

# PROSPECTS AND CHALLENGES OF SAARC COUNTRIES

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## Abstract

*The South Asia Association for Regional Cooperation (SAARC), a coalition of seven countries, namely, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, was instituted in 1985 with the cynosure to accelerate the process of economic and social development in member countries and to increase trade in the region by gradually curbing tariffs. Afghanistan became its eighth member in April 2007. Data show that these states, which have great economic strength in terms of its market size, vast natural resources and capable human resources, are all positioned within a close proximity to one another but are unable to achieve the desired results of enhancing trade. The regions' total trade accounts for less than 1% of the world trade, and its intraregional trade has also been insignificant around 4% of its total trade.*

*SAARC, which aims to develop the region as a whole, is unable to fully capitalize on the benefits of cooperation as countries are advancing their economic interests through bilateral agreement rather than multilaterally, thus jeopardizing the long-term goal of building a single south Asian region.*

*Based on the analysis of SAARC trade, this paper tries to identify the potential barriers and impediments which restrict the region from achieving its full potential. It concludes with recommendations to make this organization effective and viable.*

## Introduction

Regional trade agreements among countries are one of the pertinent trends in world economy these days. Most of the countries of the world are members of a block, and many belong to more than one. Developing countries diversify because their regions integrate with each other to specialize according to regional comparative advantage.

To reap the benefits of regional integration, a trade bloc South Asia Association for Regional Cooperation (SAARC) was instituted in 1985 as a grouping of seven countries, namely, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Afghanistan was added to the regional grouping at the behest of India on 13 November 2005 and became its member on 3 April 2007. With the addition of Afghanistan, the total number of member states was raised to eight.

These countries are extraordinarily diverse in terms of size, economic and social development, geography, political systems, languages, and cultures. Three of the eight countries under South Asian region, viz., Afghanistan, Nepal, and Bhutan, are landlocked and mountainous; while Sri Lanka is an island and the Maldives is an archipelago of low-lying coral islands in the central Indian Ocean.

This regional bloc was created with a view to promote collective economic, technical, social, and cultural development of member states. More specifically, it was meant to accelerate the process of economic and

social development in member countries and to increase trade in the region by gradually cutting down tariffs. However, data show that these states, which have great economic strength in terms of its market size, vast natural resources and capable human resources, are all positioned within proximity to one another but are unable to achieve the desired results of enhancing trade. The regions' total trade accounts for less than 1% of the world trade, and its intraregional trade has also been insignificant around 4% of its total trade.

This shows that SAARC, which aims to develop the region as a whole, is unable to fully capitalize on the benefits of cooperation as countries are advancing their economic interests through bilateral agreement rather than multilaterally, thus jeopardizing the long-term goal of building a single south Asian region.

Based on the analysis of SAARC trade, this paper tries to identify the potential barriers and impediments which restrict the region from achieving its full potential. It concludes with recommendations to make this organization effective and viable.

The paper suggests that to make SAARC a more viable venture, trade should be more liberalized by reducing tariff and nontariff barriers. Political and military rivalry, territorial disputes, border problems, and illegal immigrants are some of the vital reasons for the slow progress in the realization of the goals of SAARC. Appropriate policies need to be formulated for more regional integration.

### **Trade Creation and Trade Diversion Effects of Regional Integration**

When countries become the members of a bloc, the flow of trade diverts from the outside world to the countries entering in the new bloc. This happens because member countries eliminate barriers to trade among themselves, and thus provide considerable amount of incentives to member countries for trade. Regional integration helps the less efficient member countries to develop through trade, which would not have been possible in a milieu of free trade. Developed countries of the group, on their part, can profit by investing in the less developed countries of the group, and in this way the bloc can develop as a whole.

As most of the SAARC countries are underdeveloped, economic integration is much needed for the development of the region. This region needs to move towards a more liberal bloc as huge amount of trade barriers restrict this region from tapping its full potential. Compared with other economic regions this region has been moving very slowly.

No doubt, regional integration has positive impacts in terms of trade promotion, as trade diverts from distant countries to member countries. But on the other hand, it also has negative impact in terms of trade diversion as trade diverts from low-cost-producing countries to high-cost-producing member countries. The whole success of regional integration depends on the net of these two effects. As far as SAARC is concerned, this region has not achieved regional integration in true terms as most of the countries are trading with outside world rather than within the region. Moreover, they have more bilateral agreements which reduce the incentive to connect multilaterally, thus jeopardizing the long-term goal of building a single south Asian region. For the success of regional integration, this region needs to place emphasis on trade among themselves and divert trade from outside countries to member countries.

### **SAARC Economies: An Overview**

In terms of population, SAARC with its eight member states is the largest of all regional organizations with over 1.6 billion people (23% of world population). Two-third of the population of Bangladesh, India and Pakistan are below the age of 30. However, the total GDP of the SAARC member states was US\$ 2.1 trillion

in 2011, i.e. only 3% of the total world GDP. Considering the market size in terms of population, SAARC is one of the largest economic blocs in the world. However, as measured by GDP as well as per capita income, the size of the economy of this region is very small as compared to the rest of the world. According to a research, if the member states make an investment of 7.8 % of their GDP to infrastructure, together this bloc can attain and sustain a growth of over 8 %. Table below shows the macroeconomic indicators of SAARC countries:

Table 1

## MACRO ECONOMIC INDICATORS OF SAARC COUNTRIES (2012)

Indicators	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Population Total (millions)	32.4	150.5	0.7383	1241.5	0.3201	30.5	176.7	21.0
Population Growth (average annual %) 2005-2010	2.6	1.1	1.9	1.4	1.4	1.9	1.8	1.0
Population living below \$1.25 2005 PPP a day (% of pop. 2010)	.....	43.3	10.2	32.7	.....	24.8	21.0	7.0
National poverty line (% of Population)	36.0	31.5	23.2	29.8	.....	25.2	22.3	8.9
Economic Growth	15.7	99.7	1.5	1722.3	1.5	16.0	174.2	49.5
GDP at current prices (billion US\$)								
Growth Rate (average annual %) 2005-2010	7.5	6.2	8.5	8.4	6.4	4.4	4.2	6.4
Per Capita (2005 PPP\$) 2010	1185	1488	4780	3073	7645	1075	2411	4555
Gross Domestic Investment Rate (% of GDP)	26.5	24.9	47.9	34.8	56.7	35.0	15.4	27.4
Fiscal Balance	8.7	11.5	23.6	10.4	28	15.0	14.0	14.6
Govt. Revenue (% of GDP 2009)								
Govt. Expenditure (% of GDP 2009)	21.8	15.9	39.0	15.4	45.7	20.4	20.0	22.1

Source: SAARC Countries Statistical Year Book 2012

In terms of growth, most of the countries involved in the SAARC have low GDP growth, low per capita, and low level of human development. Over 40 % of the world's poor people live in the SAARC countries.

### **From SAPTA to SAFTA: A Way towards More Free-Trade Area**

To boost trade among the SAARC countries, the pact on South Asia Preferential Trading Agreement (SAPTA) was signed on 11 April 1993 and it entered into force on 7 December 1995. The Agreement reflected the desire of the member states to promote and sustain mutual trade and economic cooperation within the SAARC region. As far as creation of FTA is concerned, the SAARC has unique situation compared to other regional groups, because before creating an FTA, this group already had bilateral FTAs among member nations like India-Sri Lanka FTA, India-Nepal FTA, Pakistan-Sri Lanka FTA, etc. the SAARC countries even had FTAs with nonmember countries like Bangkok and BIMSTEC. Signing of SAFTA has helped in boosting the growth in the SAARC countries as member countries are now able to buy commodities at much lower prices. Moreover, it has also helped member states to raise their exports. The exports under SAFTA have been witnessing considerable growth since the launching of the Trade Liberalization Program (TLP). As of 13 September 2012, the total f.o.b. value of exports by member states under SAFTA has crossed US\$2 billion since the launching of SAFTA Trade Liberalization Program in July 2006. The cumulative value of exports under SAFTA has crossed US\$2 billion but it is far below the actual potential. For the smooth functioning of the SAFTA, customs notifications for implementing Trade Liberalization Program (TLP) are issued as per the agreed timeline by the member states. While shortening the sensitive lists is important to increase the quantum of regional trade, efforts are being made to take out of the sensitive lists those products that are of export interests to the SAARC member states for trade within South Asia.

The FTA agreement of the SAARC regions needs to be strengthened more by promoting intraregional trade, which in result will help in minimizing the trade diversion costs and in maximizing the potential benefits.

### **Trade Policies in SAARC Countries**

Intraregional trade in South Asia is relatively low as compared to other regions, such as ASEAN in Asia. The South Asian countries exchange goods principally with countries outside the region. For example, India's exports to the SAARC nations constitute less than 5% of its total exports during the last decade. Individually, India's exports to Pakistan were 0.4% of its total exports. Only Bangladesh and Sri Lanka have more than 1% share of India's total exports.

Trade liberalization in South Asia started with a series of sweeping reforms in Sri Lanka in 1977-78 followed by a new second phase of trade liberalization during the 1990s. For the rest of the Asia, the 1980s and 1990s saw substantial reductions of tariffs and phasing out of QRs along with liberalization of the exchange regimes. Even after trade liberalization, this economic group still has persistent high level of tariff and nontariff barriers and these result in low trade among the SAARC countries in comparison with other economic groups

Table 2

AVERAGE TARIFF IN THE SAARC COUNTRIES, 2006 (Percent)	
Countries	Tariff Level
Afghanistan	5.7
Bangladesh	15.2
Bhutan	22.1
India	15.8*
Maldives	20.2
Nepal	13.9
Pakistan	14.3
Sri Lanka	11.2
SAARC	15.5

SOURCE: World Tariff Profiles 2006, WTO;

\* Trade Policy Review 2007, WTO

The table clearly shows that SAARC still has considerable amount of tariff barriers, which leads to low trade growth in these countries. Even after the signing of SAFTA agreement, member countries are using various trade barriers. Take for example, the case of tea import by Pakistan. As reported by *the Economics Times*, "The country consumes an estimated 140 million kg of tea a year. Nearly three-fourths of this is brought from far away Kenya when its immediate neighbor India together with another SAARC nation Sri Lanka can solve its purpose. Tea is just one example. Be it transport equipment, machinery, drugs and pharmaceuticals, cotton yarn, chemicals or consumer durables, the SAARC nations can easily meet their needs within the group. But till date they chose to look for these goods elsewhere. In fact, Pakistan has been importing consumer durables at exorbitant rates from distant countries, rather than obtaining the same at almost half the cost from its neighbors."

### Role of India in SAARC

India is the third largest Asian economy after China and Japan. Among the major emerging markets, India ranks second in terms of economic growth with the IMF forecasting a GDP growth rate of 6.0 percent for 2012. India is the second most populous country in the world, and approximately thirty percent of the country's 1.2 billion inhabitants reside in urban areas. India is the major contributor to human capital development in the SAARC through education and health. Because of its territorial size, huge population and fast growth, India can be central player in the SAARC. In this way, India's notable growth could act as an anchor for the whole region and make a positive contribution to the development of this region. On the other hand, India's position of prominence seems to be a great obstruction in the way of South Asia's complete integration, as small countries of the group view India as both a savior and part of the problem. Another difficulty is that while India borders every other SAARC country, the other SAARC countries with the exception of Afghanistan and Pakistan, do not share any mutual borders except with India. This means that most SAARC countries have geographical access to the other members only through India. India on its part fears that its neighbors will join together to oppose its interests. This fear is lit and fueled by the role of Pakistan and China's involvement in the region.

To tide over these hurdles member countries need to harmonize their political relation. The success with which European countries had managed to overcome the age-old rivalry between France and Germany and achieve economic integration has inspired many countries, particularly from the developing world, to emulate this model. However, it is difficult to imagine a similar development in the case of India and Pakistan. Nevertheless, India could play a pivotal role in integrating trade and investments and promoting economic cooperation. This could help India to access the energy resources it so badly needs to power its growth. The whole cycle can begin through a process of compromise.

Emphasizing the importance of India in bringing economic integration DS Rawat, the secretary general of the Associated Chambers of Commerce and Industry of India, writes:

"India is required to play a lead role by integrating trade and investments while promoting economic cooperation." "The BIMSTEC member countries could jointly develop infrastructure and technology in enhancing renewable energy." The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) brings together 1.3 billion people or 21 per cent of the world population, a combined GDP of 750 billion dollars and a considerable amount of complementarities," said the Associated Chambers of Commerce and Industry of India (Assocham) in a statement issued. (*The Times of India*)

#### **SAARC – A Bright Hope for South Asian Development**

Most of the SAARC countries are well endowed with natural resources, and all are positioned in proximity to each other, but a major problem lies in the utilization of natural as well as human resources. If all the SAARC countries use these resources for their benefits this could help in the development of this region as a whole and thus provide bright hope for South Asian development. Except India and Pakistan most of the countries of this bloc are poor, and are having low GDP growth; the hope of their development lies in the utilization of resources they are well endowed with.

A report in the New York Times gives an estimate of the resources found in Afghanistan alone:

The United States has discovered nearly \$1 trillion in untapped mineral deposits in Afghanistan. The previously unknown deposits—including huge veins of iron, copper, cobalt, gold and critical industrial metals like lithium—are so mammoth and include so many minerals that are essential to modern industry that Afghanistan could eventually be transformed into one of the most important mining centers in the world, the United States officials believe. An internal Pentagon memo, for example, states that Afghanistan could become the "Saudi Arabia of lithium," a key raw material in the manufacture of batteries for laptops and Blackberries, which are a demand of the day. So far, the biggest mineral deposits discovered are of iron and copper, and the quantities are large enough to make Afghanistan a major world producer of both, United States officials said. Other finds include large deposits of niobium, a soft metal used in producing superconducting steel, rare earth elements and large gold deposits in Pashtu areas of southern Afghanistan. (Risen)

Not only Afghanistan, even other countries are endowed with rich natural resources that can be tapped to spur economic growth in the region. Bangladesh, for instance, has significant reserves of mineral resources. Coal reserves of about 3.3 billion tons comprising 5 deposits at depth of 118-1158 meters have been discovered so far in the north-western part of Bangladesh. It also has other mineral recourses like white clay.

The tiny kingdom of Bhutan is also not behind. Geological surveys have revealed an array of valuable mineral deposits in Bhutan, but mining remains a slow-growing portion of the economy. Calcium carbide—the country's main mineral export—limestone, dolomite, gypsum, coal, marble, quartzite, and talc are the primary products of the country's mining activities. Other minerals, extracted in smaller quantities, include slate, beryl, pyrite, and various gemstones, as well as a number of metals, such as lead, copper, tin, iron, and silver, ass sand, limestone, peat, hard stone.

All these reserve deposits with SAARC countries provide hope for their future growth. According to a research if the member states together make an investment of 7.8% of their GDP to infrastructure, this bloc can attain and sustain a growth of over 8%.

### SAARC's Global Trade Relations and FDI Flows

A major factor that contributed to the growth of ASEAN countries was external investment from Japan. But SAARC is still not in a position to attract similar investment from outside the region and from within.

The table shows exports and imports of the SAARC countries and FDI inflow and outflow in the region. Most of the SAARC countries are not open and they do not trade much with each other. FDI inflows from outside the region are negligible in comparison to other regional blocs. A major factor that contributed to the growth of the ASEAN countries was external investment from Japan. Moreover intra-regional investments are also very low. SAARC needs to harmonize investment policies to facilitate intra-regional as well investment from outside the region.

Table 3

SAARC's GLOBAL TRADE DURING 2011								
Indicators	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Exports of merchandise (% of GDP)	2.5	23.0	38.5	16.1	32.0	5.6	14.5	19.1
Imports of merchandise (% of GDP)	32.9	34.1	59.0	24.5	91.8	34.7	24.7	37.2
FDI inflows (% of GDP)	1.3	1.1	0.9	1.7	53.2	0.6	0.7	0.6
FDI outflows (% of GDP)	.....			0.8	17.7	....	0.0	0.1

Source: SAARC Countries Statistical Year Book 2012

The table clearly shows that FDI inflows in SAARC countries have been insignificant. Not only FDI inflow from outside world is low in this group, but FDI inflow from within the group is also very low. FDI could be used as one of the ways to meet financial constraint which most of the SAARC countries are facing.

### Recommendations

**1. Myanmar as a SAARC member country:** Myanmar should be added to SAARC region. A World Bank's study on cross-country trade of electricity and natural gas in South Asia makes this recommendation:

Myanmar with its vast reserves of energy, both oil and gas, and other natural resources, could export gas to India and possibly to Nepal and Bhutan. All these factors suggest that Myanmar and SAARC would both benefit by working together and the inclusion of Myanmar in SAARC may prove to be a win-win situation for SAARC and Myanmar.

In Myanmar, India can focus on agriculture and allied activities, mining and related products, hydro power, chemicals, upstream and downstream oil and gas operations, renewable energy, gems and jewelry.

2. **Resolving political differences:** Resolving political differences can help SAARC in expanding its intra regional trade.
3. **Harmonizing relation with the member countries:** India needs to harmonize its relation with the member countries which will help India to access the energy resources it so badly needed to power its growth.
4. **Developing Infrastructure:** Infrastructure development is required for better connectivity of the member countries, as most of the SAARC countries lack good infrastructure.
5. **Promoting research and development:** Focus on research and development will help this region to become globally competitive.
6. **Adopting trade-friendly measures:** Reduced problems at customs, lower rates of tariff and nontariff barriers, and better marketing facilities, open borders and trade at borders etc. will help.
7. **Knowing one another's potentials and policies:** Increased awareness of one another's potentials and policies will help in developing common policies.

## Conclusion

It will not be correct to use the same yardstick to measure the viability of SAARC countries as the ones used for other regional blocs. While assessing the viability of SAARC, one needs to take in to account the difficult starting position, the different regional situation and different stages of growth of member countries. Except India, which has an impressive growth, all the states are plagued by extreme poverty, low GDP, immense disparities between the rich and the poor, low development in the areas of infrastructure, energy production, and low utilization of natural as well as human resources. If we compare SAARC with European regional bloc, the latter took nearly 50 years to achieve its current level of economic integration and to move from a common market to economic union. After the integration, the EU has not only free trade but also free mobility of labor and capital, common external tariff policy, a common currency and a central bank. South Asia could also achieve the same level of economic integration as seen in Europe by 2020, argues the group of eminent persons (Report of the SAARC 1998).

To conclude, the growth of intraregional trade has remained subdued due to considerations other than economic issues. In ensuring stability and growth in intraregional trade, bilateral relationship between countries needs to be harmonized and well synchronized.

The trade theory based on comparative cost advantage will no longer be the binding force. The political and military rivalry between countries, often credited for SAARC's inability to work in a unified form, needs to be harmonized. SAARC has the potential for exports in a number of commodities like textiles, gems and jewelry, handicrafts, fish and fish products, minerals, engineering goods, etc. Countries like Afghanistan and Bangladesh has huge amount of mineral resources, which can be of great help in fast industrial development within the region. To be at par with other regional organizations in terms of growth, the countries within this



group need to have more multilateral trade agreements than bilateral agreements. For example, Pakistan can import tea from India rather than from Kenya, at a comparatively lower rate. Although the major SAARC countries are better synchronized in terms of their GDP cycles, they still continue to lag behind in trade integration due to high level of protectionism existing amongst the them, compared to the rest of world. The trade policy of the SAARC countries, therefore, needs to ensure that SAFTA focuses on trade creation within the region rather than trade diversion from the region. To strengthen trade ties within the region and to make this region at par with other regions, more trade liberalization in terms of reduction tariff as well as non tariff is required.

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