

Chapter 5

INFLUENCE OF OTHER ECONOMIC POWERS ON SAARC

5.1 THE CHINA THREAT FOR SAARC

The entry of China as an observer country into SAARC has far-reaching foreign policy implications for China and the South Asian region. First, it signifies the success of China's multilateral efforts for greater economic co-operation in the era of rapid globalisation. Second, and more importantly, China has begun to appreciate the political aspects of globalisation and emphasise multilateral co-operative mechanisms. Given the rise of China and its overwhelming presence, it is difficult to ignore its political, economic, or strategic influence. Moreover, it has strong bilateral ties with most SAARC members.

In the near future Japan and China are expected to play a key role in evolving a dynamic, efficient and proactive SAARC. Given the considerable stature of China and Japan, their presence will overshadow all other member states, reducing them to the position of subjects of these big powers. Moreover, Japan and China are geographically too distant to fit into the South Asian definition. Their inclusion might therefore disturb the whole idea of a South Asian organisation. The entry of China into the South Asian club as an observer was clearly a bitter pill for India to swallow. With China sitting in the organisation, India's desired status of a SAARC superpower will effectively stand dissolved.

China has come to the realisation that pursuing equal partnership is the best way for China to gain respect of other Asian nations. China's rise will also impact upon the geopolitical power structure of the world. China has long pursued a policy that opposes

hegemonies and favours a multi-polar world. As the only permanent member of the UN Security Council from Asia, with growing economic capacity and stronger regional and global influence, China, in conjunction with other Asian partners, will certainly be more active on the international political stage to protect Asian interests and to contribute to world peace and justice. A rising China inevitably makes her neighbours psychologically worried while posing a serious challenge to the traditional strategic position of US in Asia. Some Asian nations also fear that China will rise to become an intimidating superpower and a challenging force to the international order.

Learning from Europe, China is trying to improve its relationship with the other two big Asian nations, i.e., Japan and India with more tolerance and magnanimity. Japan is the second largest economic power in the world and the largest regional economic power in Asia with a GDP of 5 trillion USD (five times that of China). In parallel, India is the largest economic power in South Asia and the second largest nation in Asia, with economic growth rates in recent years have been on par with China. China and India include almost half of the world population and have the largest markets in the world.

China's trade with the Asian giant, India, is progressing strongly.¹ The bilateral trade has climbed from virtually nothing, a decade ago, to 10 billion USD today. Compared to trade volumes between China-Japan and China-Korea, the Sino-Indian trade has more room for exploration in the new century since the two nations complement each other in many fields. Both China and India are positive towards the Asian economic unification. Economically, the two fast growing nations largely comprise the "fourth engine" in the world economy. India has become one of China's biggest trade partners in South Asia. Over the past decade, Sino-Indian bilateral trade has soared, accompanying warming political climate. In 2004, the trade volume totalled \$13.6 billion. Till September 2005, India has invested 176 projects in China, with a contracted value of \$339 million and a paid-in capital of \$113 million. China has invested 19 projects in India, worth \$26.33 million. The Sino-

Indian economic and technological contracts have a total worth of \$3.56 billion with a turnover of \$876 million. In April 2005, the two giants signed the five-year plan for the overall economic and trade co-operation between China and India and decided to launch a feasibility study on the free trade area between the two countries. The two governments also expressed the hope to break through \$20 billion in their bilateral trade value by 2008. The co-operation and co-ordination between China and India is vital to the Asian economic unification process. Recent opening of 'Silk-route' between India and China may be regarded as a mile-stone in the history of co-operation between these two Asian giants.

The Sino-Indian collaboration internationally will be geared towards regions and sectors where they are unable to compete individually, and this collaboration does not require any mutual 'political' understanding, except a level of trust required for any business relationship. And, of course, a 'political' collaboration is required to the extent that it facilitates their collaborative business to fructify.

On the surface, relations between India and China are positive. India's economic ties with China are booming. China is set to emerge as India's leading trade partner in the near future, leaving its current number one partner, the United States, behind. Between 2000 and 2005, trade with China registered a hike of 521 percent, whereas India's trade with the US increased by only 63 percent during the same period.

Long-time observers of India-China relations, however, maintain that some improvement in the rhetoric and atmospherics notwithstanding, India-China ties remain fragile and as vulnerable as ever to a sudden deterioration. The combination of internal issues of stability and external overlapping spheres of influence forestall the chances for a genuine Sino-Indian rapprochement.

Though both sides are working to expand and deepen economic co-operation, there is as yet no strategic congruence between the two giants. Indeed, the issues that bind the two countries together are also the issues that divide them and fuel their rivalry because they have different positions in the international system, contrasting strategic cultures, world views, political systems, and competing geostrategic interests.

¹ RIS, 2005.

In the power competition game, China has clearly surged far ahead of India by acquiring potent economic and military capabilities, and the existing asymmetry in power and status serves Beijing's interests; therefore, China has resisted any Indian attempts to narrow the power gap. Unlike China, India's fractious polity continues to limit its economic and military potential. Nor has New Delhi been able to lend a strategic purpose to its foreign and economic policies.

Beneath the surface, frictions and tensions are simmering between the two countries over some fundamental issues: the territorial dispute, the nuclear issue, the UN Security Council reform issue, to name a few. Both remain locked in a classic security dilemma: one country sees its own actions as justifiably self-defensive, but these same actions appear aggressive to the other. In the past year, India has found itself ranged against China at the United Nations, the International Atomic Energy Agency over Iran's nuclear programme, the East Asia Summit and the Nuclear Suppliers Group (NSG) over the issue of India's membership.

Trade surplus is common among the bilateral trade between China and the South Asian countries, except India. In 2003, bilateral trade volume between China and Pakistan was \$2.43 billion, among which China exported \$1.86 billion, and imported \$575 million. Trade volume between China and Maldives reached \$3.35 million, among which China exported \$3.34 million and imported \$10,000. The phenomenon put the interest groups and experts in South Asia on alert. They claimed that China viewed South Asia as the destination of dumping, and called on their governments to take measures to address the issue.

India has taken anti-dumping measures to prevent Chinese products from entering its market, which has greatly hurt the interests and enthusiasm of Chinese manufacturers and business people, and has made smuggled goods from China prevailing in the Indian market.² India's highest tariff has dropped from 400 percent to 50 percent, and the average tariff from 87 percent to 27 percent. However, comparing with the international standard, they are still high, which constitute man-made obstacles against the growing Sino-Indian trade.

² Growing Co-operation between China and South Asia, Zhang Lijun.

Bangladesh is the largest recipient of Chinese arms. The US, China and Pakistan are interested in having their bases in Bangladesh. The biggest threat for India is not from its neighbours, but from the involvement of the western powers in neighbourhood. That is why the Indian leadership did not want to yield even an observer's status to China.

Economic and trade ties between China and Pakistan also developed substantially. In November 2003, China and Pakistan signed the Preferential Trade Agreement. The year 2004 saw the bilateral trade volume totalling \$3 billion, 26 percent more than the previous year. In April 2005, the two states decided to end the feasibility study and start the negotiation on a free trade agreement on January 1, 2006.

Pakistan Prime Minister Shaukat Aziz said Pakistan would try to convince other members to accord China full membership. "If and when the issue of inducting China as a full member comes up in SAARC, Pakistan would strongly support it because it sees the organisation as an inclusive one, which must be strengthened by greater institutionalisation," he said. Pakistan and Nepal have been claiming credit for the inclusion of China as an observer. Sri Lankan President Chandrika Kumaratunga, also came out in support of China's greater involvement in the SAARC process.

New Delhi believes that it is a desire to contain India that brought China and Pakistan together and provides the glue for the decades-long Sino-Pakistan relationship. There are other benefits that China and Pakistan draw from their bilateral bonding. For instance, it was Pakistan that brought China and the United States together in the 1970s, and continues to be a useful link between Beijing and the Islamic countries. However, it is their common hostility to India that is the main factor that fuels their "all-weather friendship."

A strategic partnership between China and Pakistan presents India with pressure on two fronts in the event of Indian military confrontation with either country. India therefore is compelled to spread its forces thin along two fronts. What bothers India about the Sino-Pakistan military and security co-operation is that Pakistan, which on its own would have been a far less potent threat to India, with China's help become a threat.³ What is more, India believes

³ Asia Time Online, 2005.

that the military muscle and shield that China has provided Pakistan has encouraged the latter to indulge in military adventurism against India. In fact, China's significant role and input in Pakistan's nuclear programme prompted former Indian defense minister George Fernandez to describe China as the mother of Pakistan's nuclear bomb.

Trade ties also have been fortified between China and other South Asian countries. Bilateral trade volume between China and Nepal totalled \$127 million. The Tibet Autonomous Region has started border trade with Nepal since 1962. The Ninth Tibet-Nepal trade negotiation was held in Nepal in 2003. The two governments further signed an agreement to strengthen their economic co-operation. China's trade with Bhutan is just fledging. Trade volume totalled \$1.97 million in 2003, \$520,000 in 2004, and \$430,000 during the first nine months of 2005. Trade relations with Maldives have started since 1981, and the direct trade resumed the next year. Bilateral trade volume totalled \$3.35 million in 2003.

Economic development is comparatively slow and the infrastructures are incomplete in SAARC countries. Their governments have attached great importance to the investment on and the development of irrigation, transportation and resource exploitation. South Asia has become a huge market of contracted projects for China. Pakistan has grown into China's biggest market in this field in South Asia. Till the end of mid-2004, Chinese enterprises had signed 383 contracted projects and large-scale export projects on electronics, involving irrigation, power, transportation, ports, petroleum and gas, machinery and exploitation of resources. The contracted value of these projects surpassed \$6.8 billion, with a turnover of \$5.38 billion accomplished. Till the end of 2003, China's co-operation with Sri Lanka and Nepal in the field of labour force exchange is also developing.

Though globalisation has made the territorial factor irrelevant, India should not forget that it can play a leadership role given its sheer size in the middle, bordering on each South Asian country, none of which borders each other. Also, the decision to grant observer status to Japan, along with China, should be taken note of, as it would indirectly counterbalance China's role in SAARC. Instead of considering China as a threat, India needs to accelerate

the region's economic integration. The challenge for India is to steer the region's economic growth and prosperity and thereby keep the mantle of South Asian leadership in its hands. By maintaining strategic alliances with China and balancing its leadership role in SAARC India will have to tread carefully in future.

In South Asia, where India knows that any slackening on its part in any field can give the Chinese a tremendous advantage, and China is aware of the near impossibility of shaking off the Indian hegemonic influence on the region, the collaboration between them acquires a different level of intensity. Both require stabilising local politics and curbing any 'nationalist' hostilities for safe intrusion and spreading. More important in the region is to facilitate market integration and capital flow, for which infrastructure too should be provided for. China and India are aware of the futility of trying to negate each other in the region. Any attempt to shutting off each other is bound to fail and result into greater instability, as both have groomed their political agencies in all the regional societies for many years now.

Add to this Beijing's worldwide campaign against India's (and Japan's) bids for permanent membership in the UN Security Council, the continuing stalemate in the India-China border negotiations, coupled with their ever-expanding economies and widening geopolitical horizons, it is clear that the bilateral relationship between the two rising Asian giants continues to be characterised more by competition and rivalry than by co-operation.

Neither power is comfortable with the rise of the other. Each perceives the other as pursuing regional hegemony and entertaining geographical expansion. Each puts forward its own proposals for multilateral co-operation that exclude the other. Both vie for influence in Central, South and Southeast Asia, and for leadership positions in global and regional organisations.

All the talk of a "new beginning" in Sino-Indian relations notwithstanding, there is little evidence to support the view that China has re-cast its foreign policy to build an accommodative relationship with Asia's other rising power — India. If anything, Beijing has unveiled major strategic moves that will effectively isolate India in South Asia and further squeeze India's traditional strategic space

in the region, keeping New Delhi tied down with multiple sub-continental concerns.

After Pakistan and Myanmar, Beijing is skilfully employing economic and military means to draw Bhutan, Bangladesh, Nepal, the Maldives, and Sri Lanka into China's orbit. The Chinese military's recent incursions and road construction activity in Bhutanese territory are aimed at coercing the tiny Himalayan kingdom to end its protectorate relationship with India and move into China's orbit "if Bhutan desires peace and development with the world's fastest growing superpower."

Taking advantage of a sharp downturn in India's relations with Bangladesh over issues ranging from illegal immigration to Islamist terrorism, transit and trade, Beijing has upgraded its ties with Dhaka to gain naval access to the Chittagong port, to establish a road link with Bangladesh via Myanmar and to acquire Dhaka's immense natural gas reserves. Chinese Premier's recent offer to provide Dhaka with nuclear reactor technology has led to speculation as to whether Beijing would replicate in Bangladesh the sort of military, nuclear and missile collaboration it has with Pakistan. Bangladesh and Nepal are also expected to join Pakistan in concluding peace and friendship treaties with China in the near future.

At the 13th SAARC summit held in Dhaka in November 2005, India's physical presence was overshadowed by China's invisible presence but growing influence. Nothing highlighted this more strikingly than India's volte-face on the issue of China's induction into the grouping as an observer or a dialogue partner. On the first day of the proceedings on November 12, Indian Foreign Secretary Shyam Saran ruled out China's induction unless it signed a memorandum of understanding for being associated with SAARC. However, within less than 24 hours, Indian Prime Minister Manmohan Singh was forced — mainly by the pro-China grouping comprising Nepal, Pakistan and Bangladesh — to come out with a statement welcoming China as an observer. (The only consolation for India was that it managed to extend the same privilege to its friend, Japan).

India's climb-down occurred in the backdrop of the pro-China grouping threatening to veto Afghanistan's entry into SAARC as the grouping's eighth member, which India supported, unless China

was allowed in. The inclusion of China as an observer is seen by most SAARC member-states as a counterbalance to India. Apparently, while India has been preoccupied with fighting cross-border terrorism on its own territory, China has been busy making significant inroads into India's backyard through cross-border economic and strategic penetration of Nepal, Bangladesh, Sri Lanka, and the Maldives.

5.1.1 China's No to US-India Nuclear Deal

India and China have long been suspicious about the other's relationship with the United States, seeing it in zero-sum terms. Seeing the US intent to help India become "a world power" as a way of containing China, Beijing has become alert to India's newfound cosiness with the United States, particularly in the wake of US support for India's civilian nuclear energy development. More importantly, China, much like Pakistan, insists that any changes to US laws and the NSG guidelines to accommodate the deal must not be "India-specific" so that they can benefit other countries (Pakistan) as well.

Furthermore, China is trying to prevent the India-US nuclear deal by presenting itself as the champion of nuclear non-proliferation. With Beijing aggressively and openly joining the voices against the nuclear pact, New Delhi's quest for nuclear technology is turning knottier by the day. From Beijing's perspective, if India and the US start drifting apart over the collapse of the nuclear deal, it will further contribute to China's strategy to isolate and concircle India.

All of these negative developments indicate that India's so-called "healthy competition with China" is becoming one of rivalry. In fact, China's behaviour toward India is not much different from that of the US's behaviour toward China for the simple reason that China is a status-quo power with respect to India while the US is a status-quo power with regards to China. Today, India has co-operative relations with all major powers such as Russia, Japan, European Union and the US. Relations with the US have been growing in the recent past and close ties with the US remains very important to India.

It is obvious that China is proving to be a threat for SAARC. But at the same time its alliances with the member countries cannot be ignored. It has helped member countries of SAARC in their economic development, when India has not taken the initiative. This indebtedness may prove to be quite expensive for India in the long run. China has acted proactively and reached out to the ignored SAARC member countries in spite of being a non member. Obviously it was to its own interests. But at the same time it has also reached out to India and formed strategic alliance with India who is one of its core rivals in the international arena. This proactive approach in developing relations has been to China's advantage.

In the long run, the member countries of SAARC might be looking towards China for their economic development and trade, something they have been doing with India all this while. Hence India will lose not only trade alliances with its neighbours but also political alliance to maintain harmony in the region. This might prove to be fatal for SAARC.

It is high time India recognises this threat and react in a proactive manner. It needs to balance its relations with China, which will help in the eventual economic integration of the region, as well as its relations with the USA. It is this intricate balance which will enable India to advance further as well as keep obstacles to economic integration in SAARC in check.

5.1.2 Using Nepal as the Transit Route to Develop Relations with China

Although both India and China are aware of their rivalry in the international arena, the trade potentials due to their geographical locations cannot be ignored. Political conflicts set aside, if the intentions in trade were pure for mutual benefit, then both the countries can develop a high degree of integration.

According to His Majesty King Gyanendra, "Nepal is ready to act as a transit point between China and India."⁴ The concept of a transit economy has been storming into the minds of policy makers and business community as to how Nepal can harvest the benefit as the transit point between the upcoming economic superpowers

⁴ Keshav Raj Jha, *Transit Economy: An Opportunity to Revive Past Glory*, 2005.

of the world. Nepal is not seen quite clear so far on the question of as to what would be the tangible benefits of transit although both China and India have taken His Majesty's proposition very positively and have also seen taking steps towards it.

It is high time to activate the trade routes to foster the relation between the people of Nepal and People's Republic of China. Since the year 2002, Nepal and China are working to open two of the major routes, Kerrong-Rasuwa, and Hilsa-Burang routes, to reopen the bilateral trade through land, which is indeed a welcoming move. The trade with Tibet Region though small in volume is contributing significantly to the economy of both the countries. Finished and manufactured goods are pronounced in import whereas in export daily necessities and consumer items are in larger portion.

One of the main problems faced by Nepali exporters and importers is the high cost and time taken in the transportation of goods to and from China. Nepali businessmen do not have the complete business information about China to establish working relation with their Chinese counterparts in different cities of China. They have no detailed information on nature of products China presently requires.

There is no doubt both India and China would extend support to build infrastructure in Nepal, if the country could give some vision of its transit economy. Besides it would attract foreign investment and promote tourism and revenue as well. Once strategic rivals, India and China can now be turned into business partners and for them the route through Nepal is shorter and reliable. As a mild gesture, on first week of August 2005, India has agreed to provide over 5 billion rupees for a project targeting to upgrade border check posts along the Nepal-India border within the coming three years. Nepal Government in its budget estimates for the fiscal year 2002/2003 has also announced the construction of seven highways to develop Nepal as a transit point between India and China.

Nepal celebrated the 50th anniversary of its establishment of diplomatic relations with the People's Republic of China with various programmes and events. In the past five decades, Nepal, China and India, all have witnessed unprecedented changes in

the social, economic and political fields. Both China and India have made tremendous growth and from poor and developing economies, both have elevated themselves as potential economic powers in the world. Despite being in the middle of such economies, Nepal's economic situation has not seen much progress.

While providing transit facility to China and India via Nepal, the country should think about establishing benefit mechanism based on equal basis. Nepal should calculate thoroughly the technical, managerial and judicial aspect of the transit point; keeping in mind the pros and cons on the deal. Otherwise Nepal will have to satisfy herself by the nominal toll given by the business groups for using road facility. The time is ripe that through the vision of a transit economy, Nepal could lift her position from that of an unstable economy to a stable one. Nepal wishes to see that upcoming transit routes would serve as a modern 'Silk Route' that will connect China with rest of South Asia through Nepal. It should be structured in such a way that it becomes more capable of coping with the realities of the changed world context at the bilateral, regional and global level.

If trade between China and India does flourish through Nepal, then it's not only the two super powers that benefit. Nepal will be able to reap the benefits too. The hostile relations between the two powers can be subdued through effective trade, which mutually benefits both the regions. Trade can help the countries settle their political disputes if the economic gains are significant. Nepal can act as the mediator to facilitate this trade.

If India initiates this trade then it will not only help in its own development but will also help the SAARC region as a whole. It cannot be ignored that China has already formed close alliances with the smaller SAARC member countries. So keeping good relations with China should be one of the major priorities of India. Otherwise it will lose the control it has had so far in the SAARC when the smaller members unite with the help of China. If China avails the trading opportunity with the smaller SAARC countries, which India has been ignoring so far, then it is only a matter of time when India will lose its hold over the region. So instead of working against China, working with it holds greater potential for India.

5.2 THE USA-INDIA RELATIONSHIP

Long considered a "strategic backwater" from Washington's perspective, South Asia has emerged in the 21st century as increasingly vital to core US foreign policy interests. India, the region's dominant actor with more than one billion citizens, is often characterized as a nascent major power and "natural partner" of the United States, one that many analysts view as a potential counterweight to China's growing clout. Washington and New Delhi have since 2004 been pursuing a "strategic partnership" based on shared values such as democracy, pluralism, and rule of law. Numerous economic, security, and global initiatives, including plans for "full civilian nuclear energy cooperation," are underway. This latter initiative, launched by President Bush in July 2005 and provisionally endorsed by the 109th Congress in 2006 (PL 109-401, the "Hyde Act"), would reverse three decades of US nonproliferation policy. It requires, among other steps, a Joint Resolution of Approval by Congress. Also in 2005, the United States and India signed a ten-year defense framework agreement that calls for expanding bilateral security cooperation. Since 2002, the two countries have engaged in numerous and unprecedented combined military exercises. Major US arms sales to India are planned. The influence of a growing and relatively wealthy Indian-American community of more than two million is reflected in Congress's largest country-specific caucus.

Further US interest in South Asia focuses on ongoing tensions between India and Pakistan rooted in unfinished business from the 1947 Partition, competing claims to the Kashmir region, and, in more recent years, "cross-border terrorism" in both Kashmir and major Indian cities. In the interests of regional stability, the United States strongly encourages an ongoing India-Pakistan peace initiative and remains concerned about the potential for conflict over Kashmiri sovereignty to cause open hostilities between these two nuclear-armed countries. The United States seeks to curtail the proliferation of nuclear weapons and ballistic missiles in South Asia. Both India and Pakistan have resisted external pressure to sign the major nonproliferation treaties. In 1998, the two countries conducted nuclear tests that evoked international condemnation. Proliferation-related restrictions on US aid were triggered, and then later lifted through congressional-executive cooperation from

1998 to 2000. Remaining sanctions on India (and Pakistan) were removed in late 2001.

India is in the midst of major and rapid economic expansion. Many US business interests view India as a lucrative market and candidate for foreign investment. The United States supports India's efforts to transform its once quasi-socialist economy through fiscal reform and market opening. Since 1991, India has taken major steps in this direction and coalition governments have kept the country on a general path of reform, yet there is US concern that such movement is slow and inconsistent. India is the world's fourth-largest emitter of greenhouse gases. Congress also continues to have concerns about abuses of human rights, including caste- and gender-based discrimination, and religious freedoms in India. Moreover, the spread of HIV/AIDS in India has been identified as a serious issue. (CRS Report RL34161, India-US Economic and Trade Relations)

5.2.1 Trade

Though, the trade between the United States and India is relatively small, it has risen sharply over the years. In terms of India's major trading partner, USA continues to lead. However, India's share in US trade is 24th in US export and eighteenth in US imports. The two countries have been making efforts to strengthen institutional structure of bilateral economic relations. The signing of "India-US Economic Dialogue" in 2003, aimed at deepening the Indo-American partnership through regular dialogue and engagement.

India's sizeable population and growing middle and higher income class makes India a potentially large market for US goods and services. According to the figure from government sources, US exports to and imports from India in 2003, totalled US\$5.0 billion and US\$13.1 billion, respectively. United States is India's second largest source of FDI (after Mauritius), accounting for 16% of total FDI flows to India from 1991 through July 2001. USA has 17.08% share in FDI inflows to India while Mauritius is at top with 34.49% and Japan comes 3rd with 7.33% share.

On investment front, USA covers almost every sector in India, which is open for private participants. Both government-to-government level and business-to-business level conduct regular

interactions with each other to promote and strengthen the trade and economic interactions between the two countries. The US investor community is today increasingly sharing confidence in the future of the Indian economy. Several areas like infrastructure, IT, Telecom sector, energy and other knowledge industries such as pharmaceuticals and biotechnology possess immense potential for progressing economic co-operation between India and the US.

Among the major multi-national corporations of USA that are doing a profitable business in India are — General Electric, Whirlpool Ford (India), 3M, Tecumseh Products (India) Limited, Pepsi, Proctor and Gamble (India), Microsoft, Intel, IBM Corporation, EDS, Sun Microsystems, Adobe Systems Inc, Agilent Technologies Inc, Oracle Corporation, Texas Instruments etc. American Express, Citicorp, Microsoft, Dell, Hewlett-Packard, HSBC, Standard Chartered and Convergys etc are taking advantage of the opportunities offered by India's IT Sector. Other Fortune 500 companies such as Morgan Stanley, AT&T, Reebok, GM, Fujitsu, Boeing, Pepsi, Swissair, Coca-Cola and British Airways have identified India as their outsourcing partner. FDI in banking is permitted up to 49%. US success stories in this sector include Citicorp, GE Capital, and American Express. The insurance sector in India is opened up for up to 26% FDI. However, there are proposals to hike this limit to 49%. US companies that have successfully entered this field in India include New York Life, AIG and Chubb.

The United States-India summit on July 18, 2005 between President Bush and Prime Minister Manmohan Singh reaffirmed the following:⁵

- United States and India's commitment of November 2001 to establish a United States-India strategic partnership, as agreed by President Bush and Prime Minister Vajpayee.
- United States commitments made in March 2005 on behalf of President Bush, that it is the policy of the United States to forge a "decisively broader strategic partnership" and to "assist India to become a major world power in the 21st century."
- The United States has made a conscious choice to assist Indians to rise to global power status by a comprehensive

⁵ United States-India Summit, Dr. Subhash Kapila, Paper no. 1477, 27th July 2005.

package of fast-track co-operation in political, economic and military fields. Significantly, it also expands to the civilian nuclear energy field. That the United States was serious about its choice and its implication, US Secretary of State, emphasised in May 2005 that: "And we used the words that we are fully willing and ready to assist in the growth of India's global power and the implications of that, which we see as largely positive."

Added to the above was the rapidly changing international security environment. With US-China entering a new Cold War phase, the United States to stay embedded in Asia, recognised afresh that a United States-India strategic partnership was inevitable.

Another important aspect of India-US economic relations is the huge number of people of Indian origin residing in the US. These people according to some surveys conducted in the US, contribute a lot to US economy and are among the most highly educated class in America. Relaxations in Visa norms by the US administration are considered as a vital step to boost the existing relations between the two countries.

India's Telecommunication sector, already a major recipient of US investment, is expected to continue to provide substantial opportunities to US investors. The proportion of households moving towards richer and well to do category is going up in India. There also exist huge untapped rural potential. India's energy sector has been an important destination for US investment. Since, the entry of private sector participation in generation, distribution and transmission in power sector further liberalised. Considering the vast present and projected demand supply gap, there is tremendous potential for economic co-operation between the two countries in this area. Pharmaceuticals, biotechnology and chemical industries also provide great opportunities for closer co-operation.

Recently, the US India Business Council (USIBC), along with FICCI, has launched a Knowledge Trade Initiative (KTI). KTI aims to strengthen Indo-US leadership in the knowledge economy by harmonising bilateral positions on key issues affecting knowledge trade. This is expected to provide a fillip to Indo-US relation further. Thus, given the comparative advantages of the two countries,

there is a tremendous scope for further strengthening the business ties between the two countries in this sphere.

Gains made by the United States and India in terms of their national security interests as they move forward to a meaningful strategic partnership after the USA-India summit of 2005 are:

- United States' overall gains can be summarised as under:
 - United States gains the partnership of India as a regional power and an emerging key global player.
 - United States can expect to remain more firmly embedded in Asia in the 21st century, with India as a strategic partner.
 - United States could outsource to India, regional security in South Asia, South East Asia and the Indian Ocean Region. This would enable USA to concentrate on strategic challenges it faces in East Asia and the Greater Middle East.
 - United States gains a credible partner (in the form of a major power) to deal with global war on terrorism and WMD proliferation.
 - United States gets a foothold in the \$100 billion Indian arms market.
 - United States obtains a more strategic economic partner in terms of FDI and consumer markets and a partner unlikely to be involved in a Cold War with USA.
 - In the overall global balance of power strategic calculus, the scales dip in favour of the United States with India as a partner (not to be confused with a defence alliance ally).
 - In United States strategic calculus, it gains a dynamic, positive-oriented major power which is neither likely to be a strategic threat or a strategic irritant to USA.
- India's gains from the parameters of strategic co-operation spelt out in the Joint Agreement are far more substantive in real terms. These can be assessed as under:
 - United States-India comprehensive strategic partnership as envisaged implies a partnership between the world's only super-power and Asia's second most powerful nation.

Such a combination could redefine both Asian security and global security. India politically and strategically emerges as a far more decisive player in international affairs.

- India can expect to gain access to high technology expertise (including dual use technologies) both for its civilian uses and defense purposes. India can hope for substantial FDI from the United States and economic assistance for its infrastructure projects. International financial institutions like the World Bank and the IMF under United States control would be more forthcoming with a US-India strategic partnership.
- On the question of whether the United States can deliver on the promises made, some Indian criticisms and reservations seem justified in the light of past US record in policy tilts towards Pakistan on grounds of political expediency. However, in relation to rapidly changing global strategic realities and recognition by both USA and India that a strategic partnership can best secure their respective national security interests, the following can be said in favour of USA making good on its promises. President Bush has made a personal commitment to assisting the rise of India as a world power.
- President Bush could translate his commitments into concrete achievements because of two reasons:
 1. US Senate and Congress which have to legislate changes to US laws to facilitate US commitments to India, are both dominated by Republicans with a majority.
 2. President Bush has still time in the office to push through the changes.

Unlike in the past, major sections of the US State Department and Pentagon now support a comprehensive strategic partnership with India. All prominent think-tanks in USA and who considerably influence formulation of US policies support the new policy initiatives towards India. In view of the above, the chances today are that the United States can deliver on the commitments of July 18, 2005.

5.2.1 US-India Nuclear Energy Co-operation

The US Congress on October 1, 2008, gave final approval to an agreement facilitating nuclear cooperation between the United States and India. The deal is seen as a watershed in US-India relations and introduces a new aspect to international non-proliferation efforts. First introduced in the joint statement released by President Bush and Indian Prime Minister Manmohan Singh on July 18, 2005, the deal lifts a three-decade US moratorium on nuclear trade with India. It provides US assistance to India's civilian nuclear energy program, and expands US-India cooperation in energy and satellite technology. Furthermore it will strengthen Indo-US bilateral ties and emerge India as a "responsible nuclear power" with advanced nuclear technology. But critics in the United States say the deal fundamentally reverses half a century of US non-proliferation efforts, undermines attempts to prevent states like Iran and North Korea from acquiring nuclear weapons, and potentially contributes to a nuclear arms race in Asia.

As far as the deal is concerned, India seeks to maintain "strategic equipoise" in the region. India does not intend to be a junior partner to Washington. China views the nuclear energy co-operation agreement between India and China as a mere political move on the part of US to contain China by strengthening India politically and economically. It is interpreted as Washington's efforts to offset the regional balance in the Indian sub-continent. Their stand is that it encourages other powers to provide nuclear energy supplies to states of their interests. It thwarts the emergence of a pan-Asian security arrangement excluding the US. It is seen as a hard blow to the non-proliferation regime.

India has made it clear that it does not wish to engage in any US-sponsored containment policy of China. It has assured that there is no intention to engage in nuclear technology (weapons) competition with China. India looks forward to enhancing mutual confidence with China to dispel its doubts over the deal. India cannot afford to act in ways uncomfortable to China and keep the USA happy. Being an Asian country India can form successful strategic relations with China and its neighbours. This will benefit India in the long run due to its geographic location. But at the same time its relations with USA cannot be ignored. USA is helping

India for its own benefit. And India is gaining in the process. But maintaining this delicate balance in the relationships is crucial to India. It has to be careful and avoid complete exploitation by the USA and as well as maintain good relations with its neighbours for future economic development. Its priorities have to be carefully sorted and developed on to ensure its diplomatic position.

5.2.2 USA Using India as a Pawn to Retain Power in Asia

The period of honeymoon between USA and Pakistan, which began from the time of Eisenhower administration of the United States in 1957 appears to be over in view of the emerging situation in Asia with the rise of China and India as global powers. This trend has been reflected during the visit of President Bush to India and Pakistan in the first week of March 2006. This is for the first time a Republican administration in Washington has made almost a U-turn from Pakistan. History shows that the Republican Party in the United States somehow or other has favoured Pakistan since Pakistan and India became two states after the partition of British India in 1947. All these years as a matter of fact India either remained non-aligned or tilted towards the Soviet Union. With the end of cold war era, China is growing economically and militarily while the Soviet Union crumbled in 1991 and the United States emerged as the only superpower in the world.

Dramatic shift of policy was noted after change of administration in the United States in 1961. Secret commitment was made by the United States in 1962 to come to Pakistan's protection against Indian aggression. Apart from verbal assurances from the United States for protection, military hardware was supplied to both Pakistan and India. During the period of Nixon administration, Henry Kissinger, National Security Adviser to President Nixon, played ping-pong diplomacy to establish relations with China. Offering corridor to Nixon administration to reach out to China, Pakistan enjoyed unequivocal support, both financial and military, from Nixon administration. During the Bangladesh liberation war, Nixon administration sided with Pakistan.

President Musharraf has been enjoying US favour since September 11, 2001 when he joined President Bush's war on terror

project.⁶ The Bush administration gave salami for that in the form of writing off Pakistani debt. Bush administration made promise in 2005 for 3 billion in aid over five years and selling another \$1.00 billion worth of weapons, apart from committing to sale dozens of high performance F-16 war planes. President Bush's war on terror drew Pakistan into much more active role in 2001 which gave it a new status as most active non-NATO member.

The signing of document on sharing nuclear technology with India has caused concerns to US hard core ally Pakistan. The US President did not comply with Pakistan's request for signing such agreement. Pakistan's track record of exporting nuclear weapons technology to the declared rouge states by its scientist did not qualify it for such demand. Therefore, it appears that Pakistan's relations with the United States are not static. May be Pakistan is used as pawn on the chess board.

There is no doubt that balance of power in South Asia will favour India. This represents a major shift in decade long policy for the United States, which had criticised India after its debut in nuclear arena in 1974 when she conducted first nuclear test and imposed sanctions in 1998 following more tests. Now under the agreement, India would receive nuclear technologies including uranium, fuel while India would separate its civilian and military nuclear programmes and place it under international inspections. The fact remains that India did not sign nuclear non-proliferation treaty as yet despite pressure.

Foreign ministers of South Asian countries agreed in principle to grant South Asian Association for Regional Co-operation (SAARC) observer status to USA, South Korea and the European Union as well. This recent development brings the position of the observers' into a whole new perspective. The interest of the western world in a region which has been slow to see significant changes since the inception of the trading bloc three decades ago is highly implausible. The political motives and economic interests behind such endeavour can be attributed to the belief that the region holds immense potential, maybe even more than the inhabitants and the policy makers envisage.

⁶ *The Daily Star*, August 2006.

India fully realises that it cannot achieve its due role in the region and globally without American participation. Only American power can restrain Pakistan's adventurism and contain China's increasing influence in the region. The former Prime Minister of India, Inder Kumar Gujral, put it that normal relations with America are regarded as a momentous breakthrough.

India has been able to come out of the straightjacket of the Cold War and has been taking a long-term view of its national interests. It was the former Prime Minister Narasimha Rao in tandem with Manmohan Singh in 1991 who had launched economic reforms that provided impeccable cover for closer political and military ties. Economic reforms have a two-fold impact: First, it can provide India to pursue an ambitious foreign policy and secondly, it makes engagement attractive to US businessmen who powerfully shape foreign policy.

Times have changed so much that Manmohan's ministers are eager for the courtesies shown to them in Washington. The senior members of the Bush administration spend so much time with their counter-parts from India that was not seen earlier. India seems to have abandoned its avowed policy of non-alignment to placate American wishes, such as vote against Iran on nuclear programme at the IAEA Governing Body meeting in Vienna.

India's military nuclear programme was based on the belief only when the button is in its own hands and not someone else's finger on the button. The Vajpayee government accelerated and resumed vigorously the nuclear military programme and conducted nuclear tests in 1998. One of the Vajpayee's Ministers, Ram Jethmalani, who wrote to Vajpayee before President Clinton's visit in 2000 to suggest a mutual defence treaty. Substantial advantages, he argued, would flow to India if it was a part of what he called the Washington-London-Jerusalem-Tokyo axis.

Unprecedented in American politics, India was able to conclude a nuclear deal with America for nuclear fuel and technology that would provide an edge over China and Pakistan in the area. India's leaders have been able to impress the Bush administration that Indian democracy and tolerance could have a moderating influence on the Muslim World.

On the American side, oil is their civilisation as James Baker III, former Secretary of State said. Its domestic sources produce only 2 per cent of the oil and 3 per cent of the gas that America devours. It must import oil for its economic and military power.

Saudi Arabia accounts for its 25 per cent of American requirement. It is no wonder that it is haunted by the nightmare of the volatile Middle East oil supplies. Iraq and the looming confrontation between the US and Iran on nuclear programme add to its concern. The US must look out for other areas for oil. Africa has become one of the regions for oil besides the Central Asia.

An American analyst said: "Who controls the Rimland rules Eurasia and who rules Eurasia controls the destinies of the world." India, Pakistan and Afghanistan constitute the Rimland and the "Great Game" in the region, in the eyes of Kipling, is now for a bigger prize, the reserves of oil in the Caspian Sea. The hydrocarbon reserves in the Caspian Sea are larger than the combined reserves of Alaska's Northern Slope and the North Sea. The US Heritage Foundation estimates reserves of 25 billion barrels in the Caspian basin alone. According to Unocal's Vice President, it is estimated that the Central Asia has over 236 trillion cubic feet of proven natural gas reserves and over 200 billion barrels of crude oil. The Caspian Sea oil can be piped through the Rimland to the Arabian Sea. The US has been successful in getting oil from the Caspian Sea bypassing Russia and Iran through Azerbaijan, Georgia to Turkish port of Ceyhan in the Mediterranean Sea.

There is another strategic reason for the superpower to be friendly with India. As Japan and Europe grow weaker and China stronger, the Bush administration has seen India as a counterweight to China. The US needs to contain China, its strategic competitor, in the Asia Pacific region and there is no country other than India that can do it.

America also sees a great market in India. In a speech prior to his visit to India this year, The US President said: "India's middle class is now estimated at 300 million people. Think about that. It is greater than the entire population of the United States. India's middle class is buying air-conditioners, kitchen appliances, and washing machines, and a lot of them from American companies such as GE and Whirlpool."

Bilateral ties are important for the US as for India. India however does not want others to see the relations with the US as sacrificing its policies. Rather it considers the relationship with the US as a partnership to achieve its dominant role in the region and globally. SAARC in fact remained hostage to the continuing hostilities between India and Pakistan, the two major actors of the region. And this aggression has been further fuelled by the involvement of the USA. Rest of the SAARC region has been suffering due to these hostilities.

Indeed, SAARC and SAFTA continue to be a hostage to the political differences that exists among its member states. Under these circumstances, what makes membership of SAARC an attractive proposition for extra-regional powers? For instance, since the organisation does not offer an economic incentive that could not be pursued bilaterally, why this newfound attraction? While discussing various aspect of this issue Dr. Sreeradha Datta in his recently published article titled "SAARC: A Potential Playground for Power Politics" has rightly pointed out that the incentives are not necessarily economic; the rationale for the rush appears to be the political calculations of major powers.⁷ By being a part of the organisation, they seek to consolidate their overall influence in South Asia. It would also enable them to evolve a regional policy that transcends their traditional Indo-Pakistan dominated South Asian policy. In some cases, it also facilitates an activist policy toward the smaller States of the region. Since geography precluded a full membership of SAARC, these extra-regional powers have opted for the "observer" route.

Japan, a major donor to SAARC, was the first outside power to express interest in membership. Its rival China, a major trading partner of SAARC countries, followed this. Its close ties with Pakistan and Bangladesh provided a political twist to its interest. This in turn caused some concern in India, which feared that observer status might consolidate Chinese presence and influence in South Asia. The discussion on Chinese entry into SAARC came when India was keen to admit Afghanistan as a full member. However, given the official policy of maintaining close political

⁷ *The Pakistan Observer*, 2008.

and economic ties with its northern neighbour, India could not be seen to be opposing Beijing's entry. The initial dilemma in New Delhi over defining "observer" status was quickly removed when the US also envisaged similar interest in SAARC and was followed by South Korea and the EU. The idea of Iran's participation in SAARC as a full member in future is also there. It would not be surprising if Moscow also expressed its interest in the future. In short, SAARC has emerged as the new level playing field for all major powers in Asia and beyond.

The leaders of China and USA have assured to play a positive role in the development and stability of the region. It would be appropriate for SAARC to adopt a universal norm for observers by specifying a limited political role for them. The observers on the other hand can contribute economically to strengthen the organisation. In this way the inclusion of observers will energise SAARC toward greater economic co-operation and positive dynamism within the member States and with the outside world.

It could also be used to minimise political differences that often cloud its economic co-operation and progress. While all of these extra-regional players are economic powers, their political calculations are different and often in competition. While all of them maintain close economic ties with India, some of them maintain political soft corners for States that at times have adversarial relations with New Delhi. The presence of such States can make SAARC a potential playground for power politics. In short, while expansion might contribute to the economic growth among member States and the organisation, it also entails a new great power rivalry in South Asia. In other words the arguments for and against expansion can be convincingly made. The expansion would inject new blood and may accelerate the pace of SAARC's collective approach towards regional development. But it can also bring new groupings and make it even more difficult to arrive at a consensus on various issues.

Possibly the strategic alliance between the USA and India was formed to contain China's influence in the region and beyond. The lure was too big a bait for India to ignore. As India strengthens its relations with the USA, the USA's involvement in the SAARC region will continue to be reinforced. The USA has already been

given observer status in the SAARC. This in itself is a threat for SAARC as a time will come when India might be forced to comply with the whims of USA and be used as a pawn to see that USA's interests are served within SAARC.

5.3 JAPAN'S INTEREST IN SAARC

Until 2003, Japan had always been China's biggest trade partner.⁸ However, during the first three quarters of 2004, China-Japan trade dropped to No. 3. Between 1999 and 2003, Japan's reliance on China increased but not vice-versa, as China's trade with other countries rose at a faster pace. Does the resurgence of anti-Japanese sentiments in China bode well for India? The possibility of Japanese investments drifting into India is not unlikely. In this context, it is pertinent to look at how the Japan-China economic relation deepened, notwithstanding the historical scar.

India and China are the two pillars of the Asian economies. With high GDP growth and buoyant domestic sales, thanks to booming private consumption, they hold immense growth potential, unlike the West, which is under a prolonged spell of recession. Against the background of escalating Sino-Japanese tension, can India garner a higher share of Japanese investments? With the US pressuring China to revalue the yuan, the country's status as a low-cost economy may take a hit.

India has huge domestic demand and this is only likely to rise with GDP on a high growth trajectory. Interestingly, much of the country's growth has of late come from non-agricultural activities. These factors insulate investors from long-term recession or any unforeseen economic adversity. India outpaces China in offering a bigger market to the Japanese investors by virtue of intra-regional trade through SAARC. The SAARC, offers a trade opportunity of \$14 billion annually. In addition, a number of Free Trade Agreements (FTAs) are in the pipeline. India also has an edge over China in the supply of skilled manpower, both technical and managerial. Though China is the world's biggest workshop, over the decades, its development has been marred to an extent by a dearth of talent. But the most important area where India outscores China is on

the political front. Japan has hardly faced political hurdles or anti-Japanese sentiments in India. Japan's timely help during the drought of the 1980s and with the Delhi metro are but few instances of Indo-Japanese co-operation.

Japan's main claim for "observer status" is due to its role as the biggest provider of development aid to the region. Senior Chinese officials have expressed their happiness at being accorded "observer status" but would not be too happy to be once again bracketed with Japan. In recent years, relations between the two countries have been deteriorating. Japan is one of the United States closest allies in the region. India's obvious attempt is to balance China's entry with the inclusion of Japan. Some commentators in India have chosen to portray China's inclusion as a setback to Indian diplomacy. The fear in New Delhi is that the smaller neighbours will gang up against the "big brother," with encouragement from China. Indian officials point out that Pakistan and China are after all "all weather friends."

India's "big brother" attitude will cost a lot in the long run as it is still trying to retain and defend its position in the SAARC. Although the smaller nations have been compromising with India's attitude for all these years it is only a matter of time when these nations will give up on India and look for help elsewhere for their economic development. They have always looked up to India and if integration does take place successfully, then the political barriers can be overcome by the economic benefits. This will result in each of the countries maintaining closer and better relations with each other and putting greater effort to settle their disputes. The SAARC region holds a lot of potential for foreign investors. There is abundance of unexploited resources which are being left by themselves due to lack of investments and expertise. India is fearful of Chinese exploitation of the SAARC market. But it is quite comfortable with the Japanese entering the scene. Japan's interest in SAARC is not only because of the huge market the region has but also the abundant resources as well as the LDC facilities some of the countries in the region holds in the foreign markets.

SAARC-Japan Special Fund has been established, under which the Government of Japan has agreed to finance activities/pro-

⁸ *Business Line*, internet edition, 2005.

grammes relating to SAARC region. Letters were exchanged between the Secretary-General and the Japanese Ambassador confirming the acceptance of the Memorandum on the Guidelines for the Fund long time back. The Fund established entirely with contribution of the Government of Japan consists of two components. The allocation under Component-I is to be used to finance selected programmes/activities identified and managed by the member states. Component-II would be for the programmes/activities identified and managed by the Government of Japan.

To date, more than 2,000 Bangladeshi nationals have studied in Japan under the Japanese government-sponsored scholarship scheme. Young Bangladeshi people having come to Japan have exceeded 5,000 through training provided by the Japan International Co-operation Agency (JICA) and others. Each year, more than 400 young people from Bangladesh are engaged in study and training in Japan. In co-operation with the Government of Bangladesh and other donor countries and organisations, the Government of Japan intends to assist Bangladesh in improving governance which, the Government of Bangladesh is currently undertaking, including assistance for its efforts to improve the capacity of law enforcement agencies, improve civil servants' training programmes, raising resident participation in local government and enhancing transparency, as well as in capacity building efforts in implementation skills in major sectors.

At the Bangladesh Business Seminar held in Japan there was vigorous discussion concerning the enhancement of trade and investment between Japan and Bangladesh. In addition, the Japan International Training Co-operation Organisation (JITCO) and the Government of Bangladesh concluded an agreement that will enable the people of Bangladesh to acquire training and technical expertise at private companies in Japan. It may be possible to consider developments such as these as an indicator of increased momentum for investment in Bangladesh.

In the Country Assistance Programme for Bangladesh that is scheduled to be revised in the near future, Japan intends to prioritise development of the private sector, together with transportation and power. As such, Japan intends to continue to provide assistance for improving the trade and investment environment, basic

infrastructure development support as a means of invigorating investment and exports, as well as human resources development assistance to private sector companies.

Japan has long recognised the importance of SAARC as an organisation that can provide a framework for stability and development in the South Asian region. Based on this recognition, Japan has supported the activities of SAARC and worked to enhance its foundations through the Japan-SAARC Special Fund since 1993. This was the first and the only financial assistance from a country outside the SAARC region.

Japan intends to continue to make efforts to further strengthen relations with SAARC, in close co-operation with all member countries, including Bangladesh, the chair country. One idea is to strengthen functional co-operation, utilising the Japan-SAARC Special Fund, in a form whereby it is possible to share Japan's knowledge and expertise in issues that are of particular interest in this region, such as the fight against terrorism and disaster prevention.

Although India is looking to the west, and ignoring the potentials the region holds, it is not completely unaware of the potentials. Since Japan has interests in the region and good relations with the SAARC members, India will try to influence Japan's entry as much as possible.

5.4 BALANCING THE ECONOMIC POWERS

The South Asian region is endowed with many natural resources and has acquired many advantages in terms of production and trade. Being culturally rich with a diversity of subcultures, the region once was united under one banner. However, over the years, due to the exploitation by the super powers political differences emerged. This led to differences in sentiments along with rise in sensitivity. Hence, the vast potentials in trade and development that could have been a reality remained constrained to studies.

The interference of the superpowers cannot be ignored, as the region still holds the fascination of the foreigners. The high growth of the region and the geographic location makes the foreign powers seek strategic alliances. The future market as well as production

hub will be this South Asian region. Hence, it is inevitable that the foreign powers will hold high interest in the region and will continue to influence its politics for their own self-interests.

SAARC is ravaged by the political differences, which proves to be a major obstacle of integration. It is amazing how such a culturally integrated region is torn apart just by some policy makers who allow their political sentiments to rule over the decisions of economic development. On the other hand, ASEAN, which started with zero integration, is the most successful trading bloc in Asia. The superior and suspicious attitude shared by some of the member countries of SAARC has led to the tremendous trade potentials of the region remaining unexploited. However, each of the individual members is not powerful enough to resist foreign exploitation and balance the politics of trade. Thus, integration is an absolute necessity if foreign interference is to be resisted for the benefit of the region as a whole. Integration will also lead to greater bargaining power in the international arena and the smaller countries will have a voice to cry out their priorities. Together the member countries can help in their mutual economic development.

It is high time the member countries of the SAARC sit together to sort out their priorities. If they continue to allow their political sentiments to work against their own development then it would be a sad case. The politics of the region is negative in nature, creating high obstacles for smooth long lasting relations. Left unsorted it will only aggravate the worsening situation. Already some of the LDC's of the region are looking elsewhere for economic gains. But if the gains in the intra regional trade can be exploited, SAARC will come out to be a successful trading bloc with its own policies which outsiders would not be able to manipulate easily.

USA holds high degree of interest in the SAARC, especially India. It is in a way helping India to build up its power base to compete with China. Since India is looking towards the west for its economic development, it is slowly becoming indebted to the USA. This might prove to be a difficult situation in the future if India wants to tie good relations with China (which has already started with the opening of the Silk route).⁹ China on the other

hand holds high interest in the SAARC region and has slowly over the years built good relations with the smaller SAARC members. If China steps into the much ignored shoes of India and keeps up the pace of the help it is providing to the LDC's of SAARC for their economic development, then it would be only a matter of time when Chinese goods will flood the SAARC and India will be left to stare at their fiasco.

Japan has good relations with almost all the SAARC member countries. If India can influence the entry of China and Japan into SAARC, then the region will see a lot of development work. For this India will have to balance its relations with China in a manner which does not offend the USA too much. Manipulating the strategic relations is something India needs to do immediately and sort its priorities.

Since foreign intervention cannot be ignored, the member countries will have to accommodate their foreign relations and at the same time ensure that the interests of the region are not compromised with.

5.4.1 Emergence of BRIC

BRIC stands for the fast-growing developing economies of Brazil, Russia, India, and China. The acronym was first coined and prominently used by Goldman Sachs in 2001. Goldman Sachs argued that, since they are developing rapidly, by 2050 the combined economies of the BRICs could eclipse the combined economies of the current richest countries of the world. The four countries, combined, currently account for more than a quarter of the world's land area and more than 40% of the world's population. Goldman Sachs did not argue that the BRICs would organize themselves into an economic bloc, or a formal trading association, as the European Union has done. However, there are strong indications that the "four BRIC countries have been seeking to form a 'political club' or 'alliance'," and thereby converting "their growing economic power into greater geopolitical clout." In June, 2009 the leaders of the BRIC countries held their first summit in Yekaterinburg, Russia and issued a declaration calling for the establishment of a multi-polar world order.

⁹ *The Daily Ittefaq*, May 13, 2006.

Table 5.1 GDP of Rich Countries in 2008 and 2050 (projected)

Country	GDP in 2008	BRIC in 2008	GDP in 2050 (projected)	BRIC in 2050 (P)
(in millions of USD)				
United States	14,264,600		38,514,000	
Japan	4,923,761		6,677,000	
China	4,401,614		70,710,000	
Germany	3,667,513		5,024,000	
France	2,865,737	8,860,725	4,592,000	128,324,000
United Kingdom	2,674,085		5,133,000	
Italy	2,313,893		2,950,000	
Russia	1,676,586		8,580,000	
Brazil	1,572,839		11,366,000	
India	1,209,686		37,668,000	

The economic potential of Brazil, Russia, India, and China is such that they may become among the four most dominant economies by the year 2050. The thesis was proposed by Jim O'Neill, global economist at Goldman Sachs. These countries hold a combined GDP of almost 9 trillion dollars. On almost every scale, they would be the largest entity on the global stage. These four countries are among the biggest and fastest growing emerging markets.

Table 5.2 BRIC Countries among the Countries of the World

Categories (in the world)	Brazil	Russia	India	China
Area	5th	1st	7th	3rd
Population	5th	9th	2nd	1st
GDP (nominal)	10th	8th	12th	3rd
GDP (PPP)	9th	6th	4th	2nd
Exports	21st	11th	23rd	2nd
Imports	27th	17th	16th	3rd
Current account balance	47th	5th	169th	1st
Received FDI	16th	12th	29th	5th

(Contd.)

(Table 5.2 continued)

Categories (in the world)	Brazil	Russia	India	China
Foreign exchange reserves	7th	3rd	4th	1st
External debt	23rd	20th	27th	19th
Public debt	47th	117th	29th	98th
Electricity consumption	10th	3rd	7th	2nd
Number of mobile phones	5th	4th	2nd	1st
Number of internet users	5th	11th	4th	1st

These four countries have taken steps to increase their political cooperation, mainly as a way of influencing the United States position on major trade accords, or, through the implicit threat of political cooperation, as a way of extracting political concessions from the United States, such as the proposed nuclear cooperation with India.

Other critics suggest that BRIC is nothing more than a neat acronym for the four largest emerging market economies, but in economic and political terms nothing else (apart from the fact that they are all big emerging markets) links the four. Two are manufacturing based economies and big importers (China and India), but two are huge exporters of natural resources (Brazil and Russia). Two have growing populations (Brazil and India), and two have shrinking populations (China and Russia). The *Economist*, in its special report on Brazil, expressed the following view: "In some ways Brazil is the steadiest of the BRICs. Unlike China and Russia it is a full-blooded democracy; unlike India it has no serious disputes with its neighbours. It is the only BRIC member without a nuclear bomb." The Heritage Foundation's "Economic Freedom Index," which measures factors such as protection of property rights and free trade ranks Brazil ("moderately free") above the other BRICs ("mostly bound").

Though Brazil is geographically far apart from the other three countries China is connected to both India and Russia with thousands kilometres wide border. China and Russia share a 4,300 kilometre long border. Whereas China and India share a long border, sectioned into three stretches by Nepal and Bhutan which follows the Himalayan mountain range between Myanmar and Pakistan.

They can easily form a regional economic trade bloc. Besides in the 1st Summit in Yekaterinburg, Russia; they agreed to introduce a new common currency to reduce the dependency on US dollar. This can cause a dramatic change in the monetary policy of Asian countries as well as others.

The prospect of BRIC depends on the leadership of the BRIC nations. The countries share almost the same ideology regarding their status in the world. They also have immense prospects. However, BRIC is considered more political than economical. Some critics consider it as a counter alliance of G-8 or NATO just to balance power in the world.

USA, the leader of the unipolar world, is not reluctant to the formation of BRIC. USA with other super powers planned to stand under a single umbrella which was the reason behind The G-8. The Group of Eight (G-8, and formerly the G-6 or Group of Six and also the G-7 or Group of Seven) is a forum, created by France in 1975, for governments of the six richest countries in the world: France, Germany, Italy, Japan, the United Kingdom, and the United States. In 1976, Canada joined the group (thus creating the G-7). In becoming the G-8, the group added Russia in 1997.

Lately, both France and the United Kingdom have expressed a desire to expand the group to include five developing countries, referred to as the Outreach Five (O5) or the Plus Five: Brazil, China, India, Mexico, and South Africa. These countries have participated as guests in previous meetings, which are sometimes called G-8+5. With the G-20 growing in stature since the 2008 Washington summit, world leaders from the group announced at their Pittsburgh summit on September 25, 2009, that the group will replace the G-8 as the main economic council of wealthy nations. Collectively, the G-20 economies comprise 85% of global gross national product, 80% of world trade (including EU intra-trade) and two-thirds of the world population. This group of elite has the power to defend the world crisis, to save millions of lives, and has the responsibility to support the remaining one-third of the population that are out of this league. But question remains regarding the motive of G-20 that whether this a natural step towards global integration, or just another means of bringing in emerging powers under the same umbrella to help resist possible polarization by other organizations in world politics.

5.5 IMPACT OF GLOBAL FINANCIAL CRISIS IN SOUTH ASIA

The world economy has faced a spectacular change since 3rd quarter of 2008. It started from the US housing sector and then spread to both rich and poor economies. The risks of financial crisis in South Asia are mainly in the areas of export earning, remittances and foreign aid.

5.5.1 Trade

Comparing the economic integration in south Asia with the rest of the world, trade is 48.78 percent of GDP in India, 44.22 percent in Bangladesh and 38.61 percent in Pakistan according to 2006.

5.5.2 Foreign Direct Investment (FDI)

Tighter global credit markets have raised the cost of capital in the international market and are likely to reduce Foreign Direct Investment in developing Countries. From the view point of FDI, Pakistan receives the highest FDI inflow. It was 3.37 percent of GDP in 2006 followed by 1.19 percent in India and 1.13 percent in Bangladesh. Bangladesh has had little flow of FDI and most of this is longer term in nature. Net flow of FDI has remained relatively stable in recent times. Increasing FDI flow to Bangladesh depends more on domestic factors such as improvements in infrastructure, low labor cost, governance and business practices. Foreign portfolio holdings in the equity market of Bangladesh are relatively small at 2.6 percent only. As the local financial market is highly insulated from foreign markets and lacks sophisticated financial derivatives linked to western market, the country's financial markets have not yet faced any direct impact of global financial crisis.

5.5.3 Exchange Rate and Foreign Exchange Reserve

During the last 2 years the exchange rate of Pakistani Rupee has depreciated the most against US Dollar, followed by Indian Rupee as well as Nepalese Rupee (as Nepalese Rupee is pegged with Indian Rupee). While Bangladeshi Taka has remained relatively stable. The depreciation of Pakistani Rupee has adversely affected the country's ability to repay foreign debt. As a result the foreign

exchange reserves of the country have fallen so low that they hardly cover 9 weeks of imports. Pakistan has sought help from the IMF to avoid the condition of being a defaulter. Whereas the foreign exchange reserves of India, Sri-Lanka and Nepal remains relatively strong to meet its import demand for 2-3 months.

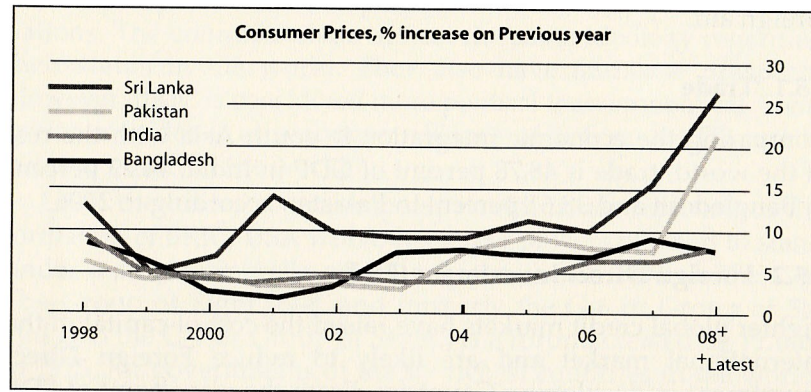


Figure 5.1: Ahead of the Neighbours Consumer Prices, % Increase on Previous Year

5.5.4 Inflation

While India and Bangladesh had a steady rate of inflation settling at around 8% in 2008, Sri Lanka and Pakistan on the other hand did not fare so well, with inflation rocketing to 26% and 21% respectively in 2008.

5.5.5 Projected GDP Growth

The World Bank and IMF has projected that the countries of south Asia are expected to experience some slow-down in GDP growth rates from the previous years. India forecasts 7.5 percent GDP growth in 2008-09. While Bangladesh Government expects GDP growth rate at 6 percent. Considering the consumer financing the most, Pakistan has experienced the growth by 7-8 percent over the past few years. But the sectors of real economy have not had much growth and impact on poverty reduction has been minimal. IMF projects high inflation of 23% and growth rate of only 3.5 percent for 2009 in Pakistan.

According to the Commerce Minister of India (2008), the global melt down in financial markets will impact demand in developed countries for Indian exports and the export target of \$200 billion for the current financial year may be missed. Real estate and textile sectors are already facing a slump. Unrelated to the crisis, tourism and some related sectors may face short-term setbacks as a consequence of the tensions following the Mumbai terrorist attacks. As demand from developed countries dropped dramatically, export growth in India slowed in the third quarter of FY 08 from 33.7 per cent year-on-year in July to 12.6 per cent in September.

Trade, commercial services, manufacturing and agricultural sectors have seen a slight decline in growth rates. Moreover, India is likely to miss the revenue and fiscal deficit targets in 2008-2009 due to the stimulus package taken by the congress lead government. The government has forgone 31,000 crore rupee worth of revenue through reduction in taxes and duties, on account of fiscal measures to stimulate growth and fight inflation. Besides, the Reserve Bank of India promptly intervened in the local money market to support the stimulus package.

Table 5.3 Key Economic Indicators of South Asian Economies (2006)

	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Population (millions)	144.30	1,109.80	27.70	159.00	19.80
GNI per capita (Atlas method US\$)	490	820	290	800	1,320
GDP (US\$ billion)	61.96	906.27	8.05	128.83	26.97
GDP (% annual average growth)	6.70	9.20	2.30	6.60	7.20
Gross dom. investment/GDP	25.00	35.00	30.30	20.00	28.70
Gross national savings/GDP	33.00	33.00 ^a	35.00	17.00	24.80
Equity market capitalization (US\$ billion)	3.61	818.88	1.31	45.52	7.77
Equity market capitalization (% of GDP)	5.83	90.36	16.31	35.33	28.81
Domestic bonds outstanding (US\$ billion)	7.30	325.68	1.22	32.41	13.71
Domestic bonds outstanding (% of GDP)	11.85	35.94	15.09	25.16	50.84

(Contd.)

(Table 5.3 continued)

	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Banking assets (US\$ billion)	32.74	587.38	4.33	50.70	10.30
Banking assets (% of GDP)	52.84	64.81	53.82	39.35	38.20
Deposit interest rate (%)	9.11	7.25	2.25	4.94	11.50
Lending interest rate (%)	15.33	14.25	8.00	11.55	14.64
No. of commercial banks	43	85	18	35	23
No. of specialized banks	5	7	46	10	14
No. of nonbank financial institutions (NBFIs)	28	428 ^b	134 ^c	78 ^d	48 ^e
Exchange rate/US\$ (year end)	69.07	44.25	71.10	60.92	107.71

Source: World Bank 2007a, 2007b; IMF 2007b; regulatory authorities.

The South Asian countries as a whole are clearly feeling the effects of the current global financial crisis in varying degrees. Pakistan might be the most affected in the subcontinent on current ranking considering the higher inflation rate and lower GDP growth. India, Bangladesh, Nepal and Sri Lanka have felt the adverse effects and trying to tackle the slowdown with several stimulus measures. The effect of global financial crisis in the economy of Bangladesh is still unclear. At present, some indicators such as remittance and foreign exchange reserve are actually encouraging. The increasing foreign exchange reserve is a result of declining price of oil and other commodities and relatively lower import.