The challenge facing the infrastructure deficit and in particular the shortcomings in policies and service delivery that has led to the deficit, is enormous. The politicization of tariff setting of services has led to prices well below costs with government subsidies but those services are not well targeted to the poor. The gap of infrastructure provision with East Asia is shown in Table 1.6.

Chapter 2

SOUTH ASIAN ASSOCIATION FOR REGIONAL COOPERATION (SAARC)

2.1 PROBLEMS FACING SAARC

2.1.1 Economic Issue

The economic case for SAFTA is relatively weak. Two important features of South Asian economies make an FTA among them economically unattractive.[1] First, the economies are relatively small in relation to the world both in terms of the GDP and trade flows. Table 2.1 shows the population, GDP and the volume of trade in the SAARC-5 (Bangladesh, India, Nepal, Pakistan and Sri Lanka) in the year 2001.

In terms of population, the region is substantial: one fourth of the world's population resides in this area. This clearly indicates the future potential of the market if per capita income reaches the level prevailing currently in the ASEAN economies. But the current per capita income is lower than that of the latter so that the economic size of the region remains small: less than one twentieth of the world in terms of the GDP. And if India is taken out of the picture, this proportion drops to 0.4 percent. The probability that the most efficient suppliers of the member countries are within the region is slim. Therefore, the probability that the FTA is likely to be largely trade diverting is quite high.

Trade related indicators reinforce this conclusion. Thus, the last column of Table 2.1 shows the share of the SAARC countries in the world trade (exports plus imports as a proportion of the

[1] World Bank, 2004.

Table 2.1 Population, GDP and Trade in SAARC–5 (2001)

Country	Population (million)	GDP ($billion)	Trade ($billion)
Bangladesh	133.3	48.6	15.6
India	1032.4	477.4	93.1
Nepal	23.6	5.8	2.3
Pakistan	141.5	60	20.3
Sri Lanka	18.7	16.4	11.1
SAARC 5	1349.5	608.3	142.3
World	6130.1	31400	12560
Population	Population	GDP	% of World Trade
Bangladesh	2.2	0.2	0.1
India	16.8	1.5	0.7
Nepal	0.4	0	0.0
Pakistan	2.3	0.2	0.2
Sri Lanka	0.3	0.1	0.1
SAARC-5	22	1.9	1.1
World	100.0	100.0	100.0

Source: World Development Index 2003.

GDP). Together, the countries in the region account for only 1.1 percent of the world trade. Alarmingly, if India is excluded, the proportion drops to 0.4 percent. The scope for trade diversion due to tariff preferences is indeed very large. Table 2.2 compares SAARC with other trade blocs, again emphasizing on the highest population but one of the lowest per capita incomes in this region.

Table 2.2 Comparison of SAARC with Other Trade Blocs

Name	Area	Population	Per Capita Income	Number of Members
SAARC	5,136,740	1,467,255,669	2,777	8
EU	4,323,782	497,000,000	28,213	27
ASEAN	4,497,493	566,500,000	5,541	10
AU	29,797,500	897,548,804	1,896	53
NAFTA	21,783,850	445,000,000	35,491	3

Source: *The Daily Jai Jai Din*, 8th August 2008.

The second reason that makes the economic case for SAFTA weak concerns the political economy of the selection of excluded sectors and ROO. When countries are allowed to choose sectors that can be excluded from tariff preferences in an FTA, domestic lobbies make sure that the sectors in which they may not withstand competition from the union partner, are the ones that get excluded. On the other hand, lobbies go along with free trade in those sectors in which they are competitive and the preference will threaten the imports from non-member countries. In the same vein, lobbies tend to go for tight ROO or outright quantitative restrictions precisely in those in which they fear the competition from the union partners the most. In contrast, when the threat is mainly to the imports from non-member countries, they are willing to accept greater liberalisation. In addition, we may note that the ROO can also be subject to abuse by the bureaucrat administering them. In cases where imports from the union partner may be threatening an inefficient domestic competitor, bureaucratic discretion may be employed to block entry of the imports.

A common argument advanced in favour of SAFTA is that there is substantial *informal trade* among the countries of the region (Table 2.3) and that this trade involves large real costs.

Recently, the Financial Express reported that the magnitude of India's informal trade with neighbouring countries was a massive $3 billion. These huge amounts indeed reduce the various impediments to formal trade within the South Asian region, which also includes movements of capital.

Table 2.3 Informal Trade between India and its SAARC Partners

Trading Partner (year of estimate)	Indian informal exports ($US million)	Indian informal imports ($US million)
Pakistan (1996)	100-500	N/A
Bangladesh (1992-93)	299	14
Sri Lanka (1991)	142	121
Sri Lanka (2000-01)	185	21

Source: Pakistan: Government of Pakistan (1996; Nabi et.al.), Bangladesh: V.L. Chaudhury (1995), Sri Lanka: Sarvanathan (1994).

For example, the bulk of India-Pakistan trade is routed through Dubai, which is costly. An FTA may help eliminate these costs. A number of prevailing issues between the member countries have caused weak trade linkages, which merits a deeper discussion.

2.1.2 Identical Comparative Advantage[2]

Trade: The South Asian region is characterised by an almost identical pattern of comparative advantages in a relatively narrow range of products. This indicates the lack of strong complementarities in the bilateral trade structures of South Asian countries. Five of the members — Afghanistan, Bhutan, Bangladesh, Nepal and Maldives are LDCs; three of whom are very small countries, with limited trade capacity; and three — Afghanistan, Nepal and Bhutan — are landlocked.

The fact that India, the largest market, is not importing enough goods from other SAARC countries could be seen as a major obstacle to the progress of integration with promised equity; while other SAARC countries see India's non-tariff and tariff restrictions as unfairly depriving them of export opportunities. India has long maintained a restrictive trade regime that favours import-substituting industries. And despite progress in easing trade protections in recent years, even today in India there are sectors reserved for local small and medium enterprises (e.g., fountain pens). More broadly, half of the manufactured goods from SAARC countries consist of textile and leather products which are subject to very high duties in India, where more than 76 percent of the region's population live. Many of Sri Lanka's manufacturing products have competitive edge or comparative advantage over India's but the exports of these items are thwarted high tariffs and non-tariff barriers.

In addition, supply side weaknesses among many of the SAARC countries also impede trade based on comparative advantage. In general, SAARC members other than India have relatively undeveloped manufacturing sectors outside of certain niche industries,

2 *SACEPS Task Force Report: A Policy Dialogue on South Asian Cooperation, Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

(especially apparel.) This limits competition with sheltered high-cost producers. Increased competition can only occur when industries capable of producing similar or "like" products under different cost conditions exist.

Investment: SAARC countries compete with one another for exports and for inward foreign direct investments. The region has a narrow export range, and depends heavily on textiles and clothing exports as in the case of Pakistan, Bangladesh, Nepal and Sri Lanka, under favourable terms allowed to LDCs. At the same time, the domestic industrial policies of all SAARC members have been restrictive for FDI until recently. As a result, investment flows have remained weak among SAARC members in almost all domestic sectors. However, there is an increasing convergence in FDI regimes in SAARC.' There are several bilateral and sub-regional preferential treaties, which overlap and undermine the regional trade spirit. Some members are in several groupings such as the Bangkok Agreement, Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Community (BIMSTEC) and Indian Ocean Rim Association for Regional Cooperation (IORARC). As a result, treaty-shopping advantages create unequal terms and conditions among SAARC members in regional trade. Similarly, bilateral trade structures hardly show any complementarities in the trade. Together with absence of comparative advantage in capital intensive and high value-added products, which are normally imported by countries in the region, they act as structural constraints to expanding intra-regional trade.

Though South Asian countries have undergone major structural reforms and its share of industrial sector has increased sharply, their industry lacks diversification. With the exception of India and, to some extent Pakistan, these resource constraints have prevented the South Asian countries from investing in high value-added exportable products, and have made these countries dependent on industrialised nations for their capital goods and technology. The regional exports largely consist of raw materials and traditional products, such as textiles and garments, categories in which these neighbouring countries are in direct competition with each other for a share of the world export market. The import requirements of the region mainly consist of capital goods and high-tech products.

In this pattern, the trade pattern of the South Asian countries is tilted towards the developed countries.

Despite the demand for the South Asian products in the region, there is a rather limited capacity to generate exportable surpluses of the product in accordance with the specifications. The specifications of products imported and exported are different, which has marred the growth of intra-regional trade.

2.1.3 Institutional Aspects

SAARC does not have independent institutions to take up the charge of regional development policies and decisions. The institutional setting of the SAARC process is based on consensus and unanimity, given the greater sensitivities among some of its member nations. The principle of consensus has been taken to its absolute limits even in routine decisions, often swaying with the bilateral currents among member countries, which limits the implementation of common regional initiatives.

Factors like poor institutions and government regulation have certainly contributed to South Asian countries not faring well when it comes to ranking countries in terms of "ease of doing business." It also takes relatively more time to enforce contracts (Tables 2.4 and 2.5). The World Bank, in its annual exercise, ranks countries in terms of ease of doing business. In the 'Doing Business Report 2008', the sample size involved 178 countries. Ease of doing business is measured in terms of procedures, time, and cost involved in launching a commercial or industrial firm with up to 50 employees and start-up capital of 10 times the economy's per-capita gross national income (GNI).

The immediate challenge on the institutional front is the completion of the SAFTA free trade agreement, which has become operational on July 1, 2006. The SAFTA framework agreement still needs to cover a lot of ground in respect of the following areas:

- ***SAFTA negotiations***: Rules of origin, sensitive lists, revenue compensation, and technical assistance for LDCs; and
- ***Implementation issues***: Dispute settlement mechanism, review and standstill clauses, standards harmonisation, and trade facilitation measures.

Table 2.4 Doing Business Report, 2008

Ease of Doing Business Index			Starting a Business			
Year	Country	Rank	Rank	Procedures (number)	Time (days)	Cost (% of income per capita)
2008	Bangladesh	107	92	8	74	46.2
2008	Bhutan	119	52	8	48	10.4
2008	India	120	111	13	33	74.6
2008	Maldives	60	34	5	9	13.4
2008	Nepal	111	60	7	31	73.9
2008	Pakistan	76	59	11	24	14
2008	Sri Lanka	101	29	5	39	8.5

Table 2.5 Enforcing Contracts

Region or Economy	Procedures (number)	Duration (days)	Cost (% of claim)
East Asia & Pacific	37.3	549.8	47.8
Eastern Europe & Central Asia	35.9	443	22.7
Latin America & Caribbean	39.3	699.9	30.7
Middle East & North Africa	43.5	699	24
OECD	31!3	4433	177
South Asia	43.5	1,047.10	27.2
Sub-Saharan Africa	39.4	643	48.7
Bangladesh	41	1,442	63.3
Bhutan	47	275	0.1
India	46	1,420	39.6
Maldives	41	665	16.5
Nepal	39	735	26.8
Pakistan	47	880	23.8
Sri Lanka	40	1,318	22.8

Source: World Bank 2008a.

Consensus on the modalities on such a large list presents a gargantuan challenge, and will inevitably delay the implementation date if the bilateral political climate deteriorates.

2.1.4 Lack of Communication Links

There are no intensive communication links between the South Asian countries, and as such the production, consumption and trade patterns of potential trading partners within the region may not be known.[3] There are hardly any ships, which call on specifically for the export of South Asia to other regional countries. Similarly, inadequate trade facilitation mechanisms contribute to the unrealised potential of intra-regional trade in certain areas.

Nepal's trade with other countries in the region depends on transit facilities provided by India. These facilities often involve high handling and transportation charges and delays in delivery, thus hampering the flow of trade between Nepal and its trading partners in the region.

A carpet manufacturer in Kathmandu reported that because of poor road conditions he has to spend around 100,000 Nepalese rupees for vehicle maintenance (Biggs et.al. 2000). The transport cost is higher for landlocked countries like Nepal while it is least for Sri Lanka (De 2008). The trade-weighted ad-valorem transportation costs are listed in Figure 2.1. Higher transport cost is a negative factor. As pointed out by Limao and Venables (2001), doubling of transport costs can lead to a drop in a country's trade by about 80%.

There are 13 Nepal-Bangladesh joint ventures in the areas of medicine, restaurants, garments, construction, mineral, banks and finance companies.[4] Some of these joint ventures are fully operational while the government recently approved some others. There are huge business prospects between Nepal and Bangladesh in the areas of education, tourism, health, pharmaceuticals, housing,

3 *SACEPS Task Force Report: A Policy Dialogue on South Asian Cooperation, Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

4 See www.saarc.org, www.southasia.net, www.saarctrade.com, www.asianews.net, www.cpd-bangladesh.org.

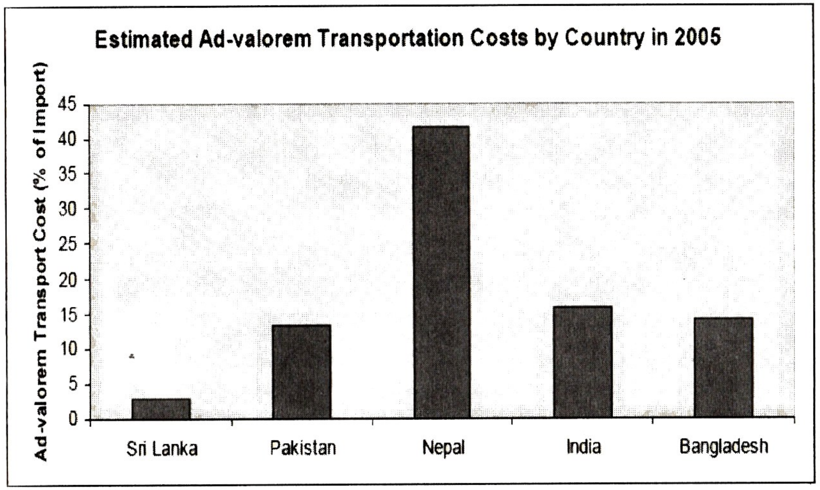

Figure 2.1: Higher Transport Costs in South Asia

ceramic, garments and vegetable production. Despite the fact that the Bangladesh government welcomed Nepali investors to invest in Bangladesh, there has been no progress in the export processing zones particularly at Mongla and Uttara. The biggest hindrance to the expansion of trade ties between the two countries is the lack of smooth transportation channel. Despite the setting up of a very large dry land port at Banglabandha in Bangladesh, the flow of goods between the two countries have not picked up due to continuing bureaucratic red tape by Indian authorities who holds a small but key transit corridor connecting the two countries.

India cannot use Bangladesh roads to get access to its north-eastern states. The southern border of Tripura is only 75 km from Chittagong port. But because access for Indian goods is not allowed at Chittagong port, goods from Agartala have to cross 1,645 km to reach Kolkata. If transit were allowed through Bangladesh, and Indian goods were allowed through Chittagong port (which was the traditional route), the journey to port of Assam for example, would be 60% shorter.

Trade between India and Bangladesh is conducted by road and sea, although transportation by sea is more cost-effective. But sea transportation requires that Kolkata and Chittagong ports make co-ordinated efforts to improve their productivity and connections to inland waterways. Most containerised traffic is handled by Kandha, Mumbai, and Jawaharlal Nehru ports on the coast of India. This obviously increases the cost of transportation. Transporting goods to Narayanganj in Bangladesh would be cheaper if the Kolkata and Chittagong ports and then inland waterways were used.

Bangladesh and India can also co-operate on road network and improved clearance procedures for mutual benefit. By road, a trade consignment takes at least four to six days for clearance from India's border to Bangladesh and vice-versa. Generally, a consignment needs at least 22 documents (total for both sides) for approval. Such complex and cumbersome procedures create opportunities for pilferage, which often changes the composition and direction of trade. Procedural complexities often deter trade between the two countries. Moreover, after cargo has been cleared, other road transport related obstacles arise. For example, the current legal arrangement between India and Bangladesh prohibits vehicles from crossing the border to deliver consignments.

Rail transport between Bangladesh and India is also difficult. The lack of container trains between India and Bangladesh curtail trade in bulk items such as cement, logs, food grains, and salt. If Bangladesh Railway Authority connected Mongla port with Bongaon (in India) via Khulna by broad-gauge railway track, export cargo would reach Delhi or Mumbai in 4 to 5 days instead of 15 days by road or 18 days by sea, which is the case at present.

During British India, the transport networks were all radiating outwards from the international seaports of Karachi, Bombay, Madras, Kolkata and Chittagong. Subsequently, several new ports have been developed in the sub-region, which includes seaports near Karachi and Bombay, Haldia near Kolkata, and Mongla in the southwest of Bangladesh. In the context of Northeast India, Bhutan and Nepal suffer due to congestion at Kolkata port. The ports at Chittagong and Mongla could have provided a very easy access to the sea. Shipments of Assam tea to Europe on its traditional route through Chittagong, is not possible since it is not covered by the current bilateral agreement. As a result, the transportation cost includes a trucking route of more than 1400 kms to Kolkata Port through the land corridor termed the "chicken neck" between Bangladesh and Nepal. The traditional route for Assamese tea via Chittagong port would have cut the journey for export shipments by almost 60%. Third-country trade for both Nepal and Bhutan is also routed through Kolkata port, with associated delays and cost Instead of moving more efficiently and effectively through Bangladesh ports.

If Bangladesh had allowed Indian cargo access to the sea through Chittagong Port, it could have earned considerable foreign exchange for the services it would render in terms of railway charges, port charge and transit fee etc.

Port inefficiency in South Asia is reflected in a number of problems: congestion in regional hub ports (e.g., Nhava Sheva) and even longer delays at regional seaports (e.g., Kolkata and Haldia in India and Chittagong in Bangladesh). Port efficiency is highly correlated with shipping costs and estimates. Clarke, Dollar, and Micco (2004) indicate that improving port efficiency from the 25th to the 75th percentile lowers shipping costs by more than 12 percent. Air and maritime ports in South Asia are generally less efficient than those in East Asia. At ports in Bangladesh, for example, clearing a vessel takes two to three days, in contrast with the couple of hours that it takes to clear a vessel at Singapore or at Laem in Thailand. It was found that the major barrier to export logistics in Bangladesh is the inefficient port and shipping sector. The cargo dwell time at the Delhi airport averages 2.5 days whereas the norm is 12 hours. It takes 45 days to transport a container from Delhi to Dhaka, as no container trains run between India and Bangladesh. The same conditions exist between India and Pakistan. If railway traffic were permitted, the same trip would take only two to three days.

Some progress has been made in this area, and global container terminal operators are upgrading facilities in South Asia. India has instituted a policy to encourage private sector investment in ports, including inland waterway ports. India's Prime Minister Dr. Manmohan Singh's call at the Dhaka summit that: "All South Asian countries would provide to each other, reciprocally, transit facilities to third countries, not only connecting one another, but also connecting to the larger Asian neighbourhood, in the Gulf, Central Asia and South East Asia" was a visionary statement. However, it remains to be a fact that mutual mistrust stands as the main impediments towards development of transit facilities among the SAARC member countries.

2.1.5 Restrictive Trade Policies

Despite the level of trade in South Asia, the potential economic benefits of cooperation were considered attractive enough to prompt the establishment of SAPTA. But the tariff concessions covered by SAPTA have not been sufficient. The tariff rates for the Most Favoured Nations (MFN) are high and ranges from 0-40% as offered by the SAARC nations. Whereas the Less Developed Nations of SAPTA (Bangladesh, Bhutan and Maldives) have to give tariff range of 10-50% with other nations receiving as high as 75% of the MFN tariff rates as shown in the Table 2.6

Table 2.6 SAPTA Concessions on Number of Products

Country	MFN Tariff Rate	Non-LDCs/ LDCs	Tariff Range		
			SAPTA-1	SAPTA-2	SAPTA-3
Bangladesh	0-40	Non-LDCs	10	10	10
		LDCs	10	10	10-15
Bhutan	20-50	Non-LDCs	15	10-15	10
		LDCs	10-15	10-15	10-20
India	5-45	Non-LDCs	10-90	10-50	10-25
		LDCs	50-100	50-100	50
Maldives	0-40	Non-LDCs	7.5	7.5-10	10
		LDCs	7.5	7.5-10	–
Nepal	5-25	Non-LDCs	7.5-10	7.5-10	5-10
		LDCs	10	15	10-15
Pakistan	0-45	Non-LDCs	10	10-15	10-20
		LDCs	15	15	30
Sri Lanka	0-30	Non-LDCs	10-20	10-20	10
		LDCs	15-25	60	10-75
SAARC		Non-LDCs	7.5-90	7.5-50	5-25
		LDCs	7.5-100	7.5-100	10-75

The product-by-product method of preferential trade concession also appears to be rather generous due to the number of concessions given. This can be seen in Table 2.7 where nearly 4,700 items have been negotiated for tariff concession. Most of the concessions have been on chemicals, textiles, clothing, machinery and mechanical appliances. It is clearly observable that India has offered the most concessions but many of products offered are not even widely traded in the region. The number of concessions undermines the actual effectiveness of the rounds of negotiations organised by SAPTA. Only actual trade coverage of those concessions that are vital can raise the value of any given preferential trade agreement. Except for the preferential margins granted in favour of the LDC members, the preferences have not done much to interest the other member nations.

Table 2.7 Item Negotiated for Tariff Concession

Country	LDC	All	Total
Bangladesh	14	407	551
Bhutan	124	109	233
India	2082	472	2554
Maldives	6	172	178
Nepal	163	328	491
Pakistan	229	262	491
Sri Lanka	44	155	199
SAARC	2962	1905	4667

Many of Bangladesh's potential exports cannot enter the markets of other SAARC countries, particularly India, because of proliferation non-tariff barriers such as costly documentation, widely varying methods of assessing duties, and lack of branding. In addition, a lack of adequate physical infrastructure at border checkpoints, lack of transit rights, and lack of financial infrastructure have kept Bangladesh's exportable away from India's market. Over and above, due to very narrow export base to India the impact of the most of the concessional treatment provided to Bangladesh under the SAPTA agreements are of very limited significance to Bangladesh.

Furthermore, many critical items have not been included in the preferential list either.

Bangladeshi exporters have complained that goods entering India face extra duties and non-tariff measures in the form of expensive mandatory certificates. These certificates relate to technical and health standards and must be obtained from places far from their place of import, such as Delhi and Kolkata, even for exports to north eastern India. Bangladeshi exporters also alleged that India imposed unfair restrictions on fish exports through West Bengal and north eastern India, including the closure of all land ports (two of which were subsequently reopened). Moreover, India allegedly has not met the commitment it had made at the meetings of SAPTA joint working groups to recognise Bangladesh's certification and testing laboratories. Furthermore, the efficacy of allowing Bangladesh transit through Indian territories to Nepal was lost because of India's long delay in providing this facility.

These are some of the key areas in which the SAFTA agreement can contribute to Bangladesh's regional export expansion. However, as noted earlier, the agreement does not specify a timeframe for phasing out non-tariff and Para tariff barriers. Unless this is done immediately, Bangladesh's exports under SAFTA will remain far below its potential.

Non-tariff and Para tariff measures are greater obstacles to trade than tariffs. Inefficient customs procedures, lack of transit facilities, inadequate infrastructure, and inconsistent standards also inhibit trade. Thus, trade facilitation measures that address all of these challenges are needed to augment trade flows, whether regional or multilateral.

The India-Pakistan relationship is one of the most crucial issues for economic cooperation in South Asia. Fluctuations in two-way trade between India and Pakistan can be attributed mainly to trade policies adopted by them. At present, Pakistan allows only 596 items that can be exported to her. The official trade between India and Pakistan stood at barely US$262mn in 2002-03, whereas unofficial trade is estimated at no less than US$1.5-2bn. A number of Indian products exported to Pakistan have been subject to not only customs duties but also para-tariff measures that must be reduced to enhance trade in this region.

Although both countries are carrying out reforms of their economic policies, it would serve very little purpose in boosting bilateral trade, as long as restrictive trade policies are pursued. Both India and Pakistan are members of the WTO and while India has accorded Most Favoured Nation (MFN) status to Pakistan, the latter has not reciprocated. Adhering to the principle of bilateralism, India has not brought this up for discussions at the WTO. Thus, the objective of SAFTA would fail, if these two relatively developed trading partners fail to increase their mutual trade.

In the north, Nepal's trade policy has been to diversify trade away from India. The share of India in Nepal's imports as well as India's share in Nepal's exports has declined. In the midst of Nepal's policy of trade deflection, India's own supply constraints compelled it to apply quota restrictions on the export of certain materials.

Sri Lanka has been having a persistent adverse balance of trade with India. Simultaneously, there has been a slow utilisation of the line of credit offered by India to Sri Lanka, due to various factors such as inadequacy of export incentives for Sri Lankan exports under the line of credit. As in the case of other neighbouring countries, a substantial volume of unauthorised trade also affects the Indo-Sri Lankan trade through legal channels. The total volume of unofficial trade between Sri Lanka and India was Rs. 121.2m, in 2000-01. These facts indicate that free trade between the two countries would be mutually beneficial. Concurrently it is of paramount importance that these problems are resolved for the enhancement of economic cooperation.

2.1.6 Barriers to Energy Trade

There are barriers that have resulted in an underdeveloped regional power market. Energy cooperation can be successful in South Asia if all parties adhere to the broad principles of gradualism, equity of benefits, and mutual understanding. Energy cooperation may be achieved through proper management of the following issues:

a. ***Broader perspective while planning***: Synergy among the neighbouring countries needs to be developed to optimally exploit the resources and effective cooperation needs to be formulated among participating countries in the spirit of mutual trust and cooperation.

b. *Tariff issues*: Presently power exchange between India, Bhutan and Nepal is decided at the government level. It is high time to formulate sound, commercially-founded, and commonly agreed principles for determining the rates for different types of exchange including long-term contracts.

c. *Energy database*: There is an urgent need to create a comprehensive energy database to enable the analysis of energy production, consumption, export, import, demand forecasts and elasticity values for the development of a regional energy market.

d. *Economic and financial models*: There is also a need to develop economic and financial models to carry out economic/financial analyses of the cost of power delivered from one country to another, including wheeling charges from intermediary systems.

e. *Commercial issues*: Analysis of ownership and contractual arrangements that allow fair allocation and management of risk need to be conducted.

f. *Legal and regulatory issues*: Analysis of the adequacy of existing legal and regulatory provisions and desirability of amendment of the laws and regulations need to be carried out as well.

g. *Energy standards*: Establishment of uniform energy codes, technical specifications and standards for all the countries in the region to streamline the regional energy trade is yet another crucial factor.

h. *Other issues*:
   - Need to improve arbitration, regional banking (payment securities);
   - Contract enforcement and payment risks;
   - Harmonise subsidy and pricing policies;
   - Harmonise infrastructure access regulation and remove infrastructure bottlenecks;

   - Improve regional pricing, risk sharing;
   - Transparency in the balance of payment;
   - Supply security (due to import/transit dependency).

There is a necessity to launch a programme to create awareness among the political establishments/decision makers and media regarding the benefits of regional cooperation and cross border sale of electricity. Countries in the region need to exhibit a strong will to maintain a spirit of cooperation to fight common problems and exploit the available opportunities. Creating a SAARC power grid that connects the cooperating countries of the region to ensure reliable and economical power supply is an attractive way for future cross-border power trade. A regional coordination committee under the auspices of SAARC could be constituted to take a leading role in developing an action plan for such regional cooperation. Suitable cross border energy projects that can be taken up as pilot projects could also be identified to create a commercially viable environment for power exchange in the region.

2.1.7 Border Crossing and Customs

Border crossing problems arise when customs clearance centres are located far from other border crossing facilities such as customs clearance truck waiting areas, storage depots, rail yards, and loading or unloading areas at ports. The sanitary and phytosanitary testing lab in Kolkata is 1,000 km from the customs facility at Bergen, Nepal. Exporters must wait for weeks for test results and in the process pay additional fees while vehicles are detained (World Bank, 2004). This not only increases costs but also affects the quality of exports.

The preparation of custom documents and custom inspections also create delays at the border. Each country requires different documents such as transit, export, and import declarations. These requirements add up: at the India-Bangladesh border, a consignment needs at least 22 documents, more than 55 signatures, and 116 copies for final approval. Another significant factor driving up costs is that at every border the goods must be transferred among carriers (i.e., cargo must be unloaded from Indian trucks and loaded onto Bangladeshi vehicles). The main reasons for transaction costs in Indo-Nepalese and Indo-Bangladeshi trade are delays caused by complex customs and transit procedures. This has led to informal trade and a consequent loss of revenue for the governments.

The major constraints to crossing borders among the SAARC countries have been aggregated below.

India-Bangladesh

- Although Road, Rail, Water routes available there is no through movement except by waterways.
- Goods by road need trans-shipment at border.
- The Dhaka-Kolkata bus operation, which started its journey in 1999, is doing well. In contrast, the Dhaka-Agartala bus operation, launched in 2002, with only one bus running on alternate days, is clearly a losing concern. The Dhaka-Shiliguri bus operation had started operating in 2005. This route is doing well due to its proximity with Darjeeling, a very well known tourist attraction in the world. The border of Bhutan, Moinaguri is just 15 kilometres from Burimari (Bangladesh border check-post) and Kakorvita in Nepal is just 22 kilometres away from Burimari. Banglabandha is also a very promising land-port for trading between Bangladesh, Nepal and Bhutan.
- Indian wagons pulled by BR Locomotives within Bangladesh. There are no inter-country trains as of the time of writing this book, in addition to the Shahbajpur/Mohishasan rail link with North East India, which has not been in use for years.
- The Sona Masjid check post in Chapainawabgonj is just 5 kilometres away from Maldha of West Bengal where the inter-city train is available to Kolkata. It is widely used by the India-going travellers from the northern part of Bangladesh.
- From Petrapole, the only modes of transport that are available to travellers to Kolkata are taxis, since bus services are not permitted to operate in the route. To make matters worse, facilities and roads on Indian side from Petrapole to Kolkata are inadequate.

India-Bhutan

- Unhindered transit facilities are provided for goods.
- Bhutanese buses are allowed up to certain towns in West Bengal and Assam.
- Private goods vehicles are allowed up to rail heads.
- Bhutanese third country cargo faces problems at Kolkata port.
- Movement of goods in containers are more viable, for which the dry port at Phuentsholing essential, where new truck parking is also required.
- The Road up to Thimpu needs improvement.

India-Nepal

- Indian vehicles are allowed free entry to anywhere in Nepal but are given a limit of 72 hours to return to India.
- Nepalese trucks require permit for every trip to India, which has a validity of 3 months.
- Acknowledging the essentiality of a multi-entry permit, a draft of this policy is already under consideration.
- Nepalese trucks are allowed freely up to rail heads at Rauxal. However, the port at Kolkata is congested, while the port at Mumbai is not an attractive alternative.
- Only third country traffic are allowed through Rauxal, but Nepal also wants to explore options for bilateral trade through this point.

India-Pakistan

- No goods movement are permitted by Road, while only one passenger bus operates per week in either direction since 1999.
- Goods movement by rail is not in use. In addition, Pakistani passenger trains move only up to Attari inside India (opposite Wagah in Pakistan), where passengers are transferred to an Indian train.
- City wise Visa restrictions; Visitors need to report to the police; while there is only a single port of entry/exit. Furthermore,

direct shipping between Karachi and Mumbai is not allowed, unless it touches a third country.

- Moreover, the border crossings lack proper banking and sanitation facilities.

In conclusion, it may be inferred that considerable inefficiencies prevail at the land border crossing between the member countries of SAARC which remain a serious impediment to trade and social intercourse in the region.

Informal Trade

The sizeable informal trade is an important element in the current economic relationships among SAARC countries. Most of this trade involves India, which is the only country having borders with four SAARC countries (except Sri Lanka and Maldives) including long sections with Bangladesh and Nepal, that are porous and difficult to patrol with current arrangement. Although there can be no reliable estimate of the volume of informal trade, primary surveys conducted by economic researchers indicates that the informal trade could be in excess of US$ 3 billion.

The institutional mechanism that operates in informal trade in South Asia is rooted in ethnic cross border relationships, and the rent-seeking practices that mitigate the risks of informal trade and also make the entire process smoother than mainstream trade. Higher investments in enforcement may not be viable, as the opportunities for rent seeking will only increase with increased deployment of border customs and enforcement personnel. The reform of tariffs and simplification of border procedures is the only feasible solution for mainstream border trade in the long run, and this requires institutional reforms and border cooperation among all countries in SAARC. Until then, border trade is unlikely to be eliminated.

Security Issues

The security issues affecting Indo-Bangladesh relations can be characterised as one of lower intensity. The first is completing the demarcation of the land boundary which is currently pending for

only 6 km. Both the countries (India and Bangladesh) share a 4095 km. long border with very few natural markers to delineate the boundaries.

Secondly, the problem of chars (Shoals) thrown up in large rivers and the enclaves are also continuing to impact the security issues. Even today there are 111 Indian enclaves, comprising 10,000 acres, which still remain in Bangladesh, while 51 Bangladesh enclaves, comprising 7,000 acres, are embedded in India. Moreover, Bangladesh has no agreed sea boundary with her neighbours. This has contributed to conflicts with its neighbours on several occasions. The conflicting claims over the ownership of a newly created Shoal in the Bay of Bengal are also continuing to be serious problems. These problems need to be mitigated in phases at the earliest, since conflicts and incidences regarding the use of land in these areas are on the rise.

Thirdly, conflicts about camps of insurgence from North-Eastern India, Tripura and Chittagong Hill Tracts (CHT) areas appear to be exaggerated beyond proportions. It is important to stress here that Bangladesh stands to gain nothing by supporting these camps. Complaints of this nature are required to be properly verified and adequate actions taken accordingly by the Bangladesh authorities. These lower intensity issues need not all be clubbed together but could be taken up sequentially and dealt with seriously.

Legal agreements do exist with regard to the enclaves. If these agreements had been implemented soon after they were entered into, we would not have come to the present impasse. Unfortunately extraneous political factors, like ascertaining the wishes of the people inhabiting the enclaves, have now entered into the picture, making the problem extremely difficult. Hard data were necessary regarding complaints about the existence of camps and shelter to insurgents.

According to a certain analyst, transit issues are also being linked to security matters. It is generally agreed that transit facilities to the Indian North-East through Bangladesh would be economically beneficial to both the countries. But this issue has become heavily politicised in Bangladesh. In Bangladesh a faction argues that transit may be used by India for troop movements to the North-East, thereby jeopardizing Bangladesh's security. Most people, however, feel that these fears are misplaced. In this context, one needs to visualise that Bangladesh is surrounded by India on almost three sides. It needs to get transit facility from India to have overland transport links with neighbouring countries of Nepal, Bhutan as well as Northern part of Myanmar. If India's access to North-East becomes a political issue in Bangladesh, its access to Nepal, Bhutan and Myanmar could also be treated the same way by India.

There are a wide range of experiences available within and outside the region with regard to the resolution of security problems. It would be worthwhile to share some of those experiences and take lessons on resolving specific problems. Governments should consult their own people, in a transparent manner, with full facts and figures surrounding the issues under discussion, and take into account their views in resolving the inter-country problems.

Visa Requirements

With regard to visa requirements for passenger movement between SAARC countries, there has been very little improvement over the years. Citizens of SAARC countries still need visas to visit each other except for travel between India and Nepal, and India and Bhutan. Maldives is the only country in the region which permits SAARC countries to enter without a visa and it extends this facility to all countries. Recently, Sri Lanka has permitted visa free entry to all SAARC countries, a move which has not been reciprocated by its neighbours. However, visa less travel has given a big boost to Indian tourists visiting Sri Lanka. With regard to visa issuance between Pakistan and India, the situation is more complicated. Visas are issued city wise, and visitors are required to report to the police on arrival. Visas are again restricted to a single port of entry and exit.

2.1.8 Political Problems

Political differences have also undermined efforts to foster regional economic cooperation in South Asia. India and Pakistan, the two largest economies of the region, have not been able to realise the full potential of their bilateral trade owing to various political

compulsions.[5] The small South Asian countries have been skeptical towards regional economic cooperation initiatives, fearing that a large trading partner like India will dominate the region economically to the detriment of the former's domestic industries. The political conflicts as well as differences in economic outlooks have hindered intra-regional trade in South Asia. Political distrust, especially between India and Pakistan, has blocked trade in the past and remains a potent deterrent to trade. The political sensitivity of other countries to India's status and power also affects regional economic relations. The prospects of trade cooperation have enhanced with improved Pakistan-India relationships along with the signing of SAFTA. However, how effective SAFTA will ultimately be remains to be seen.

India/Pakistan Relations

Much of the worst impact on the political ratings of the region comes from the tension between India and Pakistan. The central problem is Kashmir, though there are several other matters which India, in particular, would like to see resolved. There are now signs of an improvement in the situation with several rounds of discussion having already been taken place between the two countries.

Though they are yet to produce major breakthroughs, the circumstances surrounding the discussions are promising.

Pakistan argues that if it grants MFN status to India, the latter's goods will flood Pakistan's market. Some fear that Pakistan's exports to India may not grow as fast as India's exports to Pakistan, and this they say, is largely on account of the high MFN tariffs in India. Trade data for the past few years, however, do not support this argument. After relations were normalised, Indian exports to Pakistan increased in both 2002/03 and 2003/04, with the growth rate lower in the second year. India's imports from Pakistan, however, after falling in 2002/03, rose dramatically in 2003/04. Furthermore, these numbers represent just a fraction of the potential trade volumes between the two economies.

5 *SACEPS Task Force Report: A Policy Dialogue on South Asian Cooperation, Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

Pakistan also cites its adverse balance of trade as a reason for refusing India MFN status. Although the import of high value-added goods such as textiles, machinery, engineering goods, pharmaceuticals, iron and steel products, automobiles, and chemicals is likely to increase Pakistan's trade deficit with India, it is less likely to have an impact on the country's overall trade balance, mainly because it already imports these commodities from other countries at higher costs relative to the price of importing it from India. Enhanced trade with India may, therefore, will result only in cost savings for Pakistan. Lower costs for inputs would also increase Pakistan's exports to all countries. India's trading status with Pakistan is a critical issue for SAFTA's operation, and will need to be resolved in a way consistent with WTO requirements.

The movement of goods and people between India and Pakistan by road and rail remains severely restricted. Goods movement by road is not allowed. One passenger bus a week has been travelling across the border in either direction since 1999, with occasional interruptions. Goods movement by rail is not allowed. Pakistani passenger trains are allowed only up to Attari in India opposite to Wagah in Pakistan. Passengers going to Pakistan have to change their trains at that station. Direct shipping between Karachi and Mumbai port for example, is also not allowed, unless the ship touches a third country. All these restrictions apply due to lack of any political understanding, exposing both countries to high transaction costs. The matter does not end there. New Delhi and Teheran are co-operating in the development of a transport corridor from India to Afghanistan and Central Asia through Iranian territory. Since Pakistan has been denying facilities for overland trade between India and Afghanistan, this corridor has become the key to rapid expansion of economic cooperation between New Delhi, Kabul, and Central Asia.

Iran is developing a new port at Chabahar from where a road will skirt the Pakistan border into Afghanistan where it will link up with the garland road system that connects all the major cities in that nation. India will help Afghanistan build the road link from the border with Iran to its internal road system.

The Chabahar corridor will give India the much needed access to Afghanistan and Central Asia, although through a much longer and more expensive route. Had there been a more positive understanding between India and Pakistan, it could have opened up much wider avenues for economic cooperation involving other countries of South Asia as well.

SAARC could not behave as a single entity despite sharing so much commonality in history, culture and heritage and shared goals. We did not have the comprehension that national interest and regional interest did not necessarily collide but could in fact complement each other. India and Pakistan have held on to the belief that neither country has much to gain from the regional forum, leading them to look outward instead of inward. It was our collective misfortune. The smaller partners are helpless in the situation. Undoubtedly, the culture of negative politics between India and Pakistan, have adversely affected the economics of the region. This is hard to believe, still harder to accept. But the silver lining lies in the fact that there has been a change in the outlook, resulting in a willingness of both countries to cooperate in achieving common goals.

Inter-Country Disputes

Inter-country disputes are "low level priorities" but create either a hindrance to ongoing business activities, or prevent new activities from being undertaken. Of these, perhaps the one with most impact is that between India and Bangladesh. The disputes concern trade and border disputes as well as illegal immigration and water rights, where Bangladesh feels its water resources are being unfairly used by India. The consequences of this extend into the trade field, where the impositions of various kinds of duties on Bangladeshi exports to India have aggravated the situation further.

There are also difficulties between India and Nepal. The latter believes that India repeatedly interrupts its transit trade through to Bangladesh, the route which gives Nepal access to the sea. In business terms, these risks do not seem serious for ongoing business, but they may act as a brake on some promising projects, especially those involving infrastructural development.

Due to lack of political understanding with India, Bangladesh is not only losing the chance to earn foreign exchange, but is also paying a price. Although India has allowed a route between Bangladesh and Nepal across the "Chicken Neck" for bilateral trade, yet goods are required to be trans-shipped at the Banglabandha land port. Since this route cannot be used for third country trade of Nepal, its export and import traffic cannot use Bangladesh seaports of Mongla, although it has a direct broad gauge link with Rauxal, the Indian Rail head at the India/Nepal border. Due to congestion at Kolkata port, Nepal expressed an interest in using Bangladesh ports for its third country trade, but India has not agreed to this.

In the absence of a clear political understanding among the countries of SAARC, overland movement of goods and passengers among the member countries has been very limited except between India, Nepal and Bhutan.

Recently the potential impacts of Tipaimukh Dam on Bangladesh have been a much discussed issue. India has assured the Bangladeshi people that not only the proposed dam will cause no harm to Bangladesh; it actually may even benefit Bangladesh. The opponents of dam claim that this is a gross violation of international norms and the existing Ganges Treaty between India and Bangladesh. They also raised concerns about unilateral control of an international river by India, and believe that the dam will reduce the flow in the Surma-Kushiara-Meghna Rivers during dry season and will increase during rainy season. After the dam is built, only India will decide how much water they will release, and when they will release it. Therefore, without having that information about the amount of water to be released at Tipaimukh Dam, no one can predict how the river stage will change in a down stream location in Bangladesh.

Issues like these give rise to distrust and consequently affect the already troubled path towards integration. Unless countries show mutual respect and follow international laws and conducts, this lack of trust will only get more firmly entrenched and make steps more difficult for future reforms.

Internal Strife

Political instability can stem from violent disputes within countries. Four countries have been affected in recent years, namely Sri Lanka, Nepal, Pakistan and India. The long standing tensions within Sri Lanka appear to be in the process of resolution. Although there are still some outstanding matters, business is now on a path of growth, which seems unlikely to be adversely affected by any repetition of the problems which were so damaging in the past two decades.

Sri Lanka's ethnic conflict has almost ended after nearly three decades with the military defeat of the Tamil Tigers in June 2009. Comprising of about 13 percent of Sri Lanka's 19 million population, the Tamils suffered heavily after independence from the British in 1948 under governments dominated by the island's Sinhalese Buddhist majority. In the ensuing decades, however, the LTTE developed into an internationally proscribed terrorist organization known for perfecting the use of suicide bombers. Sri Lanka ramped up military spending, in 2008 alone, increasing the forces by 20 percent to about 190,000 personnel, making it proportionally one of the region's biggest. The Prime minister has focused his entire policy whether diplomatic, economic or political, on getting rid of LTTE. Concordantly, the country has experienced a declining GDP growth.

In the past few years Nepal has presented the most serious problem of internal violence and upheaval. Assassinations within the royal family, the activities of Maoist guerrilla groups, intent on overthrowing the regime, and the suspension of normal government in February 2005, have all exerted a strong negative effect. The impact on ongoing business has been negative, and events may have held up the launching of major infrastructure projects. At the level of individual firms, it certainly has not improved investment conditions.

Though the fall of Ganendro's regime, as well as monarchy, resulted in a democratic Nepal, the conflict between Maoists and Congress continues on the issue of rehabilitation of Maoists guerrilla in the army. Mr. Prachanda sued the chief of army Mr. Katwal which resulted in the fall of Prachanda's regime within one year. The Maoist leader Prachanda, who has just resigned, has accused India of aiding rivals. The Maoist will remain as a force in Nepal in the foreseeable future. As a result Beijing has become a vital factor in India's relations with Nepal, which is in chaos. The sun of fortune is still peeping through the dark sky of Nepal. With the restoration of the democratically elected Parliament it is expected that trade and commerce will get a new life.

Pakistan has had to deal with the restoration of democracy, internal conflicts and sectarian violence. The Sunni-Shia violence peaked following the Afghan *jihad* in the early 1990s; and while conditions have improved ever since, sectarian violence continues to erupt periodically. More recently, the inflexible centrist policies of an army-dominated government have reignited the dormant nationalist movement in Balochistan. The 'Talibanisation' of the Federally Administered Tribal Areas (FATA), a large swathe of the North West Frontier Province (NWFP), also reflects converging resentment against central government neglect and its pro-US stance. The most recent evidence of creeping Talibanisation has been the Jamia Hafsa incident. Vigilantes consisting of armed Islamic militants (male and female) terrorised Islamabad and drew widespread media attention by proclaiming their intention to establish Sharia (religious) law. Their provocations led to a bloody confrontation with the government. While the militants were wiped out in a subsequent army operation, the country braced for a bloody backlash that was not long in coming. Despite tight security precautions the Al-Qaeda/Taliban combination continues to strike at will, at any time and at any place of its own choosing. The Pakistani government announced in late April 2009, that it would fight the Taliban in the Swat Valley. This led to a humanitarian crisis. The United Nations Commissioner for Refugees announced that between 150,000 to 200,000 civilians had fled the war zone. The Pakistani military took back multiple Taliban strongholds, such as Rama Kandhao ridge in Matta and a Taliban headquarters in Loenamal. On the 8th of May, the Pakistani military announced that around 80 Taliban fighters had been killed and two Pakistani soldiers had been injured. Air strikes, artillery bombardment and rocket attacks by helicopter gunships are being undertaken extensively. As of 11th May, the military spokesperson of the ISPR reported that as many as 200 militants had been killed in the fighting with Pakistan Army troops, in addition to the news that Pakistan helibourne commandos had been inserted in the area which is the main stronghold of these militants. By early June 2009, most of Swat

was freed from Taliban and Mingora, the main town of Swat, was in complete government control.

The present position and outlook are not by any means good, but there does appear to be an upward trend. India is also entangled in political problems, mainly regarding their "Seven Sisters Region" that consists of Assam, Tripura, Meghalaya, Mijoram, Arunachal Pradesh, Nagaland and Monipur. People in this region are in constant conflict with the government. The demagogues in these seven states may take their chances in the name of "Equity" to create anti-state activities of "Freeing" these states from India. The endless cycle of violence, political expediency and overall impoverishment of the people are too important a matter not to be given proper attention. If these issues can't be resolved in the near future, it may greatly affect India's trading practices with other countries, thus allowing their competitors, mainly China, to gain a significant advantage in terms of capturing the market share.

2.1.9 Investment Climate

The investment climate in the ASEAN region and in China is far more attractive than that of South Asia. A study conducted by the Bangladesh Enterprise Institute in 2002, which was supported by the World Bank, found that poor infrastructure, electricity problems, corruption, excessive regulations and poor access to finance for Small and Medium Enterprises (SMEs) were important factors that impede economic growth and development in Bangladesh; that the investment climate was also a major factor in influencing FDI flows into the country. The very same problems, in varying degrees, were adversely impacting on the investment climate of all the other countries in South Asia.

2.1.10 Natural Risks

The region is prone to natural disasters, especially floods and droughts. They are generally predictable; affect especially Bangladesh, India to some degree, and from time to time Sri Lanka; often cause severe loss of life and damage to property; yet their impact on the economies of the region is not always too severe.

The nature of these disasters is such that, while predictable, is not easy to take preventive measures against them. Businesses must therefore take their frequency and severity into account, and assess whether the natural risks will have particular effects on their specific operations. Interviews with firms throughout the region indicated that no firm saw these problems as threatening to its activities. Those with substantial experience in the region have taken the necessary actions, usually directed at protecting their power supplies and their logistics chains.

2.1.11 Banking Regulations

Banking regulatory practices differ significantly in the SAARC countries. This is revealed from a study done by the World Bank (2004) on capital adequacy, asset quality, provisioning requirements, liquidity management, and directed lending programme in these countries.

Harmonisation of policies and strengthening of institutional arrangements in such areas as fiscal, monetary, and financial policy transparency; banking regulation and supervision; data dissemination; securities and insurance regulation; accounting, auditing, and bankruptcy; and corporate governance are vital for building a sound financial system.[6] If markets are global, so must be their regulation and the institutions through which that regulation is enforced. Issues of prudential bank supervision and monetary-cum-exchange rate policies are critical not only to the initiating country but also to the rest of the world. Domestic policies cannot be isolated from the global trends and policies, and therefore, it is advantageous for countries to join hands and work together to create a sound and harmonious financial environment.

2.1.12 The Fight for Super Power

No Association of regional cooperation has thrived or for that matter can thrive so long as there is a super power to thwart their programmes. This is what had happened to ASEAN, and the PACIFIC Ring countries, RCD, OIC, African Union, Gulf Cooperation Council so on and so forth. The only organisation, which has been

6 *SACEPS Task Force Report: A Policy Dialogue on South Asian Cooperation, Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

able to withstand the onslaught of the super power to some extent, is the European Union. The real threat to super power is not the smaller states of South East Asia. Their real rival in arms, ammunition, manpower and economy is China, which is an eyesore for the super power. As time goes by, China may rise to match strength with Americans in every field.

The American foreign policy is that they do not come out in open and they always have somebody to do their job. At the moment China is a bane and according to old American practice they don't want to come out in the open, even though they need some power to play their game. So far as China is concerned, at the moment India is that power. They have got their border problem with China; and America is going to be fully behind India, and build it up to a position where it can match strength with China. In order to obtain that position, India will have to have the backing of entire South Asia including Pakistan. And this made Pakistan the hero of SAARC Summit in Islamabad, and Mr. Vajpayee who had declared in India that there is no possibility of any bilateral talks, had to make a courtesy call on President Pervez Musharraf. The joint communiqué of SAARC is more the result of American pressure than the result of the policies of President of Pakistan and the Prime Minister of India.

Pakistan has linked a US report suggesting that it is building a powerful nuclear reactor to its race with neighbour India, saying it was New Delhi, and not Islamabad, that introduced the nuclear weapons state in South Asia. "Satellite photos of Pakistan's Khushab nuclear site show what appears to be a partially completed heavy-water reactor capable of producing enough plutonium for 40 to 50 nuclear weapons a year, a 20-fold increase from Pakistan's current capabilities," the Post said on its website, citing a technical assessment by Washington-based nuclear experts. If verified, the move would signal a potential new escalation in the region's arms race.[7]

It's the problems that are prevailing among the member countries which hinder the progress of SAARC. The influence of the super powers does play a dominant role in SAARC, although they are

7 *The Daily Star*, August 2006.

not directly involved. Accommodating the super powers has to be handled with tact but at the same time it is imperative that the member countries realise the importance of integration for their own benefit. Once integrated, the member countries will be strong enough to resist intimidation of the superpowers on every petty issue.

2.2 COUNTRIES SEEK ECONOMIC BENEFITS ELSEWHERE

Several South Asian countries joined wider regional groupings in Asia such as the Indian Ocean Rim Association for Regional Cooperation (IOR-ARC initiated in 1997) and BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation initiated in 1997). Both these groupings were not preferential trading blocs — IOR-ARC was based on open regionalism where unilateral trade liberalisation was advocated, while BIMSTEC was initially based on sectoral cooperation. Membership in such pan-Asian regional groupings was obtained by some South Asian countries in the hope of gaining more economic benefits, which the SAPTA process had failed to deliver.

Clearly, the SAFTA agreement has come at a time when the trading environment in South Asia is marred by the slow progress of SAPTA and a number of parallel regional and pan-regional initiatives are in place. It would, therefore, be pertinent to examine whether the SAFTA agreement has taken into account the factors governing the slow progress of SAPTA and the complications created by these parallel initiatives.

Whether regional trade is the best available option for South Asia has been a subject of debate since the mid-1990s. Critics of promoting regional trade in South Asia via preferences have argued that South Asia would be better off focusing on trade with the rest of the world, in particular with the EU. A report released by the World Bank (2003) argues: Because many tariffs in the region are very high, especially in India and Bangladesh, there are large potential trade diversion costs for the region as a whole, if the various preferential trade agreements were ever to be seriously implemented. The consequent reductions in economic welfare would be in the form of reduced customs revenue and terms-of-trade losses. It is unlikely that benefits through increased competition, economies of scale, or improved operating efficiency of import competing firms would outweigh these overall economic costs. There are much larger gains for increased trade with the Rest of the World (ROW), especially trade with the developed countries and with more advanced developing countries in South East Asia, including China. This is because the South Asian countries have a comparative advantage in relation to ROW in similar, mostly labour intensive products. Hence, the volume of trade and the economic benefits from trading these products among themselves are limited.

2.2.1 The Sino-Bangla Deal

From the geopolitical point of view, Bangladesh is a strategic stronghold to access the Bay of Bengal. That is why China has always adopted measures to deepen economic and trade cooperation and diversify the areas of interaction with Bangladesh. China has actively initiated measures to reduce the trade gap by importing more from Bangladesh for several consecutive years. Last year, Chinese delegations made US$ 76 million worth of purchase from Bangladesh.

China has already rung its bell of presence in Bangladesh's energy sector particularly in the coal exploration and power production. Most of all, China, which is known to be an energy hungry country, is showing its interest to provide technical cooperation in the nuclear energy field. China has expressed its interest to invest in offshore exploration, particularly in the hydrocarbon exploration in deep water. The government must seriously consider the fact that it must not fall in trouble after signing an investment agreement with any country. The trade diplomacy with China will have to be a successful one, as it was sounded by the energy advisor, but it should protect Bangladesh's interest by all means.

Bangladesh has abundant labour resources and its ever expanding market should attract a large part of Chinese overseas investment. The FDI inflow in Bangladesh is growing day by day from Chinese enterprises. They are prompted to invest in industries where Bangladesh has comparative advantages such as light industry, textile, garments and home appliances in accordance with the rules of market economy, mutual benefit and common not directly involved. Accommodating the super powers has to be handled with tact but at the same time it is imperative that the member countries realise the importance of integration for their own benefit. Once integrated, the member countries will be strong enough to resist intimidation of the superpowers on every petty issue.

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China has competitive advantage in the textile industry and enjoys economies of scale when it produces in bulk. China, with its double digit growth rate, is already having problems meeting the country's needs. Due to this high growth rate, labour is likely to become expensive in the near future. If this happens, China will significantly lose out on its competitiveness and will not be able to hold its position in the market. That is when Bangladesh enters the scene. Bangladesh has an abundance of cheap labour. So the Chinese textiles that were previously manufactured in China could now be manufactured in Bangladesh. Moreover according to the product life cycle theory, a country loses its competitiveness in basic goods as it moves to manufacture higher, more sophisticated products. Since China has moved a long way from producing the basic clothes, Bangladesh could very well try to develop a strategic alliance with China where China will allow Bangladesh to produce the simple basic textile products while China will hold onto the hi-end fashion products manufacturing.

China and Bangladesh signed an agreement on peaceful use of nuclear energy in 2005 which opened the door for conducting nuclear cooperation between the two countries. Under the Asia-Pacific Trade Agreement, China provides zero-tariff facility for 84 commodities of Bangladesh and preferential tariffs for 78 other items. The two sides are now discussing the matter on renewing and enlarging the list of Bangladesh commodities enjoying preferential treatment in the Chinese market.

China agreed to give duty-free access for many Bangladeshi items and assistance from Chinese side for export-capacity building. Earlier, it had granted 83 Bangladeshi products duty-free access to its market as part of measures to reduce a huge trade gap between the two countries. China also agreed to invest in Bangladesh and showed its desire to use natural gas for producing products that would be imported by China.

Defence cooperation is an integral part of Dhaka-Beijing bilateral relationship. Both the sides want to continue the cooperation for the sake of security, peace and stability in both the countries.

Chinese government has been helpful in providing support in building a strong Bangladesh defence force.

China has taken an active role on the proposed Chittagong-Myanmar-Kunming road link project, as it would enhance personnel exchanges and trade among countries in the region. In addition, Bangladesh government has submitted several proposals on railway, road and bridge projects for construction of 130-km rail track connecting Chittagong, Gundum (Myanmar) and Kunming (China) to China, about possible financial and technical assistance from the latter. Moreover China has taken initiatives to assist the education and agriculture sectors in Bangladesh. Considering the Chinese assistance in various sectors alongside the big brother attitude of India; is it not justified for Bangladesh to opt China as a better partner than India?

The last two years have been a difficult time for the Sino-Bangladesh relationship. This problem had arisen as Bangladesh was trying to come closer to Taiwan and score a few economic benefits. However, Bangladesh realised soon enough, that it cannot afford to alienate China at a time when its relationship with its next door neighbour, India has been strained and China also does not want to lose its influence over Bangladesh.

2.2.2 Sri Lanka-China Relations

The President of Sri Lanka, reiterating the country's healthy environment for investments to the Chinese Business community, invited the latter to set up joint venture projects in the country, assuring them of all the support and facilities from the Government. Since Sri Lanka liberalised her economic policies in the 70s', it has followed a consistent, liberal and free market economic policy. Sri Lanka's trade and tariff policy is moving towards an increasingly lower tariff regime. After signing of the China-Sri Lanka agreement, Sri Lanka wants to further strengthen economic relations with China. These include joint ventures, contractual and consultancy services for various mega infrastructure projects including power, transport and communications.

In Sri Lanka, the civil war against LTTE has just ended, with the government crushing the violent insurrection for a separate homeland for the Tamil minority. India had turned a blind-eye to

President Rajapakse's actions, despite the pro-Tamil sentiments in its own state of Tamil Nadu. The new coalition government will now be obliged to seek a role in the resolution of the minority problem. If Colombo is uncooperative, Delhi will perhaps exert a degree of firmness, but not to a degree that will cause Colombo to completely veer towards Beijing.

But many analysts critique, after the fall of LTTE, the real victor in the island's 25-year civil war was China. China had, in the last few years, become a crucial supplier of weaponry and aid to Sri Lanka. More than that, it had helped to deflect international criticism of mass civilian casualties in the war. In return, Beijing had won access to a key Sri Lankan port. Sri Lanka cemented relations with Beijing in 2007 when it awarded Chinese companies the contracts for developing a port in the island's south. Although Beijing says its intentions are peaceful, many believe China intends to eventually to use the port as a naval base to project power into the Indian Ocean and over the nearby shipping lanes, which carry two-thirds of the world's oil trade. Thus China is having a strategic foothold under the nose of the south Asian regional power, India. Military analysts has dubbed this the 'string of pearls' strategy in which China was building a network of Indian Ocean allies, including Sri Lanka, Pakistan and Myanmar.

2.2.3 Bhutan's Relation with China

Chinese development aid has poured into Bhutan, mitigating the latter's heavy economic dependence on India. In light of the fact that Eastern Bhutan is the least developed region of the country, a rise in aid and personnel, has resulted in increased espionage activities. The Chinese aid towards eastern Bhutan consternates India as it borders Arunachal Pradesh state, which is still claimed by China.

If Bhutan ever tries to bypass India in any matter that jeopardises its security sensitivity, India will have the following options to bring the overzealous Druk regime under its grip. Firstly, Bhutanese currency, Ngultrum is pegged at par with Indian rupees. India guarantees Bhutanese Ngultrum. If India withdraws its guarantee, Bhutanese currency will not be worth 1 to 5. It will be a serious blow to the growing economy of Bhutan which can completely bring the Bhutanese economy into shambles. Secondly, India could have Nepal-style trade embargo against Bhutan. While Nepal could survive for a year or so Bhutan cannot survive even for six months. Again, India can influence its traders along the borders to hike the prices of commodities entering into Bhutan. Thirdly, there will be serious impact on food supplies to Bhutan. The Food Corporation of India (FCI) supplies the staple food like rice, flours or sugars at much subsidised rates to Bhutan. If FCI stops food supply, the poor Bhutanese will starve. Fourthly, Bhutan does not pay India in foreign currency—especially for the supply of oil and oil-products. Bhutan may be compelled to pay in foreign currency, which she cannot afford. Fifthly, India funds the entire expenditure of Bhutanese security forces, which is not reflected in the national budget of Bhutan. If India stops that subsidy, Bhutan will have a huge fiscal budget deficit, which its resources could never meet. Sixthly, India might cut back the huge planned budget of Bhutan, thereby seriously affecting the establishment cost of the government and the development projects. Seventhly, Bhutan's third country exports are mainly horticultural products. Concurrently, any bureaucratic delay in the Indian borders might damage them, thus making Bhutanese farmers to incur enormous losses. Eighthly, an irate Indian security apparatus might help the dissidents to create insurgency inside Bhutan to overthrow King Jigme's autocratic rule. Lastly, India could revive the Sikkim episode; though given the above options, it would appear somewhat unrealistic in the present context. Thus, it will be very much in the interest of Bhutan not to over-antagonise India.

2.2.4 Sino Pakistan Relations

China has helped Pakistan with development projects that were intrinsic to Pakistan's progress. China assisted Pakistan with development projects in the fields of communications, nuclear energy, defence production and defence training, health and education. Several projects, including the expansion of the Gwadar dam project and the Chashma-II nuclear power project, were undertaken with China's help.

Pakistan will derive early tariff concessions from China and Malaysia as it conducts free trade negotiations with them. The initial tariff concessions from China would cover almost everything which Pakistan is exporting right now, including textiles, apparel sports goods, surgical instruments and fisheries. For some items, the concessions are immediate and in two years they will come down to zero depending on where the tariffs are right now. Pakistan would also offer import tariff cuts to China on primarily machinery and raw materials as well as fruits and vegetables.

2.2.5 Nepal's Relation with China

Nepal-China relations have always remained positive and cordial. These relations have been marked by friendliness, mutual support and appreciation of each other's aspirations and sensitivities. They are close neighbouring countries linked together by common rivers and mountains. Nepal and China share a long border, spanning a range of about 1414 kilometres. Nepal and China have continued to support each other in many international forums, including the United Nations. Nepal has always been upholding 'One China' principle and is committed not to allow Nepalese territory to be used against China's interests especially by the Tibetans.

Both the countries share common concern about ecology of the Himalayas, glacial lakes and river, which are located between Nepal and China's autonomous region, Tibet. The Himalayas is not only a scenic place to attract tourists; it is also a reservoir of water to provide an unending flow into the rivers. The Himalayas is considered to be the third greatest reservoir of water apart from the snow mass of the North and South poles. In the Himalayans range, China has been providing financial and technical assistance to numerous irrigation and hydro-electric projects, which have greatly contributed to Nepal's development especially in infrastructure building, establishment of industries, human resource development, health, sports, etc.

China has been assisting Nepal in its efforts for socio-economic development since the mid-50s. The first 'Agreement between China and Nepal on Economic Aid' (20 million Indian Rupees in cash and 40 million rupees for aided projects) was signed in October 1956. While Chinese investment in Nepal has been growing, there is still huge potential for further growth. Chinese investors, it was found, are interested in making investment in hotels and restaurants,

electronics, radio paging services, readymade garments (pashmina), nursing home, hydropower, civil construction, etc. The volume of Nepal-China trade is increasing every year. Nepal's trade with China is largely conducted through Tibet and Hong Kong. The volume of Nepal-China trade has been aggregated in Table 2.8.

Table 2.8 Nepal-China Trade (Rs. in thousands)

Fiscal Year	Export	Import
1999/2000	514,276	12,530,062
2000/2001	528,012	11,573,870
2001/2002	1,040,075	8,744,459
2002/2003	1,631,050	9,098,978
2003/2004	2,348,150	9,299,902

Source: FNCCI.

Six points along the Nepal-China border have been opened for overland trade, namely: Kodari-Nyalam; Rasua-Kerung; Yari (Humla)-Purang; Olangchunggola-Riyo; Kimathanka-Riwo; and Nechung (Mustang)-Legze.

Moreover a railway extension is being made to Lahsa. It should be linked to Kathmandu by the next decade. If the railway could be operated with electricity from Nepal, the pollution-free trans-Himalayan railway journey may be a remarkable adventure on the roof of the world. If the Nepalese electricity can be used for heat regulation inside the compartments of the train, an epochal leap can be recorded in the field of electricity generation creating an alternative energy market for Nepal.

2.2.6 Pakistan's Relations with the EU and other Trading Partners

The EU is Pakistan's largest trading partner, accounting for 28% (€ 3 billion) of its exports and around 17% (€ 2 billion) of its imports in 2004. Poverty reduction and eradication as well as linking trade with development through furthering Pakistan's integration in the world economy are key objectives of the 2002-2006 European Commission's Country Strategy Paper for Pakistan. EC and the Government of Pakistan have agreed on two priority areas for cooperation during this period, which together would account for

Thus, in light of global trends, irrespective of the pros and cons according to academic debates, South Asia has been pushed to adopt regional economic integration. In the SAARC, promoting intra-regional trade is part of a larger package of economic cooperation and SAFTA is a part and parcel of South Asian Economic Cooperation.

The movement to SAFTA is taking place in an environment where: (i) the precursor to SAFTA, i.e., the four rounds of SAPTA have failed to show concrete results, (ii) several bilateral FTAs are well entrenched in the South Asian trading system, and (iii) South Asian tariffs are already coming down under World Bank/IMF structural adjustment programmes. The third factor in effect is automatically reducing the preferential margin. Moreover, there are a number of shortcomings; clauses open for interpretation and items for further negotiations in the SAFTA agreement. This shows that most of the research work that was done by the SAARC second-track "think tanks" has not been fed in effectively to the SAARC first-track or the official process.

Given this situation, not much can be expected from SAFTA. The initial euphoria that came with the signing of the SAFTA agreement will soon taper away. The realities and the geo-politics of the region will once again determine the pace of negotiations in SAFTA. By that time, the bilateral FTAs would have delivered most of the results for the smaller South Asian countries and SAFTA will be an agreement mainly to promote India-Pakistan trade. Could it be due to this realisation that the SAFTA agreement did not bother about a vision and ignored a number of worthy suggestions of the GEP Report? A lot of questions remain unanswered. If the SAFTA is not mutually beneficial for all the member countries, not many will be keen on implementing it rigorously. The smaller LDC's are looking towards India to help in their economic development. But it would be only a matter of time when they will concentrate their efforts elsewhere with other regions once they realise that India would not be much of help. Politics of trade will rule over the regional discrepancies. And over time preferences might shift towards those countries which help the smaller countries to develop their economy. In such a case India will not only lose the opportunity to form strategic alliances

with its neighbours but might also be involved in greater conflicts regarding trade with them. Hence the potentials and the vast opportunities of trade and development due to the economic integration and peaceful coexistence by settling disputes will inevitably remain confined to paper.