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Economic integration within SAARC with special reference to India

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ABSTRACT

The importance of trade as growth facilitators has been recognized today by all the countries in the world. The best theory in trade is perhaps of "Free Trade", with no trade barriers. The second best option to global free trade is economic integration. Economic integration refers to trade unification between different countries within a block by the partial or full abolition of custom tariffs on trade taking place within the borders of the block. This is meant to lead to lower prices for distributors and customers and goal is to increase trade. Economic integration leads to the formation of trade blocs. Driven towards integration by the pressure of economic interest of the region seven South Asian countries – Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri-Lanka formed the South Asian Organization for Regional Co-operation (SAARC) in 1985. They formed South Asian preferential trade agreement (SAPTA) in 1993 and transformed it into South Asian Free Trade (SAFTA) in 2004 with a view to enhancing their productive capacity and regions trading interest. Afghanistan joined the SAARC on 3rd April 2007. Considering the market size in terms of population, SAARC is one of the largest economic blocs in the world. The prime objective of the SAARC is the development of intra-regional trade in this area. Since emergence of SAARC, intra-regional trade among the member nations has been low. Besides the trend analysis, the present study intends to analyze the trade intensities among the SAARC member countries. It also studies the potential for trade in the SAARC region. India has great potential to develop the intra-regional trade in the SAARC region and in doing so the Indian economy will also benefit in the form of increase in the exports through market diversification. Some of the studies reveal that India being the biggest and the better-developed nation among the SAARC nations should take up the leadership of SAARC.

Key Words : SAARC, Economic integration, Intra-regional trade, Trade intensity

INTRODUCTION

The importance of trade as growth facilitators has been recognized today by all the countries in the world. The best theory to promote trade is perhaps of "Free Trade", with no trade barriers. Free trade is advocated by many economists and its benefits are realized by certain countries in the form of much faster progress. However, many other economists opine that in free trade, terms of trade are favorable to the developed countries.

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The second best option to global free trade is economic integration. Economic integration refers to trade unification between different countries within a bloc by the partial or full abolition of custom tariffs on trade taking place within the borders of the bloc. This is meant to lead to lower prices for distributors and customers and goal is to increase trade. Economic integration leads to the formation of trade blocs. EU, NAFTA, ASEAN are some of the successful trade blocs in the world.

Driven towards integration by the pressure of economic interest of the region, seven South Asian countries – Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri-Lanka formed the South Asian Organization for Regional Co-operation (SAARC) in 1985. They formed South Asian Preferential Trade Agreement (SAPTA) in 1993 and transformed it into South Asian Free Trade Area (SAFTA) in 2004 with a view to enhancing their productive capacity and regions trading interest. Afghanistan joined SAARC on 3rd April 2007. According to Sharma (2012), "SAARC is the first major step of a long journey towards the regional integration on the pattern of European Union".

The SAARC countries are of different sizes both geographically and population wise and have different resource endowments. As per the designation, the contracting states of Afghanistan, Bhutan, Bangladesh, Maldives and Nepal are among the least developed countries in the world, while India, Sri-Lanka and Pakistan are the non-LDCs. They account for 23% of the world population and only 3.8 % of the total land area. Thus, this is a densely populated region inhabited by poor people. Considering the market size in terms of population, SAARC is one of the largest economic blocs in the world. The economic structure of these countries is agrarian. Their share in the world output is mere 2.3% and that in world merchandise trade it is 1%. India and Pakistan are the two largest economies in terms of regional Gross Domestic Product and population. In terms of economic wellbeing as measured by the human development index, Sri-Lanka and Maldives are better off than the other six. The SAARC economies have been closed economies until nineties. Sri-Lanka was the only economy, which led the process of liberalization in the eighties.

South Asian Association for Regional Co-operation (SAARC) provides a platform to the people of South Asia to work together in a spirit of friendship, trust and understanding. It aims to promote the welfare of the people of South Asia and to improve their quality of life through accelerated economic growth, social progress and cultural development of the region. However, the prime objective of the SAARC is the development of intra-regional trade in this area. If the intra-regional trades among the member nations increase, it would also lead to increase in the national income of these countries, poverty alleviation, economic growth, catch-up of the laggards with the forerunners, removal of infrastructural bottlenecks and technological development in this area.

Review of related literature :

Research studies are conducted with in-depth analysis, insight and intensive logical thinking. In building up a proper framework for this study, the contribution of the earlier researcher provides an input. Literature review will help to examine the gaps in the existing practices applicable to the problem under study.

According to Kher (2012), the most critical element of the integration process in South Asia is building confidence and filling the huge trust deficit between the countries. India will have to take on disproportionately greater responsibility while the other South Asian countries will have to commit to cooperation and openness. Agreements such as SAFTA need to be made more meaningful with appropriate emphasis on non-tariff and strict timelines for tariff reductions. The changing dynamics

in region and the world economic order make this an opportune time for South Asian countries to change their approaches and strategies towards each other.

An analysis by Bhattacharya and Das (2009) shows that intra-regional trade among the SAARC countries is low at present, which implies the existence of sufficient potential to enhance this trade. The major beneficiaries of the FTA among SAARC will be the members having lower tariffs than the countries with higher tariffs *viz*., India. Once intra-regional trade is completely free from tariffs, almost all SAARC countries will be able to increase their exports to India substantially since India's tariff rates are higher than those of other countries of this region. India's trade gain is not so substantial at least in the short run, mainly because of its high customs tariffs compared to other countries concerned. However, in the end, its gain will be much higher because of its trade and overall economic integration with other countries of this region.

In the study by Ali and Talukder (2009) the prospects and challenges of preferential trade liberalization and regional integration in South Asia are discussed by analyzing regional and international trade structures of South Asian countries through conventional trade measures such as commodity composition and direction of trade, and bilateral trade shares. South Asia is a large regional bloc with huge potential but achievement in regional economic integration is insignificant so far. Conventional trade measures indicate that the region is engaged in trade with the outside world- not within the economies of the region. In a static sense, small countries may lose and large countries may gain from a free trade area. However, the static welfare effects should not be the sole criterion for judging a discriminatory trading area. The static losses may be outweighed by dynamic gains. From SAFTA, the region can achieve considerable gains due to enhanced bargaining powers to the outside world if the region can improve its terms of trade with the rest of the world by acting in concert.

Weerahewa (June, 2009) concludes that the key trading partners of the South Asia are Non-South Asian developed countries and the food and agricultural trade among South Asian countries is rather small. Even though attempts have been made to improve intra-regional trade in South Asia through trade formation of RTAs, they are not considered successful in improving trade in South Asia. It is evident that the status of trade facilitation in South Asia is quite low and there is an opportunity to improve trade flows by improving trade facilitation. The Logistic Performance Index has large positive effects on value of exports of all the product categories. This indicates that, by reducing inefficiencies at the borders in South Asia, significant trade gains can be achieved. The Gravity model estimated and simulated in this study indicates that there exists a room to expand bilateral trade by reducing trade costs and time delays in South Asian countries.

Jain and Singh (2009) opine that in ensuring stability and growth in intra-regional trade, Indo-Pak bilateral relationship plays a very crucial role. Apart from this, SAARC countries need to put in place adequate physical infrastructure, which hampers their global competitiveness even in those sectors where they have revealed comparative advantages. Successful outcome of SAFTA could play an important role in strengthening trade ties within the region. It is however, expected that with further dismantling of tariff barriers under the SAFTA, a large part of the informal trade may come under purview of formal trade. This along with favorable Rules of Origin could raise intra-regional trade in the SARRC region. Trade policy of SAARC countries, therefore, needs to ensure that SAFTA helps trade creation rather than trade diversion from the region as many researchers apprehend.

Kumar (2009) states that in the rapidly changing global environment, regional integration in South Asia has assumed a new strategic significance. As the largest economy of the region, it is

imperative and an opportune time for India to inculcate an environment of trust among SAARC partners, which would encourage greater commitment to regional integration among all the countries. India stands to gain substantially from greater economic integration in the region, in terms of both economic non-economic payoffs. India's emergence in the world economic order in the twenty-first century is not possible until and unless she ensures a stable and secure regional economy.

Taneja *et al.* (2011) use pair-wise Revealed Comparative Advantages for India and each of the exporting countries in SAARC to identify items on India's sensitive list that are vulnerable to competition from imports from SAARC member countries. The analysis suggests that these items should be retained on India's sensitive list and removed gradually in a phased manner over a period of three to five years. This approach has implications for India's import policy *vis-à-vis* SAARC members and could be used to liberalize India's imports in other bilateral Free Trade Agreements.

Pitigala (2005) uses various definitions of the "natural trading partner" hypothesis—based on "trade volume", "geographic proximity" and the "complementarity" approaches. This study demonstrates that the South Asian countries can be characterized only moderately as "natural trading partners". This characterization is, however, largely a consequence of previous impediments to trade among regional members. This study further demonstrates through additional statistical measures—including "revealed comparative advantage" indices, "trade concentration", and "trade competition" profiles—that the trade structures that have evolved among the South Asian countries may not facilitate a rapid increase in intra-regional trade.

Taneja and Sawhey (2007) remark that by addressing the barriers to goods liberalization, India could regain the trust of other member countries - a precondition for any further widening and deepening of the integration process in South Asia. Since most countries in the region are unilaterally liberalizing tariffs at a much faster rate than is envisaged under SAFTA, the focus will have to be on the removal of para-tariffs and other non-tariff barriers for any substantial gains in intra-regional trade flows to occur. India should take the lead on addressing these barriers and pave the way for further integration in south Asia.

Volrath (1991) identifies ten alternative indexes of revealed comparative advantage. Kunimoto's integrative framework is used as a basis for evaluation because it provides a useful statistical link to theory and economical interpretation. Nine of the summary measures of RCA are trade only indexes. RCA7 is the only trade cum production index. RCA5 and RCA6 are not consistent with Kunimoto's probability framework. RCA8 and RCA10 encompass both supply and demand effects but are more pronounced on the import than on the export side. For these reasons, RCA3 and RCA9 are preferable. RCA9 is more conceptually satisfying measure than RCA3 because the former eliminates double counting.

Statement of the problem :

The review of literature reveals that within the SAARC region there is a lot of scope and potential for encouraging intra-regional trade. The present study intends to analyze the possibilities of trade integration focusing on trade intensities among the SAARC member countries.

METHODOLOGY

Trade data within the SAARC region and with the outside world is used to analyze the trends of India's trade within SAARC region.

Trade Intensity Index (TII) is used to analyze the current trade between India and the various

SAARC countries. It will also help to study the potential for trade in the SAARC region. The Trade Intensity Index (TII) is used to determine whether the value of trade between two countries is greater or smaller than would be expected based on their importance in world trade. It is defined as the share of one country's exports going to a partner divided by the share of world exports to the partner

TIIij = [Xij / Xi] / [Xj / (Xw)]

TIIij – Trade Intensity Index of exporting country 'i' (source) here India to country 'j' (destination) here (SAARC member country)

Xij- exports of source country 'I' (India) to destination 'j' (SAARC member country)

Xi- Total exports of 'I' *i.e.* source country India.

Xj- Export to country 'j' *i.e.* destination (SAARC member country)

Xw- Total world exports

RESULTS AND DISCUSSION

India's trade with the SAARC countries :

Since emergence of SAARC, intra-regional trade among the member nations has been low. This can be examined from the Table 1. The table analyses India's current trade with the SAARC countries and also compares it with India's total world trade.

Table 1 : India's Trade with the SAARC Countries for the year 2014-2015 (in US $ millions)

Sr. No.	Countries	2014-15 Exports	2014-15 Imports
1.	Afghanistan	422.56	261.91
2.	Bangladesh	6,451.47	621.37
3.	Bhutan	333.94	149.87
4.	Maldives	152.38	4.32
5.	Nepal	4,558.77	639.91
6.	Pakistan	1,857.18	497.31
7.	Sri Lanka	6,703.72	756.17
	Total SAARC	20,480.02	2,930.85
	Total World	310,338.48	448,033.40
	% Share	6.59	0.65

Source: Report, Department of Commerce, Government of India, year-2014-15

We can observe from the above table that India's exports to the SAARC countries are only 6.59% of its total exports to the world. Whereas India imports from the SAARC countries is as low 0.65% of its imports from the world. Srilanka and Bangladesh are India's major trading partners from the SAARC region. It is interesting to note that India's trade with Maldives is very insignificant from India's point of view. But for Maldives India is its major trading partner.

Tables 2 and 3 and Fig. 1 show that as compare to imports, exports of India to SAARC region have grown at faster rate during the period of analysis. It also shows that India has great potential to develop the intra-regional trade in the SAARC region and in doing so the Indian economy will also benefit in the form of increase in the exports through market diversification. According to Taneja and Sawhney (2007), "The slow progress under the SAPTA and then under SAFTA do not lend much creditability to India and may come in the way of its regional trading engagements with

the rest of the world. It is therefore, in India's interest to invigorate SAARC trade"

Table 2 : Trends in India's Export to SAARC ($ Mn.)

Sr. No.	Country	Avg 1996 - 2001	Avg 2001 - 2006	Avg 2006 - 2011	Avg 2011 -2015
1.	Afghanistan	23.172	107.744	342.302	470.1075
2.	Bangladesh	844.482	1442.88	2545.566	5388.148
3.	Bhutan	10.704	63.978	110.088	288.155
4.	Maldives	11.878	43.2	93.262	126.3525
5.	Nepal	150.05	567.456	1541.268	3490.37
6.	Pakistan	137.25	369.478	1670.67	1934.448
7.	Sri Lanka	508.636	1261.784	2642.032	4900.183
	Total Export to SAARC	1686.17	3856.518	8945.194	16597.76
	Total export to World	36571.29	69,403.03	180,681.71	307,777.07

Table 3 : Trends in India's Import to SAARC ($ Mn.)

Sr. No.	Country	Avg 1996-2001	Avg 2001-2006	Avg 2007-2011	Avg 2011-2015
1.	Afghanistan	17.908	36.384	108.36	190.6825
2.	Bangladesh	66.82	77.04	299.908	582.6925
3.	Bhutan	18.49	53.642	168.648	167.1475
4.	Maldives	0.21	0.738	9.236	8.3675
5.	Nepal	149.558	329.884	479.326	565.7275
6.	Pakistan	85.46	88.358	318.042	465.93
7.	Sri Lanka	39.994	261.81	471.156	671.585
	Total Import from SAARC	378.44	847.854	1854.68	2652.13
	India's Total Import from World	44656.02	90331.54	279845.5	469572.3

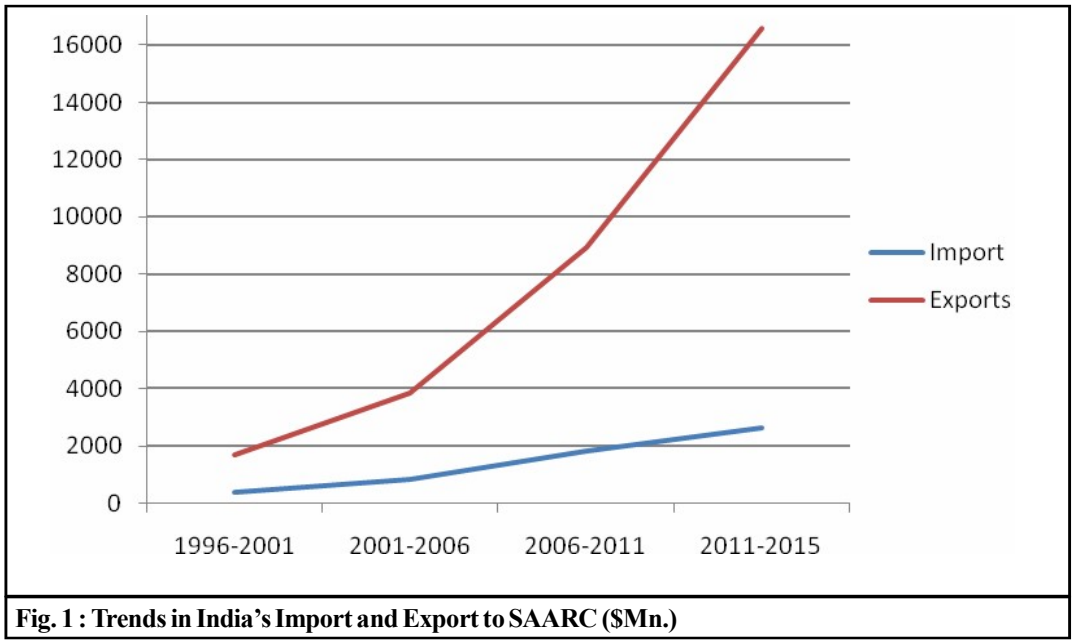

Fig. 1 : Trends in India's Import and Export to SAARC ($Mn.)

Trade Intensity Index between India and other SAARC Countries :

The value of TIIij ranges from 0 to 100. If the value is 0, it implies no trade relationship between home and partner country. On the other hand if the value of export intensity index is more or less 100, it indicates that the home country is exporting more or less to the partner country than might be expected from the country's share in total world trade.

Trade Intensity Index (TII) shown in Table 4 is used to analyze the trade between India and the various SAARC countries. It helped to study the potential for trade in the SAARC region. The Trade Intensity Index (TII) is used to determine whether the value of trade between two countries is greater or smaller than would be expected on the basis of their importance in world trade. It is defined as the share of one country's exports going to a partner divided by the share of world exports to the partner.

Table 4 : Trade intensity index

Years/Countries	2000	2003	2006	2009	2013
Afghanistan	--	--	--	9.15	5.52
Bangladesh	13.28	20.26	10.43	59.23	9.45
Bhutan	8.70	43.17	15.05	12.24	16.0
Maldives	8.23	10.49	7.00	5.26	4.44
Nepal	1.34	4.41	3.73	2.74	29.42
Pakistan	2.28	1.80	4.16	1.98	2.85
Sri Lanka	14.41	22.92	20.60	8.09	13.71
Total SAARC	8.30	12.27	8.66	5.54	8.40

The regional trade in South Asia is dismally low as compared with the regional trade of the European Union, the Association of Southeast Asian Nations (ASEAN), the Common Market for Eastern and Southern Africa, Gulf Cooperation Council, Latin America and Caribbean. Main reasons behind this might be that in spite of the free trade agreements among the SAARC countries, these countries have a sensitive or negative list of commodities which are not entitled for free trade. Similarly the rivalry between the two largest countries India and Pakistan is one of the causes for poor intra-regional trade. However, potential of SAARC as a Trade bloc can be anticipated and reflected in the keen participatory interest shown by China, European Union, United States, Japan and South Korea in getting the observer status.

India is the world's second most populous nation and the seventh largest in terms of geographical area. India is the largest country in the SAARC region with regards to both the geographical area and population. India also has a diversified export basket. India is a major trading partner of most of the SAARC countries especially Maldives. However, these countries imports from and exports to India are a very small part of India's total trade.

India's Role in SAARC since its Establishment :

SAARC has witnessed limited success since its inception. Many of its achievements and programmes remain just on paper. Some of the studies reveal that India being the biggest and the better developed nation among the SAARC nations should take up the leadership of SAARC. According to Taneja and Sawhney (2007), "The slow progress under the SAPTA and then under SAFTA do not lend much creditability to India and may come in the way of its regional trading engagements with the rest of the world. It is therefore, in India's interest to invigorate SAARC

trade" In a study conducted by Dash (2008) on SAARC countries has stated "India can make or break SAARC". The world today looks at India as an upcoming super power and India can prove itself by first enhancing its relationship with its neighbors.

India's free trade agreements with Sri Lanka and Bhutan, and the trade and transit agreement with Nepal have highlighted the potential benefits of regional economic integration and also revealed that India wants to enhance trade with these countries but outside the ambit of SAARC. However, various studies have revealed that for SAARC to be successful India has to take a proactive role. Also the success of SAARC is associated with India's political and economic interests. For economic integration with other countries in the world and foreign direct investment in the country the world will look at India's relations with its neighbours and its role in its own regional trade bloc *i.e.* SAARC.

India's Present Interaction with SAARC Member Countries :

India has actually taken the step towards regional integration in the SAARC region by inviting the heads of all SAARC member countries for the Prime Minister Mr. Narendra Modi's oath taking ceremony. All the SAARC nations were overwhelmed by Modi's actions and all of them attended the function.

After taking oath as the prime minister of India Modi choose Bhutan for his first visit. India and Bhutan reiterated their commitment to achieving the 10,000 MW target in hydropower cooperation and not to allow their territories to be used for interests "inimical" to each other. Modi inaugurated one of India's assistance projects - the building of the Supreme Court of Bhutan and laid foundation stone of the 600MW Kholongchu Hydro-electric project, a joint venture between India and Bhutan.

India also announced a number of measures and concessions including the exemption of Bhutan from any ban on export of milk powder, wheat, edible oil, pulses and non-basmati rice. The two sides recalled the free trade arrangement between them and the expanding bilateral trade and its importance in further cementing their friendship.

Prime Minister Narendra Modi also mooted the idea of an annual hill sports festival with India's northeastern states along with Bhutan and Nepal. He announced doubling of scholarships being provided to Bhutanese students in India which will now be worth Rs. 2 crore. India will also assist Bhutan set up a digital library which will provide access to Bhutanese youth to two million books and periodicals.

For his second visit he chose Nepal. The country with which India shares its north eastern border. The last visit of an Indian prime minister to Nepal was in 1997. India funded hydroelectricity projects and other infrastructure projects in Nepal. PM Modi announced a credit assistance programme of US$1 billion to Nepal.

With Pakistan however India's efforts have met with limited success. India has a long association with Sri-lanka. In his address to the Sri-lankan parliament PM Modi emphasized on Co-operative federalism. Expansion of the maritime security cooperation between India, Sri-lanka and Maldives to include others in the Indian Ocean area is also seen as a dynamic step as in recent years. India and Sri-lanka signed four agreements on visa, culture, youth and customs.

Thus, India has taken the first steps towards closer regional integration in the SAARC region and to play the role of a leader and big brother of the SAARC member countries. Now the success of these actions also depends on how the neighbors reciprocate to India's gesture.

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