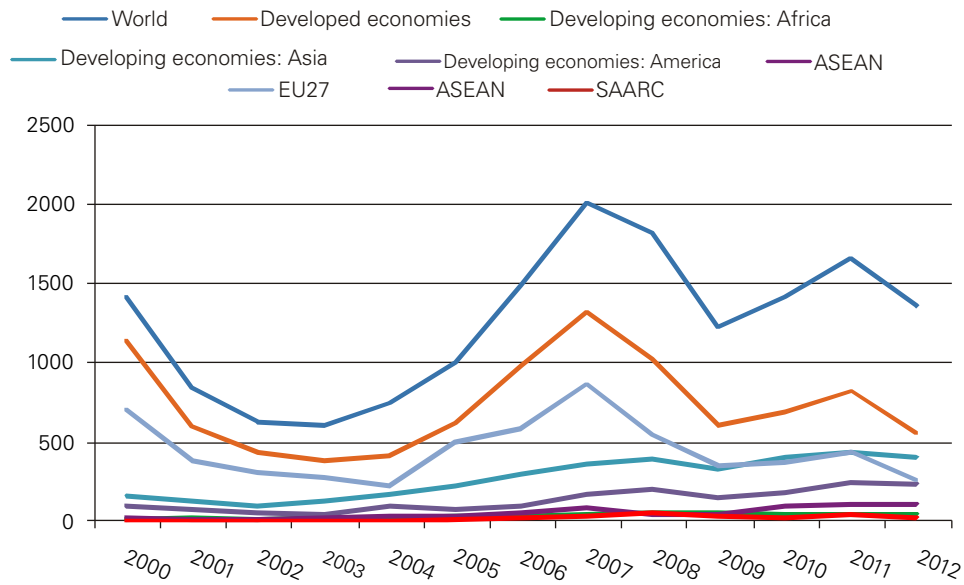
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[14] *UNDP 2011.Prospects for a Services Agreement in South Asia. December 2011.*

[15] *Moazzem ;Khondaker G 2013. Regional Investment Cooperation in South Asia: Policy Issues. Commonwealth Secretariat. March 2013*

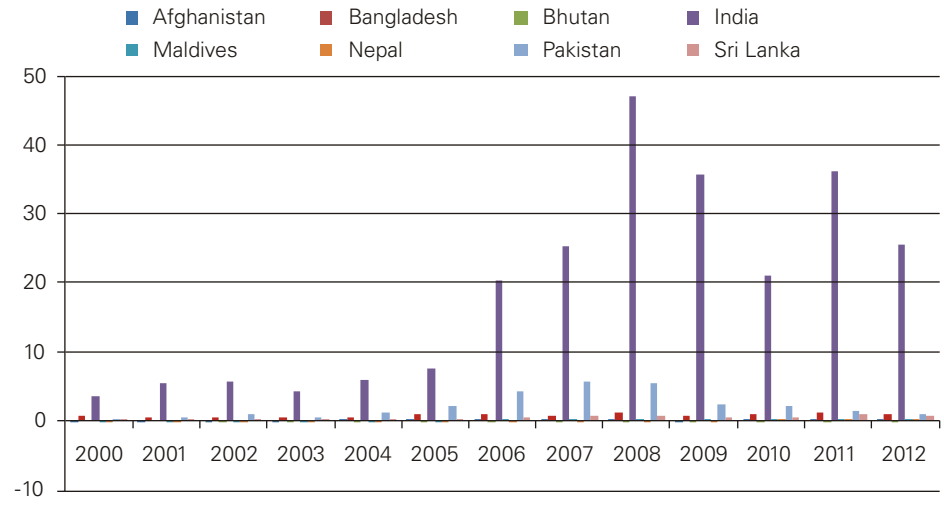
South Asia is among the regions receiving the least amount of FDI inflows (see Fig 7). Total FDI received by South Asia in 2012 was US$ 28.6 billion, with India receiving US$ 25.5 billion, 89 percent of the total FDI inflows (see Fig 8 & 9).

Fig 7: FDI Inflows (US$ Billions)



Source: UNCTAD Statistics

Fig 8: FDI Inflows in South Asia (US$ Billions)



Source: UNCTAD Statistics

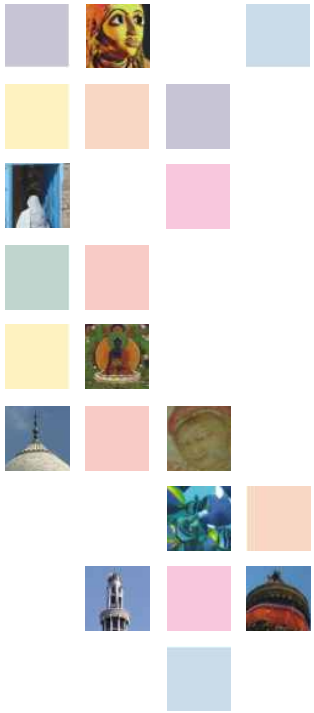
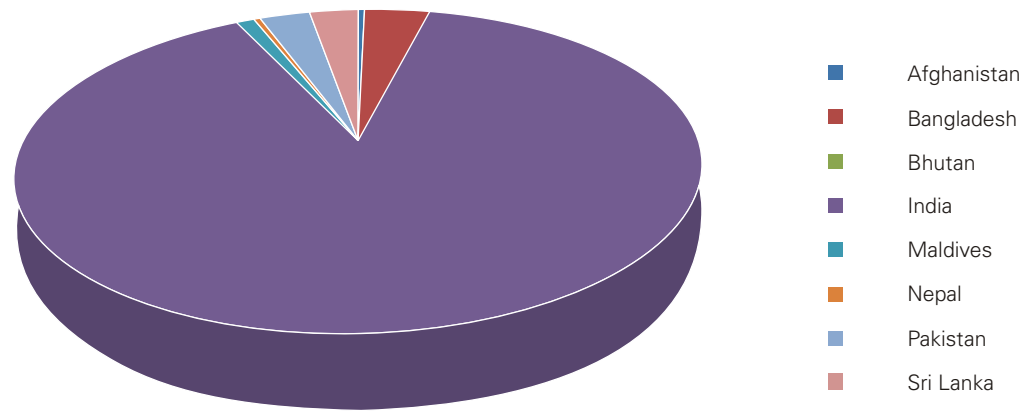


Fig 9: Composition of FDI Inflows Received by South Asia 2012 (%)



Source: UNCTAD Statistics

Various studies have cited different reasons for poor FDI inflows:

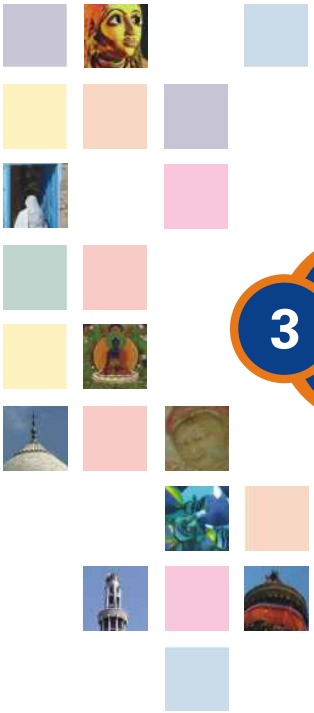
- Relatively small size of individual country markets,
- Labour market inefficiencies
- Relative failure of regional integration efforts in unifying these markets by removing border and behind the border impediments and weaknesses,
- Political interference and corruption,
- FDI regimes not matching international best practices,
- High transaction costs, procedural delays stemming from institutional requirements and presence of non transparent procedures.

A recent World Bank study identifies the key forces for attracting FDI to South Asian countries: investment policy openness, natural resource endowments, trade liberalization growth, changes in control of corruption, corporate tax changes, and the initial inward FDI stock as a share of GDP[16].

[16] *World Bank, 2013.Getting the most from FDI in South Asia: The estimation results are based on a world panel (79 countries over the period 2000- 2010) as well as subsample estimations for 33 developing countries.*

3. DEMOGRAPHICS

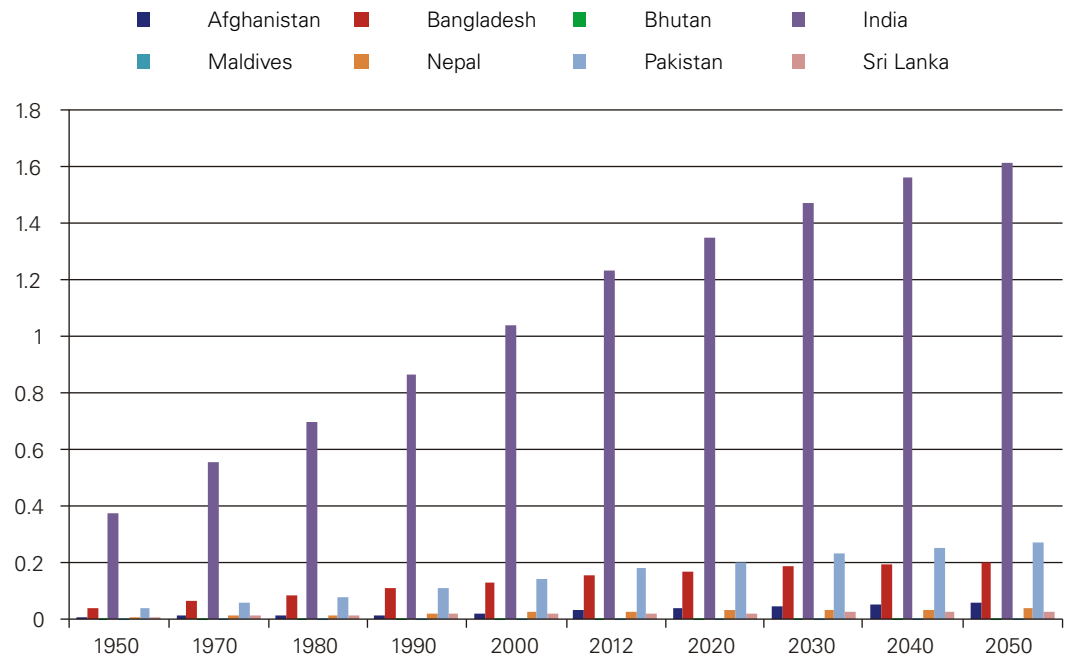




3 Demographics

Demographically, South Asia is a diverse region of 1.67 billion people (almost 23 percent of the world's population). According to the World Development Report 2013, South Asia grows by 1 million people every month. The key asset of South Asia is its people.

Fig 9: Annual Population (Billions)



Source: UNCTAD Statistics

South Asia has a young population. Elsewhere, the working population is rapidly aging, and more and more workers are delaying retirement. The means that more workers will be entering the labour force in the future and the region will need to add between 1 and 1.2 million additional jobs every month for the next 20 years. Creating jobs for them will contribute to growth, equity and peace in the region[17].

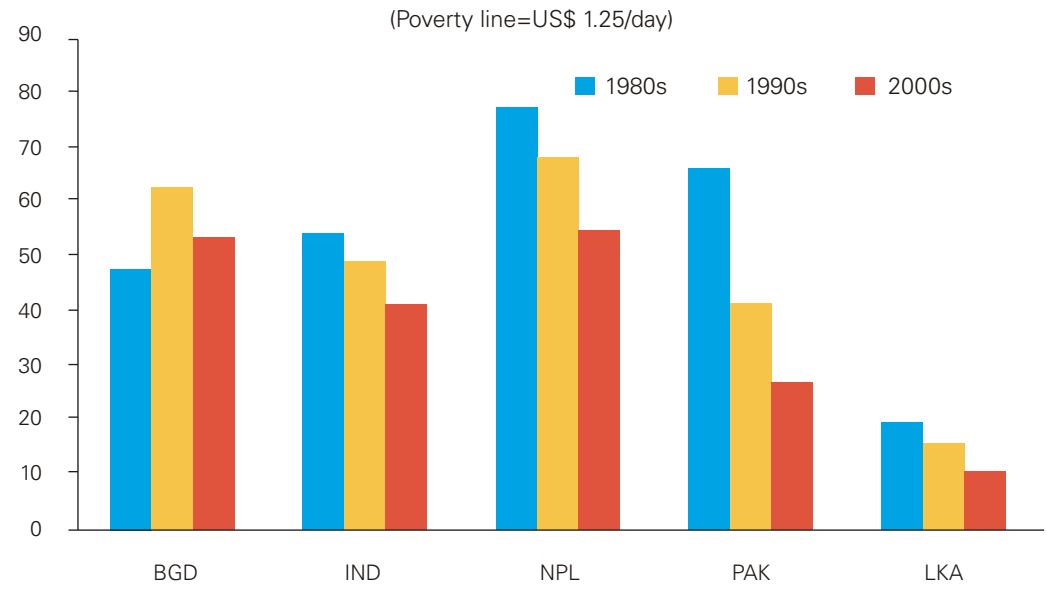
[17] *World Bank South Asia Economic Update*

The working age share of the population is a crucial indicator of a region's potential for reaping a demographic dividend. For South Asia, the general rising pattern of economic growth in the region since the 1960s corresponds, albeit roughly, to the increasing ratio of working-age to non-working-age people. In other words, higher the ratio and faster the pace of its increase, greater the demographic impetus for a more rapid economic growth. If a direct correspondence between growing demographic opportunity and the economic realization of that opportunity is created and sustained, South Asia is positioned to have a bright economic future.

To capitalize on the high share of working-age people in the population, the region will have to ensure that this group is healthy, well-educated, and well-trained to meet the demands of the labour market.

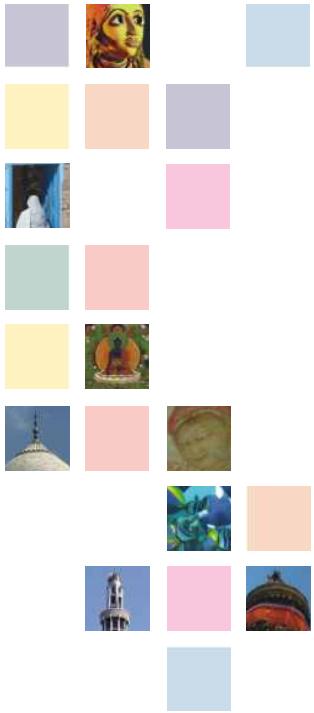
In this regard opportunities for investments in education and health programs, greater enrolments in skill development and youth training programs, and increased R&D activities can be useful.

Fig 10: Falling Poverty Rates in South Asia



Source: World Bank South Asia Update 2012

Also, South Asia is home to many of the developing world's poor. According to the World Bank South Asia Economic Update 2012, the percentage of people living on less than US$ 1.25 a day fell in South Asia from 61 percent to 36 percent between 1981 and 2008. The proportion of poor is lower now in South Asia than any time since 1981.



This calls for concerted efforts by the SAARC member countries to address the incidence of poverty. Towards this, a SAARC Development Fund (SDF) Secretariat had been inaugurated by the Heads of State/Governments of SAARC member states in April 2010 during the 16th SAARC Summit in Thimphu. The primary objective's of the SDF are:

- To promote the welfare of the people of the SAARC region,
- To improve the quality of life, and
- To accelerate economic growth, social progress and poverty alleviation in the SAARC Region.

The SDF has three windows i.e. social, economic and infrastructure. Currently social window is in operation and projects are under implementation in SAARC countries. There is a need to open economic and infrastructure windows in order to provide maximum benefits of the SDF for accelerating economic growth and infrastructure development in SAARC countries.

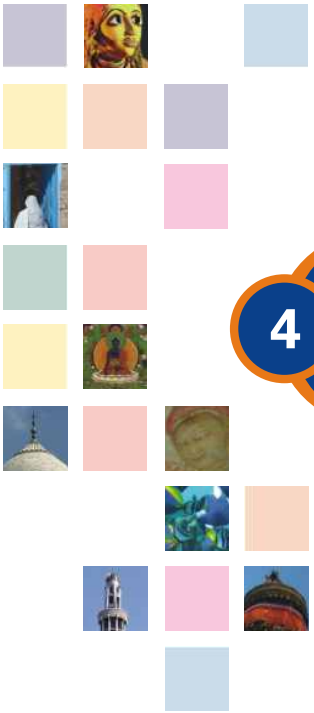
Table 6: South Asia Development Statistics

Region	Poverty below US$ 1.25 (PPP) a day (percentage)	Gini index (percentage)	Mean years of schooling (years)
	2010	2000-2011	2011
WORLD	..	39	7.2
Afghanistan	..	28	4.8
Bhutan	10.2	38	3.2
Bangladesh	43.3	32	..
India	32.7	34	4.4
Maldives	<2	37	4.4
Nepal	24.8	33	3.2
Pakistan	21.0	30	4.9
Sri Lanka	4.1	36	10.8

Source: United Nations. Department of Economic and Social Affairs. Population Division

4. RECOMMENDATIONS





4 Recommendations

In its 28 years of existence, SAARC has done well to lay the institutional base and mechanism for regional cooperation. The test of SAARC now is to benefit from the process of globalization through deeper regional integration, eventually creating a South Asian Economic Union and become the region of the century. To achieve this goal, a deliberate shift from "independence" to "interdependence" is needed, with identified priority areas for implementation. These areas are delineated below:

1. The objective of integration of the SAARC region would be facilitated through initiatives in trade and investment policies. Comparative advantages should be used to fuel growth, and the private sector should be the engine of growth. South Asia should reduce political distance to increase trade; studies show an inverse relationship between political distance and trade growth. This requires a combination of political and business leadership.

2. The SAARC region should take advantage of the growing international demand for manufactured goods by developing integrated regional value chains. Similarly, the SAARC region should encourage the growth and integration of services trade, which, in turn, will lead to greater people-to-people interaction, especially in sectors such as tourism.

3. The basket of traded goods in South Asia is quite concentrated. This is largely because of multiple reasons such as the large sensitive lists in SAFTA, restrictive rules of origin & preferences, protectionist policies and a host of tariff and non-tariff barriers. There is a need to remove tradable goods from the sensitive lists and build in product diversification within the trade basket to fully exploit the region's comparative and competitive advantage. In turn this will generate employment opportunities in the region.

4. Non-tariff policy barriers have gained importance as tariff-based barriers to economic cooperation have generally declined. High transportation costs, poor institutions, inadequate cross-border infrastructure, and absence of a regional transit trade are some major factors penalising the region's trade

and integration. Development of cross-border infrastructure, especially transportation linkages and energy pipelines, across the region, will contribute to the regional integration by reducing transportation costs and facilitating intraregional trade.

5. Poor physical connectivity remains one of the biggest stumbling blocks in the region which has caused the cost of trading across borders to be one of the highest in the world.

6. SAARC should look at ways to improve trade and transportation linkages, including cross border railway links, roads and civil aviation connectivity. Road, rail, air and sea links not only connect the entire region but can also connect South Asia beyond the region into South East and East Asia and the larger Indian Ocean region.

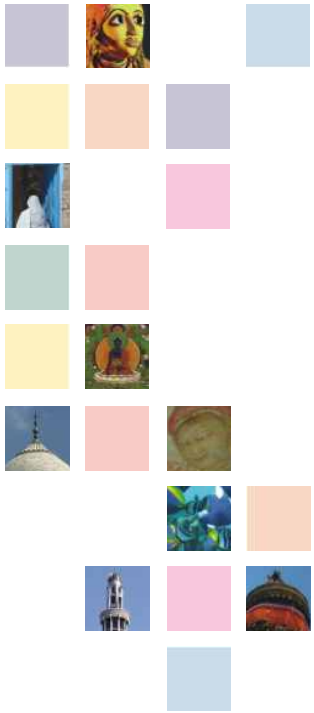
7. To provide for greater efficiency in movement of goods, a SAARC Multi-modal Transport system needs to be developed.

8. To address the various non-tariff barriers, it is important to ensure that regulatory regimes are transparent. One way of doing this is for all member countries to make available trade-related information through the electronic media to reduce information asymmetries.

9. The efficiency of border corridors and land customs stations (LCSs) is an important factor for South Asia's competitiveness and its trade prospects. The objectives of the trade and transport facilitation measures in South Asian region should be to (i) constantly improve the performance of border corridors and land customs stations (LCSs), (ii) eliminate the asymmetry between the LCSs pair, and (iii) remove multiple handling of goods at border.

10. Most of the LCSs suffer from limited warehouse capacity and the lack of banking and foreign exchange facilities. In some cases, banks are located several kilometres from the border. Adequate foreign exchange facilities are also unavailable at some borders. Some LCSs do not even have a foreign exchange facility. There is an urgent need to upgrade custom stations and harmonize custom standards.

11. There is a need to boost the abysmally low and negligible intra regional investments. SAARC countries should enter into a regional Investment Promotion and Protection Agreement.



12. A liberalized regional visa regime would go a long way to improve people-to-people interactions. Thus, there is a need to review visa regime by SAARC countries to encourage intra-regional connectivity.

13. Bilateral transit agreements do not exists among all the countries in South Asia. Transit in South Asia is long overdue and countries should enter into Regional Multi Modal Transport and Transit Agreement.

14. To enhance air connectivity, the SAARC governments could explore the possibility of an Open Skies policy. A South Asian airline with equity holdings across the region could be considered.

15. SAARC should facilitate the enhancement of maritime transportation links, including ferry services, to link and integrate SAARC countries.

16. To further regional integration in the energy sector, SAARC should look at regional energy connectivity, to manage the region's energy supply potential and demands in a comprehensive and sustainable manner across the region.

17. SAARC should look at articulating common positions on Climate Change issues with a view to integrating environmental protection activities in the region.

18. To this end, in-depth analytical studies should be undertaken under SAARC auspices, preferably by member federations of SAARC Chamber, including FICCI. These studies should incorporate issues such as concepts of environmental justice, provision of temporary work permits for climate change-refugees, the generation and transfer of environmentally friendly technologies, mitigation and adaptation measures, the impact of Climate Change on riverine and maritime eco-systems (such as the atolls of the Maldives and the Gangetic delta/Sundarbans) etc.

19. A SAARC Climate Change Fund should be created.

20. Integration within the region can also be promoted through greater cooperation in higher education and in the health sector. Opportunities for reducing the cost of high end medical care products exist, if SAARC countries can cooperate in this regard. SAARC should publicize positive examples of cooperation to demonstrate that progress towards regional integration has been initiated during the past 28 years. For instance, the

South Asian Network of Economic Research institutes (SANEI) is a SAARC recognized institution.

21. Apart from the growth of the tourism sector in facilitating greater people-to-people interaction, SAARC should look at increasing student exchanges. This measure would have a significant impact in the medium term by creating a new generation of South Asians who see value in integration.

22. The region has a huge 'demographic dividend'. However, a higher labour force participation rate does not necessarily imply more productive labour force. The human development index has been lagging on the lower side and needs further improvement in the form of skill development and overall knowledge base. This will have a positive spill over effect on the economy, thereby contributing to the macro economic development of the region.

23. It is imperative to build human capital by ensuring that the people of South Asia have access to education, health care, and social safety.

24. In order to implement the proposals for integration in South Asia in a broad-based manner, there is a need to involve industry and civil society in greater consultative manner in the SAARC process.

25. There is a need to engage SAARC observers in a more constructive manner, learn from their best practices and experiences in the process of integration.

26. There is a need to put in place an independent monitoring mechanism for SAARC activities to create accountability. This should include an assessment of the implementation of SAARC declarations over the past 28 years.

27. There is a need for greater engagement among national Chambers of Commerce of SAARC countries to boost intra-regional trade and investments.

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About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies. FICCI has contributed to this historical process by encouraging debate, articulating the private sector's views and influencing policy.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry.

FICCI draws its membership from the corporate sector, both private and public, including SMEs and MNCs; FICCI enjoys an indirect membership of over 2,50,000 companies from various regional chambers of commerce.

FICCI provides a platform for sector specific consensus building and networking and as the first port of call for Indian industry and the international business community.

Our Vision

To be the thought leader for industry, its voice for policy change and its guardian for effective implementation.

Our Mission

To carry forward our initiatives in support of rapid, inclusive and sustainable growth that encompass health, education, livelihood, governance and skill development.

To enhance efficiency and global competitiveness of Indian industry and to expand business opportunities both in domestic and foreign markets through a range of specialised services and global linkages.

Federation of Indian Chambers of Commerce and Industries

Federation House
Tansen Marg, New Delhi 110001
T : 91-11-23738760-70
F : 91-11-23320714, 23721504
E : saarc@ficci.com
W : www.ficci.com