

# **Political Economy of Regional Trade Integration in South Asia**

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## **1. Introduction**

### **1.1 Political Economy of Trade Integration: Peculiarity of South Asia**

Political Economy is about the pursuit of ‘interest’ by the relevant actors’ to influence the outcome of a decision or a phenomenon. It is used more in such cases where the decisions have a higher likelihood of creating benefits and losses. Such interests could be pursued in different forms and multiple ways. The actors could be states, institutions representing or being directly or indirectly controlled by states, organized groups, corporate sector, political groups, development actors, representatives of bureaucracy. As the outcomes depend on the nature, value and quality of agency and power of the actors, the PE, in its simpler forms exerts from above to weaker, lower, less organized entities as was the case with Mercantilist Colonialism. PE could be pursued in different formats and fields. It could be through wars, inter-governmental negotiations, mass media, protest/resistance movements. With globalization, the Interests also have global reach. This is best exemplified in the attempts to control/secure the natural resources by agreement, negotiation or coercion the natural resources. As a stable way to secure an Interest is to secure favourable governance laws and structures, the decisions to secure maximum benefits from trade are fought less in battlefields and more through treaties at the multilateral or bilateral level. As the field of trade involves more and more of voluntary exchange among plural suppliers and buyers in a market, the pursuit of interest unfolds in the form of competition, aided by complimentary political economy strategies. As stability is an important condition of exchange, the political economy of the participants from above or below or among the nation states or among different sectors in an economy takes place on negotiating tables and decision making fora. At the national level, the

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business groups would try to influence the direction of a country's strategies at the higher for a on the one hand and would try to consolidate their position internally also by influencing the domestic policies/reform. As the decision making at the local level passes through the political institutions, the interest groups would try to work closely with the political and executive. With an increasing awareness of the consumer welfare, who may have to bear the bear the costs of decisions favouring certain lobbies, there are pressures from below, from grass root for equitable, fair decisions in line with universally recognized rights of development of citizens.

With an increasing role of trade in development, there has been a big effort to provide a fair and predictable system of international trade. In the process, World Trade Organization has emerged as a pivot of international negotiations. Though the post second world is marked by an enduring presence of nation state as a universally recognized entity comprising the international politico-economic order, regionalism has started playing an important part in the globalizing world as a new but potent actor at the international scene. Different countries would have different interests and objectives while opting for one or another initiative of regional integration. Countries have agglomerated to benefit from Market Efficiency Effects [Trade Diversion, Trade Creation] and Dynamic effects in the form of scale, investment and technology flows etc. Geographically contiguous areas, with high population, have a natural tendency to make such attempts to benefit from the factors of vicinity and large market size. Countries have also opted for regionalization to realize shared socio-economic and cultural policy objectives. Countries have also entered into regional arrangements as a more promising political economy strategy to influence the global governance systems and get better terms of engagement from larger economies such as US, China, EU etc. In any case, whatever are the motivations for regional integration, there are Political Economy Effects of any regional integration pertaining to the distribution of costs and benefits, regional disparities and the challenge of policy harmonization.

A number of instruments are used for regionalization. The stalemate at WTO has given an impetus to bilateral and pluri-lateral FTAs and Comprehensive Economic Partnership Agreements.

Historically, certain regions have taken a lead on this way such as NAFTA, EU etc. Closer at home, ASEAN is fast emerging as a model. Latin America and Africa also high on regionalism. Cohesive and strong regional trading blocks have started asserting themselves in influencing the governance system of trade at the global as well as regional levels. Appearance of a large number of regional integration initiatives has provided an opportunity to national governments to pick and

choose which in turn motivates the national stakeholders in trade integration such as organized business sectors or popular movements to assert themselves.

The phenomenon of regionalization is not welcome by everybody. In many countries, there are strong Interest who are not in favour of ceding national sovereignty or compromise on national security interests in favour of regional superstructures. Many, especially in the developing countries believe that the regionalism is a disguised form of multilateralism and needs to be resisted. Many, who oppose un-fettered 'trade openness', view regionalization of trade as an attempt at further openness which can harm the domestic industry, agriculture, environment or labour. Failure of many some regional integration efforts have created the feeling that regionalism is an animal to be approached with caution and has reduced the political appetite to undertake such a complex undertaking.

Given the complexities involved, the national bureaucracies, local groups, industry, regional and international agencies having interests or stakes in this phenomenon could be seen engaged in a plethora of initiatives. As the phenomenon of globalization and regionalization are not liner and en-globe local to international and two hundred plus countries, the sum total of all this movement presents itself as a big flux. There is a need of a large number of cross-sectional analyses to develop a better understanding of any one region, which in our case is the South Asian region. Our analysis therefore proceeds from international to local and back giving due attention to the horizontal 'pushes' and 'pulls'.

South Asian regionalization initiative started in the form of South Asian Association for Regional Cooperation [SAARC]. It got a boost with the emergence of South Asian Free Trade Agreement [SAFTA] in 2006. Though the whole region was under one colonial administration, South Asia at present is one of least integrated region in terms of trade. Regionalization of trade can bring development and inclusiveness to the region. The region could also have a better say in the matters of regional and global governance. The presence of certain historical factors and processes such as a huge contiguous geographical mass having 1.6 Billion inhabitants, strong lingual, ethnic and cultural ties and affinities have not helped in a faster integration.

The question of slow process of trade integration has been a subject of active discussion and research over the past few years in the region and elsewhere. The political economy aspects of trade integration in South Asia, however, have been given relatively less attention. This paper attempts to identify political economy aspects of trade integration in South Asia which is aspiring

to integrate to make trade deliver growth, produce convergence of income among the member states and enhance inclusiveness. As an historical moment, stares in the face of SAARC Secretariat and its member states, the need of policy analysis leading to policy recommendations was never as great and urgent as it is now. We hope, this paper would enable UNCTAD to produce policy relevant knowledge to prepare South Asians to face the emerging challenges to regional integration better and fulfill their legitimate aspirations sooner than later.

## **1.2 International Regulatory Political Economy**

‘Narratives’ about policy choices provide an access to the political economy considerations and forces at play. Narratives by nature are almost always ‘normative’. On the one hand is the ‘theory’ of international free trade eulogizing free movement of goods and factors and on the other hand are the policies of the governments, laced with ‘normative’ narratives protecting and promoting the welfare of its citizens at time by opening the trade and at another time by restricting the trade. By accepting WTO principles of MFN and National Treatment as sacrosanct, the WTO member countries have willingly signed up to the sway of a certain International Regulatory Political Economy in shaping global trade governance system. Government policies on trade at any given time are embedded in a particular socio-economic environment and pre-existing policy frameworks. In democratic settings, multiple narratives regarding the macro socio-economic environment bestow pro-evolutionary stability as well as a creative uncertainty to the practice of government policies. Democracy keeps the government policies tied to the local whereas the theory of free trade and perceived benefits of globalization bring in regional and international opportunities and threats in play. All the SAARC member countries, except Afghanistan which is a new SAARC member are WTO members. In the international regulatory framework, Nepal, Bhutan, Bangladesh and Afghanistan enjoy the LDC advantages. EU and US GSP Schemes, which put a premium on Openness also benefit all the SAARC member countries. SAARC member countries have ‘reproduced’ the framework of multilateral liberalization in SAFTA with a more ambitious trade liberalization programme. The positions of SAARC member countries for further liberalization under DDA are slightly different from each other but there is a general agreement on the positions of G77 and China. More active WTO members of SAARC also participate in the ‘thematic’ or ‘regional groupings’ under the shadow of multilateralism. India is heavily engaged with two heavy pro-openness trade blocks of EU and ASEAN in trans-regional FTAs. Pakistan is keen to see a breakthrough at DDA. Though, it has bilateral FTAs with China, Malaysia and Sri

Lanka and is a member of many regional trade integration initiatives such as GCC, ECO, D-8, OIC etc. But all these are very slow moving and inconsequential, at least in the short term, initiatives. Pakistan is hoping to get GSP Plus status from EU from 2014 and has just been given autonomous Trade Preferences in EU for seventy five items for about one year. Pakistan therefore has more stakes in multilateralism. Sri Lanka also had enjoyed GSP Plus status and has bilateral FTAs with India and Pakistan. The South Asian LDCs have been integrated very well with the global trading system. Therefore, one can say that South Asia as a region has displayed serious commitment with multilateralism. The region has also been a significant recipient of foreign aid and some FDI. However, if we look at the development and competitiveness indicators, the region by and large is steeped in poverty and backwardness.

### **1.3 South Asia rising?**

In South Asia, SAFTA would be entering into a much awaited phase of very low tariffs and very small Sensitive Lists'. Pakistan's decision to normalize its trade with India and coming under SAFTA programme has removed one potential 'brake' on the implementation SAFTA's TLP across the region. During the last few years, the concomitant issues such as Trade Facilitation and Connectivity, Harmonization of Standards, Removal of NTB's have been given due consideration and the region is making significant progress on all these accounts. The results however have been rather lower than expected. It is feared that even with deeper tariff cuts and removal of irritants, the gains from SAFTA would remain small if the SAFTA member countries do not agree to SAFTA Plus [no sensitive lists] and SAFTA Sub[no subsidies] implementation. [World Bank 2010] The end of sensitive lists and subsidies for the SAFTA members would however be a giant step forward towards regional integration. Changes in for the sake of regional trade integration could have serious repercussions for the national governments as some countries would have to take some losses possibly in the short term for long term gains, bear adjustment costs for certain sectors and balance immediate welfare aspirations of people with anticipated benefits of regional public goods and development dividends for the whole region in the long run. Regional Integration is eventually about convergences. SAFTA has realized all the milestones and SAFTA members are set to trade on tariff rates between zero to 5 %. [except some exclusions for the LDCs and Pakistan.] A large number of complimentary policies, institutions and initiatives have been implemented under SAARC Secretariat. The cooperative space in South Asia is increasing. During

the SAARC Summits and public for a, one does here lofty hopes and promises of South Asia emerging as a strong block or Community. In a way, the regional integration efforts in South Asia are now flattening. Tariffs have come down, LDC have a free access, NTBs and Trade Facilitation issues are being addressed. In terms of Services and Investment liberalization, SAARC member countries are reproducing 'multilateralist' approaches i.e., slow, Special and Differential treatment, offer lists etc. Compared with ASEAN, the pace of regional integration in South Asia is painfully slow. The region appears to be indecisive about the merits of faster, deeper integration. Part of the answer lies in divergent, opposing political economy strategies of a multitudes of stakeholders for this sub-continent of 1.6 Billion people.

High hopes regarding the future of SAARC in terms of trade and investment flows through SAFTA or otherwise has been regularly voiced; both by the academicians whose Gravity Models have always thrown up fabulous figures or by the proponents of South Asian Regionalism who would like South Asia to emerge as a 'region of consequence' like EU and ASEAN. There has been a great effort at identifying the impediments to regional trade. The issues such as Trade facilitation, connectivity, size of sensitive lists, enhancing complementarities, removal of NTM's etc. are getting due attention from trade economists at the bilateral as well as regional level. As the trade integration is a process led by states and organized interest groups, the political economy aspects can provide interesting insights into the larger and longer term strategic frameworks coming into play in the evolution of trade integration in South Asia. It is not that this aspect has never been studied. However, as the political economy considerations keep on changing, in response to the emerging or anticipated situations, there is always a need to of fresh analysis. Last five years have seen big events at the global level such as the financial crisis of 2007/8, ongoing crisis in EU, re-election of Barrack Obama etc. The region appears to be heading towards the end game in Afghanistan. The implications of the renewed interest of US in Asia and the slowing down of growth in the two Asian economic giants i.e., China and India have yet to unfold fully. Notwithstanding the feeble attempts at reviving some hope on way to Bali in December 2013, fate of Doha Development Agenda appears to be in doldrums. SAARC member countries in the meantime are struggling with the impact of global financial and trade slow down on the external front and a slow pace of reform at home with ever more vibrant democratic backlash/ redux against the [pro-globalization] structural reforms initiated during 80s and 90's.

## **2. Flux and hybridity in national Trade Policies of regional integration in South Asia**

Trade Policies are perceived, more often than not, to be highly susceptible to ‘public choice’ considerations. In developing countries, it is expected that the economic actors can influence the policies even more easily. The government laws and practices, crystalized through historical developments, however start manifesting certain pattern of positions. In ‘low context’ i.e., low lobbying activity situations, the governments react or respond to external demands or pressures, within the general macro-framework and could be fairly predictable. A socialist government would be more receptive to trade unions and a Washington Consensus steeped government machinery would be more receptive to the voices coming from the corporate sector. The political class would align its positions across the political spectrum, which in old days used to be spread out between extreme left to free market. The economic and social impacts of trade policy related decisions are reacted differently by economic and political actors. The beneficiaries would try to maximize their gains and the potential losers would try to minimize their losses and deploy all the resources at their disposal such as ‘bribing’, ‘lobbying’, media contestation, advocacy and awareness campaigns. As the trade to GDP ratio in almost all the South Asian countries is rather low, foreign trade policies seldom find a place in the manifestos of political parties nor do they make any significant impact in election campaigns. There are exceptions though in case the nationalist elements try to link electorates socio-economic well being with the foreign trade policy decisions. Pakistan has gone back on its commitment to grant MFN to India by 31.12.12 due to the politisization of MFN issue by some right wing groups. But they have succeeded only when the farmers lobbies in Punjab and some other business interests mounted a pressure on the government.

Trade Policy Reform or re-orientation in a regional context is a result of a large number of processes which evolve over time. The forces sponsoring these changes deploy various resources to impact upon these processes. Isolation of more important of these processes and nature of the forces and the methods they employ is important for anybody who wants to understand the nature and direction of trade policy changes in a regional context or wants to impact upon the direction of this change. Hypothetically, a scientific body of knowledge exists on international trade and its benefits thereof and how the benefits are channelized. The vested interest therefore should hold its horses back and let the policy wonks decide about an issue as scientific as trade integration. But

the counter-argument is that all the policy experts have a starting point and no starting point is 'politically neutral'. In a competitive environment, no position is neutral; even to say I'm politically neutral, is a political statement. However, it must be said that embarking upon a research aimed at isolating all the processes is an infinite search.

National government's regional trade policies reflect the influence of national interest groups. Most of them---exporters, importers, domestic commerce national and multi-national economic actors --- either have only a modest interest in the region or they conceive the economic actors from other countries as competitors. Many South Asian regional organizations have been established during the last few years on issues such as Climate Change, Tourism, Energy etc. These are primarily intergovernmental organizations. In business, there is a SAARC Chamber of Commerce which holds business to business interactions and there are many bilateral business forums too. But, the kind of 'cooperative' space, which one saw in EU in its formative phases or among ASEAN countries at present does not really exist in South Asia. The implications of a competitive rather than cooperative dynamic are very much apparent. National governments who at times define themselves negatively vis a vis their neighbours in South Asia, diversity of cultures and religions, uneven development within the member states reduces the cooperative space among member countries. As a result, the scope of 'policy driven regionalization' appears to be limited rendering 'regional trade policy' a hostage to minimum denominators. Policy coordination and harmonization therefore is not an explicit agenda in South Asia yet. There are efforts at enhancing interconnections within South Asia welding the states around India with it but similar efforts are there to interconnect these states on the periphery with the states non-South Asian states bordering them. The development of Nepal-China, Pakistan-China, Bangladesh-Myanmar road links and Chinese investment in Gwadar, Chittagong also portray a picture of a region which is keen on keeping itself open to other regions and keep its option open too. The regions which have a strong outward orientation need strong normative regionalism inside to develop regional identity to cement the solidarity within.

### **3. Regional Integration of South Asia: India and China helping and hindering at the same time**

Within the region, South Asian countries trade more with China collectively than with each other. China has emerged as one of the most important trade partners of India and the rest of South Asia, excluding India, trade more with China than with India. China provides free market access to the LDCs of South Asia and has an FTA with Pakistan. China, which borders with four of the eight South Asian countries is bigger investor and donor in South Asia than India. Pakistan at one time was suggesting to include China and Iran in SAARC. It is an open secret that both the countries vie for influence in South Asia and could be seen as G 2 in the South Asian context and their approaches, strategies and actions towards South Asia integration would impinge upon heavily on the future of South Asia as a region. Would India act as an 'anchor' of an integrated South Asian region or South Asia would have two 'anchors' in a more open South Asia is a question discussed in the following section.

### **3.1 India and South Asian Regionalism**

India advanced the SAFTA has not only implemented the trade liberalization programme of SAFTA, it advanced its commitments with LDCs by one year. India has shown flexibility to Pakistan in terms of the reduction of the Sensitive List under SAFTA over a longer period of time. Over the past ten years, India is believed to have projected its economic strength in military/state power too. India does not mask the fact that her regionalization efforts are driven by security considerations. Any move considered potentially harmful to the 'security interest' of Indian state was viewed with suspicion. India has been supporting friendly governments in Nepal and Bangladesh and has invested heavily on building an arch over Pakistan to Central Asia through Afghanistan.

In trade matters too, India has been keen to integrate with global economic players beyond the region. It has been an active player, along with other BRICS countries in the so-called high politics of regionalism from above. In case of India, the past twenty years reform, which saw India growing at very high rates and being recognized as an economic power of global proportions, have created stable structures. In the construction of these new processes, Indian state, media and corporate sector are enjoying a sense of becoming, of directionality, in its performance value. It is this kind of integration which does not have the possibility of an erosion of sovereignty. India, however, being a large country, also has in the process raised the expectations of hundreds of millions of people living at one dollar a day. In an age when being anti-capitalism is becoming fashionable,

there are numerous new voices---if you consider social media also as an actor, then countless---demanding the power holders to deliver sustainable and balanced development. This has brought local to the fore, face to face, with global in a big way, with the Indian state almost stuck in the middle. This resembles the pre-colonial times in South Asia in the sense that the 'local' is directly confronting the 'virtual' enemy of neo-colonialism the way the local challenged the colonial 'other' in the first half of the twentieth century. During the last sixty five years, the local was constrained to interact with the global more through the 'nation state'. With Globalization, local started interacting, challenging, cooperating with the global directly too or in conjunction with the state. Regionalism was thought to be a more suitable level to mediate between the local and global trying to get a better deal from each other. India considers itself a region unto itself being big enough. In some other parts of the globe, regionalism is presenting itself as a new pillar of a global economic order, which could have the potential of being more and more human by being less and less neo-colonial. Insisting on the fair trade therefore is a very political phenomenon in the international political economy. A region can ask for it only if it has ensured fair trade within its own boundaries. ASEAN is able to do it, let us say vis vis EU, because the 'economic system' in ASEAN member countries are homological. This is not the case in South Asia. The economic systems in SAARC member countries have common features but also have divergent features in terms of social security burden of state, regulatory intensity, trade openness, role of state enterprises, state support to economic activity. This goes without saying that a minimum amount of harmonization of trade related policies would have to be agreed by the member states to promote regional integration. Without this convergence, even the conditions required for the free flow of goods, investment and technology would continue being weak. Many analysts have noted a rather lackluster attitude of India in presenting itself as the leader of South Asia. [References] But this behavior of Indian state is understandable as the global as well as parallel regional blocks are keener at engaging India directly as an economic actor of global consequence. In other words, India is under no external pressure whatsoever to move towards a tedious process of policy harmonization in South Asia and a loss of sovereignty, however small it might be, to embrace a South Asian regional block/community.

If the opening up of Indian market, under the existing conditions of SAFTA, does not, in any significant way, dent the economic security of ordinary people in India, India should continue its 'high politics' seeking to consolidate its place at the high table of global economic governance.

India keeps on deploying more resources to this 'high politics'. The 'low politics' of regional integration for India is a rather passive act. It has opened its market to LDC and would open it to non-LDCs also soon. She is leaving it to the imagination of other countries as to how to benefit from the market opportunities presented by India. If there were obstacles like the provision of state support to local manufacturing, the political economy of trade integration for India was not strong enough to reduce the state support or think of 'equalizing' it in case India would like to keep the level of state support as a bargaining chip in its 'high politics' with global partners.

India however is not oblivious to the future of its friendly relations with its South Asian borders and deploys its soft power to portray India as a senior partner in the regional development. In the recent past, it has been active in promoting *regional development* through SAARC or other regional institutions and at the bilateral level. Indian investment is growing in the region as well as its development assistance.

### **3.2 China's Regionalism Strategies**

#### **3.2.1 Traditional Geo-economics**

China has an entirely different approach to regionalism during the same period. Having sorted out almost all their border conflicts, they transformed their economic power into a soft power through more aid and investment. Chinese relations with ASEAN and SCO are developing in the direction of 'harmonious development'. Within Asian regionalism, China has participated in a range of multilateral organizations and advocates a layered regional cooperation in its governance diplomacy. As it is the Chinese behaviour which will determine whether hedging or harmonising strategies become dominant in regional governance, Chinese way of engaging with all players and organisations, including those of which it has tended to be wary of, or has demonized, in the past such as Washington, New Delhi, Tokyo etc. would become an important phenomenon to watch. India also would be carefully watched for its relations with 'significant others' on the way to strengthen its global and regional position.

#### **3.2.2 Mandalic Regionalism**

The Chinese Soft Power appears to be unique in terms of regionalism. For the regional policy analysts, isolating the so called 'hegemonic inclinations' of China from 'mutually constitutive'

development in terms of Chinese regional integration policies would be a big challenge in the coming years. If the Chinese would prove more apt at building 'correlative relationships', [which for many is a hallmark of East Asian thinking] which involves working with others and recognising them as being part of one's identity, smaller South Asian countries would immensely benefit from the opportunities offered by the unique 'soft power' of China. A Soft Power characterized by Asian values, projecting Asia as a 'spiritual region', describing the process of regional integration in Asia [Far East] in Mandalic terms i.e., Asia is a 'mandalic region' as the spiritual and the political sit well with each other. For Rosita Dellios, this model incorporates the normative perspective of constructivism with the adaptive architectural qualities of the systems approach. [Dellios 2008] Moreover, Buddhism's principle of 'co-dependent origination' is highly pertinent to constructivist mutuality and the micro-macro processes of complex adaptive systems. Co-dependent origination stresses the interdependent existence of all phenomena; that they are empty of their own existence and therefore contingent. The pivotal Buddhist term, 'emptiness' (Sanskrit: sunyata), is a simplified form of co-dependent origination (see Grey 2005). Thus a mandalic region is a Hindu-Buddhist inspired model of regionalism in a de-territorialized world. The borderless world is also a cosmological world. This is not only empirically evident in the way in which market values are no longer constrained within national borders, providing a secular cosmology, but also religious values. Thriving cosmological communities may be found in the growth religions of the 21<sup>st</sup> century such as Islam and Buddhism. Thus a mandalic region in the global age is also a global region. It displays spatial and relational features that give rise to the notion of 'regional place in global space'. Mandala is an apt metaphor for the global age because, like globalisation, it represents a compression of a wider field of experiences. Its contours are a symbolic rendering of a complexity that co-arises. Mandala as a cultural technology may be equated with 'tantra', a term used to refer to a body of Hindu and Buddhist practices that hinge on the macrocosm-microcosm interaction. The region as the unit of analysis deserves particular attention as it is on this (mandalic) platform that global macro forces are moderated to address the security of the microcosms of state and individual. Regional governance, then, becomes a significant factor in the management of economic security down the scale to states and citizens as well as up to the global level. The region is no mere transmitter (chain-gang metaphor) but also transformer (mandala metaphor). Functionally speaking, if economic security is the heart of the mandala in terms of enquiry, then the region is the theatre of operations for its implementation. Governance of the region may be

regarded as the strategy employed. The institutions and actors involved in the strategy also require consideration, especially their correlative (yin-yang) relationship when viewed from a Chinese philosophical standpoint. For example, how will a declining global power (US) relate with an ascending one i.e., China? Their relationship may be mutually constraining, a condition termed 'institutional balancing' as distinct from traditional military balancing (see He 2008). This is familiar language in traditional Chinese thought with its emphasis on harmonizing the generative and restrictive energies of the 'five elements' (wuxing: earth, metal, water, wood, and fire) within the concept of the yin-yang and the five elements. For example, the wood element representing growth and creation, is constrained by metal (hard power and capability), but fire (change and activity: revolution or transcendence) can melt metal; on the other hand, water (cool and in pursuit of the path of least resistance) is supportive of wood, and earth (reproduction and nourishment: economy) is supportive of metal. 'Chinese strategic culture' still reflects a desire to pursue the balanced path, and China's disposition is clearly of relevance to the future profile of the Asian mandalic region. In this background, it is not necessary to presume a super-power rivalry between US and China, benefitting Indian keenness to forge a strategic alliance with US. US is very keen to grow its strategic partnership with India to contain Chinese influence. If enhanced Chinese economic cooperation with smaller South Asian countries would be perceived as a security threat by India, this would involve these countries in some sort of a 'Great Asian game' and continue producing mistrust and tensions in bilateral relations.

**3.2.3 Role of Chinese State Owned Enterprises:** While comparing the role India and China may be playing in regional integration in South Asia in the coming years, the role of State Enterprises of China would be very important. As the role of state is becoming more important again, the second most important reform to watch would be the role and performance of 'state enterprise'. This is not only significant in terms of 'inclusiveness' but also in terms of regional trade and production networks. Here again, the role of Indian and Chinese state enterprise may be different and the Chinese model may turn out to be more effective. The politics of influence between China and India may however stop the State Enterprises of the two countries from working together. Indian MNC's---both international as well as Indian origin MNC's ---may play a more significant role in promoting regional supply chains. Here in this case, the role of aid, foreign assistance and investment would play an important part.

#### **4. Regional Integration for the rest of South Asia: From the Edge to Hedge**

In South Asia, the efforts by smaller countries to enter into agreements which may have direct or indirect geo-strategic impacts have always been problematic. However, in the recent past, the smaller states at the edges of India, perhaps pessimistic about the future of South Asia as a region, appear to be becoming ‘hedging states’ by linking their economic future more and more on outside world. Regionalism, as hinted above, started more as an offshoot of multilateralism. In due course of time, it became an important appendage to member states strategy to benefit from the trade opportunities from the neighbourhood. As the South Asian region is a region open to the outside world, the South Asian rim countries have started emerging as bridges to the neighbours next door in the absence of a strong imperative to integrate within South Asia. In the traditional debates on the centre-periphery, the state at the periphery would be considered to be at a disadvantage. The smaller South Asian countries appear to be adopting an alternative vision that being a ‘state at the edge’ of a big nation was not an inherent disadvantage, that such states were not condemned to be on the receiving end of the ‘great games’. In this context, what is in store for the smaller countries/edge states of South Asia?

It is highly likely that the bilateral conflict is reduced in South Asia and China and India establish more harmonious relationship and the ‘edge states of South Asia become harbingers of a kind of Asian non-aligned movement and profess and practice the vision of a de-territorialized community like ASEAN Plus Three, which is not interested in remaining a ‘site’ of contestation. Once the ‘South Asian rim countries’ as a result of regulatory dialogue, more so as a result of getting GSP Plus, improve their economic governance and efficiency of competitive markets, they would start resembling EU periphery of Mediterranean countries, keeping their own multiple identities in a stable mix and improving their development prospects by trading with their neighbours as well as non neighbours. In the process, these become ‘hedging states’; hedging with multilateralism, with Asianism, with China, with India. Pakistan, Bangladesh and Sri Lanka are not likely to have the kind of disadvantages of ‘marginal location’ like many CIS countries have vis a vis Russia. They should be able to leverage their location in the traditional ‘power based political economy of regionalism’ better than most of the CIS countries.

#### **5. Emerging Imperatives**

## 5.1 Regionalism from Below

Though Multilateralism is also a hostage to the economic and political power play to a significant extent, the growth of fairly strong and growing institutions of global governance are now relatively more responsive to the 'developmental rights' of communities. One good example is the importance bestowed by multilateralism to small Island States. Communities and regions and the people living there are as important as the citizens of 'power' based nation states. While living in a post western world [World Trends 2030], development right even of a miniscule community is recognized somewhere by somebody. This is an alternative manifestation of 'regionalism from below'.

Another form of the Regionalism from Below is the sub-regional cooperation. International organizations have been active, with the help of some governments in promoting sub-regional cooperation within the existing institutional arrangements. Both EU and ASEAN have been giving a strategic importance to sub-regional cooperation be it in the form of sub-ASEAN Economic Zones or cross border trade and investment cooperation. In most of the cases, the sub-regional cooperation draws its strengths from associative, cooperative instances of people to people contact informed by cultural affinities.

The relationship between the culture and regionalism could be very complex and different regions of the world had/are having different trajectories in this regard. The attachment of South Asian nations with 'sovereignty' appears to be a result of embedding national identity in culture and history. The resultant configuration is possibly impacting very heavily upon the future forms of regional governance in South Asia in a post-western world. Apparently, ASEAN nations have adopted the notion of 'identity in progress', through mutual interaction and norm formation, where each party requiring the other for adequate articulation' creating a dynamic, difference and balance within the 'whole'. In case of South Asia, 'culture' has acted as a huge divisive force. Though, one hears very often, the commonalities, in South Asian cultures---much more talked about in media and films--- the common moorings of South Asian culture is far from being worked at. Buddhism and Islam in ASEAN have been fairly successful in discovering some kind of a common 'spiritual and humanistic' ground. This is not the case in South Asia where the adverse mentioning of each other's culture in media, academics, literature, text books is quite rampant. There are many works now which propose to 'use' culture as a strategy for regional integration or suggest that 'cultural

harmony' is a positive condition for regional integration. In case of India, such suggestions are made more vigorously while proposing a region integration between India and ASEAN. In case of Pakistan, culture is invoked in case of D-8, OIC, ECO, GCC and host of other FTA/PTA initiative between 'brotherly' countries.

ASEAN and EU have used culture in a more productive way. ASEAN as a regional block was concerned more with security/political aspects in integration in the beginning in 1967. From there, they built the economic integration, led by the business and political elites and now it is expanding to socio-cultural pillar and so many policy experts and academics are involved in identifying the 'Asian' moorings of ASEAN. In case of EU, they started on the strength of socio-cultural identity and benefits of market integration. After building economic community, now they are working more on the 'community building' side and have not been successful on building the Security side. With the presence of NATO and reduction of threat from Soviet Union, they do not feel like having a common security apparatus, though they coordinate the foreign policy now more than before.

In case of South Asia, SAARC started with high sounding 'community building' vision and has been successful in establishing a large number of cooperative institutions, which has surely enhanced the institutional interaction among the member countries. However, the socio-cultural pillar presents serious challenges to member countries despite a uniform popularity of Hindi films. People to people contact in South Asia is still very low. South Asia has inherited a very complex baggage linking culture with identity in variable ways. The desirable relation between the culture and identity in case the region was to develop towards a Community are not yet problematized/mainstreamed. This pillar actually provides the much needed lubricant for more ambitious regional integration. Absence of this qualitative leveraging factor has also somehow stopped the SAARC institutions from achieving much. The economic pillar is however getting more attention lately and the trade and investment linkages are expected to grow in the coming years after beginning of the last phase of SAFTA's Trade Liberalization Programme and the normalization of trade between India and Pakistan. As far as the security pillar is concerned, there has been a reasonable progress in the sense that the conflict is largely de-linked from conflict. But the mistrust in this matter however lingers on. As long as the outstanding conflicts were not satisfactorily sorted out, some countries may continue considering their national security as a zero-sum game vis a vis their neighbours. The insecurities on this account, fanned by a reckless media too may have the

corporate sector taking sides too. The resistance from below of the communities and grass root may be ineffective in front of this lethal combine.

## **5.2 Domestic Economic Governance Systems and Regional Integration**

Sixty five years appear to be long enough time in a fast moving, globalizing national economies to start having distinct economic systems for the countries which made an integrated region i.e., Indian sub-continent. There are congruence and common features among all the SAARC member countries such as jinxed structural adjustment reform programmes, ever expanding cash transfer programmes and less than competitive markets but the State-Market relations in each country are qualitatively different from each other.

In most of the cases Trade Policy Reform appears to be caught between Openness and Democracy. Though Multilateralism and unilateral liberalization have proved beneficial to all SAARC countries, the states' policies to winners have resulted in inefficient markets. The growth rates have been decent for the whole region, but the governments have been facing serious difficulties in channelizing adequate resources to socially desirable new activities. . Bilateralism also was also resorted to heavily by SAARC members. As the inequality grows, the political economy of development is not only encumbering the state more than ever, especially in federal systems, corruption has become a major issue in all the countries. There is an opposition to further opening up of the economy as evidenced by the recent debate and acrimony of FDI issue in Pakistan and the reversal of tariff reforms in Pakistan undertaken ten years before. In the circumstances, when, the J Curve of political instability versus openness was looking likely in South Asia, the future of market efficiency reform in South Asia looks bleak. In the presence of significant market failures, guided openness or selective openness is paving the way for the emergence of an entrepreneurial class which would resist any kind of reform even for the sake of regional integration.

## **5.3 Political Economy Interests of entrenched business interest**

Despite so many studies and simulations, the trade in South Asia has not really grown much. One possible interpretation is that the traditional trade flows still bring more profits as compared to the

trade within South Asia. The trade flows in the same direction create strong business stakeholders in that particular direction of trade who influence government decisions to deploy more resources in the same direction such as the efforts to get market access. The strong business interests may develop alarmist defensive postures for any new integration, especially if the regional integration would mean more competition. The auto sector in Pakistan for example cites the example of Indian sector to justify its own unusually high protection levels. At the same time, they are not willing to lower protection levels for each other to trade in a larger market. They would like to have a captive market for themselves and would not think of taking any risk for the longer term sustainability. They would assert that they would not be able to compete with Indian auto sector as the latter enjoys benefits of scale. There are hardly any studies to calculate the advantages of scale, if the decision maker was to confront their media campaigns with evidence that the benefits of scale were not infinite. In the absence of such evidence, they might very well end up extracting a very high price/subsidy to 'integrate'. In the face of such sectors the choices of the government were really limited. By 2017, Pakistan needs to trim its Sensitive List to 100 items. Fifteen Auto Sector tariff lines would stay in the list at the cost of some other sector, which may deserve more to stay there. The cost of excessive protection to one sector is borne by all the sectors. But the lobbying strength of such sectors and lack of credible evidence combine to favour the status quo. Hypothetically, efficiency driven trade integration should make everybody better off at the end. In order to reach there however, the entrepreneurial class has to play its part. With their active involvement, the governments can dedicate more resources to legitimate adjustment support instead of entering into an obscene race of providing more subsidies than your neighbor. An inadequate handling of big sectors by the government in its zeal for regional integration can create serious macro-economic volatility. On the other hand, if the government continues being a hostage to these interests, they would settle for low efficiency equilibrium. In theory, the interest of democracy [read consumer welfare] and free market [read efficiency] should go hand in hand. But democracy and openness seem to be at odds in many regions like South Asia. These ideological constructs exist only in theory. On ground situation crystallises as per the political economy percolations. This however does not mean that these ideals are not worth pursuing. The un-ending conflicts of 'prevalent multilateralism' [host to the agricultural lobbies of the North for example] and the 'prevalent' democratic pressures [host to the interest of subsidy addicted businesses and social protection supported masses and unscrupulous politicians] have resulted in a stalemate in

Doha Development Agenda. How would the lame regionalism fare vis a vis the 'democratic pressures' of member countries, one can imagine. But one needs to know. As a good quality knowledge may also bring with it some least bad solutions.

The private sector business interest is never a monolith. In any economy, variable sectoral characteristics and market conditions would finally determine the balance of power between competing private sector claimants to government's supply of policy. An interest group would try to influence the policy if its assets are liable to policy change and/or if its assets were specific due to the high costs of exit and adjustment. Existing theories suggest that specificity of factors should make lobbying and rent seeking more prevalent (Brainard and Verdier, 1994, Alt et al, 1996, and Coate and Morris, 1999). In many cases, a collusion is cemented between the government and private sector as the former identifies it for being an easy source of revenue. Beverages Sector, including Liquor is a good example in this regard. High asset specificity is also usually associated with fewer firms and greater industrial concentration. Such sectors with high concentration should find it easier to undertake collective action (Olson, 1965). The political economy at the sectoral level is a very complex phenomenon. In South Asia, the policy makers in smaller countries have a very little idea of this largely internal dynamic.

Governments usually favour policies which raise revenue. Even though liberalization seeks to reduce the role of the state, it also requires a reduction in borrowings and the debt burden to improve fiscal solvency and this has made policies which adversely affect the buoyancy in tax revenues a low priority for the state. Let us take the example to Textile Sector in India. It is a leading sector in terms of employment, foreign exchange, and revenues. When there is a question to open up the textile sector let us say to Pakistan, for whom Textiles and Clothing account for more than 55 % of its total exports, the government would try to support the restructuring of the sector, if at all it was needed in such a way that Textiles continues retain the leading sector status and it continues to make its contribution to the government revenue.

While studying the political economic explanation of the behavior of interest groups, a change in underlying market conditions can change the leveraging capacity of a sector. Final policy outcomes are a result of the ability of heterogeneous interest groups to influence the state. In this regard, the competition between the specific asset holding sector, for whom the exit option is costly and those whose assets are more easily redeployable.

The success of interest groups in getting favourable policy depends also on the intellectual orientation of decision makers, including politicians. In India, one comes across ever more virulent voices against the 'Fabian/Nehruvian mix. At the same time, the public distribution system keeps on expanding.

The exercise of influence by interest groups over the state and policy is also a function of the nature of a supply chain as the operation of the supply chain can provide insights into how industrial units influence the organization of production, logistics and marketing, and the options open for improving competitiveness such as moving into more sophisticated product lines (product upgrading), acquiring superior technologies or reorganizing production systems (process upgrading), or even acquiring new functions such as moving from production to design or marketing (functional upgrading) or backwards and forwards to different stages in the supply chain (vertical integration). In India, Pakistan and Bangladesh, each segment of the supply chain has a number of Trade Associations which lobby with the government to get policies favouring their particular segment. The governments may want these Associations to be 'consolidated' into fewer interlocuteurs but apparently, trade associations in South Asia continue to proliferate. In Bhiwandi in India, a power loom cluster, there are a dozen associations. Most of them came up in response to the policy regime of controls, licenses, and permits and have seldom any permanent organizational set-up. In case of Leather sector in Pakistan, each segment has at least one association and they have failed to give themselves an apex organization.

#### **5.4 Political Economy of Level Playing Fields in South Asia**

The presence of Level Playing field for trade between two countries is supposed to be an important pre-condition of a win-win trade. The WTO principles of MFN and National Treatment provide a general framework for the presence of a level playing field. Special and Differential Treatment for LDCs notwithstanding, WTO has introduced many Agreements and mechanisms to 'level' the field, if one party feels so, such as Dispute Settlement Body, Agreements on Subsidies, Trade Policy Review etc. In case of SAFTA, the principle of SD was etched into the agreement and LDCs in South Asia had fewer obligations. As exporting to India from its South Asian neighbours has not been very easy, almost all of them have been complaining on the absence of level playing field in India. During the last ten years, the Non Tariff Barriers of India have been identified and critically evaluated.

Some key conclusions follow from the simulation results. First, and Perhaps most important, full implementation of the SAFTA agreement would Provide a stimulus (even if a relatively small one)to economic growth in all South Asian economies except Bangladesh. Second, full implementation of SAFTA would help to reduce consumer prices in Bangladesh and the Rest of South Asia. Though it would slightly raise prices in Sri Lanka, Pakistan, and India, the increases would be small and outweighed by larger increases in Nominal incomes (i.e. real incomes rise).Third, SAFTA increases intra-regional Trade at the expense of trade with the rest of the world. Fourth, removal of the Current list of sensitive products in SAFTA would hurt Bangladesh and the Rest of South Asia, which therefore would need to be assisted. Finally, Combining SAFTA with the elimination of all trade distorting subsidies in South Asia would be the preferred policy because it would raise real incomes Throughout the region while providing the largest benefits to the poorest countries: Bangladesh and those making up the Rest of South Asia.

India have responded rather positively on the issue of NTBs and have been trying to remove some of them such as visa restrictions etc. In the context of the normalization of India with Pakistan, the term gained significance, as the Cabinet while approving the transition from the positive list to negative list trade regime with India, linked the abolition of Negative List and granting of MFN with the presence of Level Playing Field between the two countries. There have been various claims on the subject ranging from a very optimistic position that the Indian NTBs were not Pakistan specific and let trade normalize after which the SAFTA Framework should be able to take care of the emergent issues and a very pessimistic position that Pakistan would not be able to export much to India---as it had not despite having MFN since 1995---and the Pakistani market would be flooded by Indian goods. While putting the Normalization of Trade with India on backburner, Pakistan has not yet formally stated that a level playing field did not exist between the two countries. If it does so in the coming months, the situation would be more like a member acceding to WTO. Would India be ready to equalize its state support for Pakistani exporters in lieu of the end of the negative list, once independent experts are able to establish that the 'fields' was not level between the two countries? Once India agrees to do so in case of Pakistan, the other SAFTA members may raise the same demand? What would be Indian gains in accepting these demands especially when the issue of 'domestic support and export subsidies' has lost much of its sheen in Geneva over the past few years?

Indian trade regime has its own peculiar characteristics. The regime is evolving either autonomously or as a result of its WTO commitments or as a part of its understanding with big trade partners such as EU. Indian Trade Policy reform could be broadly divided in two parts spread over two decades i.e., from early 90's to early 2000's and the last decade. Tariffs and some subsidies have gone down but the regulatory regime has not been dismantled as such. Being a mixed economy, the role of both corporate sector and State Enterprises has gone up. With democratic pressures, coming especially from the States, the pace of reform has slowed down and the Public Distribution System which impacts very heavily on the agricultural trade policy has even grown bigger and more complex over the recent years. With growth rates coming somewhat down, it is hard to see a radical shift in State-Market relations.

India has embarked upon a reform program, curbing the input subsidies and making efficient income support programmes. The supply side efficiencies targeting at the enhancing of productivity are also being talked about. Would India like to wait for a successful conclusion of this phase of reform or would India embark upon a fourth track also i.e., opening up its agricultural sector under SAFTA Plus, SAFTA Sub scenario? What are the costs and gains? Their 'reform' might take a long time. It is a question of 'differential' treatment to your South Asian Partners basically. If the hopeful signs do not come from India in the coming months, it would be a very bad news, particularly for Pakistan and she would be forced to look elsewhere.

Having said that, the 'cost escalating' barriers, at the border and beyond the border would have to be identified in a bilateral or regional context. Most of the barriers might not have significant trade distortion effect but it would be hard to reach at a consensus until these were quantified, possibly through some robust case studies. This would give concrete, necessary data to the policy maker and would also help them develop different 'policy options' and negotiation positions.

From November 2013, the new phase of the trade liberalization programme [TLP] of SAFTA starts. It is unfortunate that Pakistan is not a part of the new phase. Otherwise, the SAFTA members would have sit together to chalk out a progressive trade development and policy reform agenda. Pluri-lateral approaches in order to grow policy convergence in SAFTA could be more promising as compared to a bilateral approach. It is highly likely that Pakistan was not really interested in the harmonization of trade policies nor in convergence of development outcomes. The end result of all this may very well be some more subsidies to agricultural sector in Pakistan and some steeper

cuts in tariffs for sectors such as textiles. If Pakistan tries to use regionalism to introduce competitive efficiencies across South Asia and in the process reforms its own competition policies, it would be good news for the whole region, at least for Pakistan. In the final analysis, domestic policy reform appears to be more important than the regional trade policy reform. It would be instructive to watch the pace of this reform. It is not the policy harmonization in South Asia, which is the medium term for South Asia. It is the emergence of policy reforms in a common direction in individual countries which would pave the way for a policy harmonization in the case of the general cooperative space expanding among the member states, especially among the bigger four. A stronger political will among political leaders may very well expedite the process. What makes politicians 'will' something common in the region depends on a lot of factors, including attractions linked to enhanced trade in the first place at the bilateral level need in the second place in the form of regional value chains. That is why, it is important to better understand the political economy of bilateral trade too as well as the political economy of sub-regional trade integration.

### **5.5 New Enablers**

A good number of organizations and institutions have emerged over the past few years, which speak of the progress made. Some of these initiatives are as follows: South Asian University, SAARC Secretariat and its development institutions, SAARC Chamber of Commerce, SAARC Development Bank, SAARC Food Bank, South Asian donor institutions, South Asian Business Forum; region wide as well as bilateral, quasi political initiative such as Aman ki Aasha, Track II Diplomacy, South Asian TV, South Asian Virtual University,

### **5.6 Unleashing the Integration Potential at the Sectoral Level**

Many donors are chipping in to support the export promotion activities of LDCs in India and enhance the competitiveness of LDCs. The SAARC member countries are economically growing. At the moment, the trade potential of these countries is big enough only to make them relevant to some sub-sector of Indian economy. These small sectors have relatively small traction with the Indian government. However, the intra-industry trade has been recently increasing. This is an opportunity which could be leveraged by donors and policy analysts as these early exchanges in the context of intra-industry trade can grow into regional production networks. As these networks would grow, the demand for a smoother flow of capital, technology and professionals would also

grow. As the normative visions of a South Asian region making its name in the world remain rather weak due to the factors discussed elsewhere, the best way to enhance the regional trade integration is to positively invest in enhancing trade, investment and technology development.

Some of these sectors such as Leather are fairly big. There have been serious efforts at creating regional trade development associations aiming at the development of regional value chains. A cooperative sub-text of cooperation is discernible in the formative phase which needs to be built upon as a possible success story. Nestle in Far East, foreseeing the emergence of a regional market in ASEAN re-organized its production and distribution networks across the ASEAN member countries with emphatic positive results. Nestle now is a strong proponent of ASEAN Community. If the intra-industry trade in the Leather Sector in South Asia can deepen and in the process South Asian Joint Ventures appear on the latent strengths of the sector and enhance the South Asian share in the global leather trade, they would also become a strong voice for more regional integration in South Asia. They should then also be able to get the bottlenecks removed more efficiently in the Leather Sector in SAARC member countries. This would require a painstaking analytical effort to identify the competitiveness deficits in terms of human capital and technology, financing needed to modernize, anti-competition policies etc. This body of knowledge would inform the regional trade enhancement strategies. There is a need to identify some other sectors also which had strong positives/incentives to enhance intra-industry trade. IT services, Textile, Processed Food and auto-sector should also be able to develop strong regional value chains.

### **5.7 Sectoral sub-regionalism from below**

Apart from the inter-sectoral cooperative vibes from the Leather Sector, there is another positive cooperative sub-text which is the sub-regional economic cooperation. Agriculture is supposed to be a game changer in South Asian trade integration, which at the moment is taken more as an obstacle. India-Pakistan normalization of trade has been slowed down due to perceived threat perception of Farmer Lobbies in Pakistan of the 'subsidy laden' exports of agricultural commodities from India. If we look closely at the sub-regional trade, more of it is in agricultural products and though the quantities are small, SME are involved more in these exchanges; formally or informally. Existence of a large number of SMEs in formal and informal trade in agriculture also means a large scale people to people contact. People to people contact between intelligentsia, students, media, artists plays an important role in bringing different countries together. The

benefits of large scale interaction of SMEs across the land routes, be it Pakistani ‘exporter’ sending a van loaded with ‘chapatis’ at Pak-Afghan border or exchange of fruits and vegetables at Pakistan-India border or the exchanges on the eastern side between Bangladesh-India, India-Nepal are much less understood and projected. Buoyed, in most of the cases, by close cultural affinities, these exchanges are growing with time and becoming more formal also. These trans-frontier exchanges could have a very strong positive effect on inclusiveness through trade. The trade integration negotiations in South Asia have yet to come up with a robust solution to enhance the flow of goods, investment and people in these rather cohesive cultural zones. A solution which should not create the kind of defensive political reactions as we get at the national level. Growth of trans-frontier exchanges in Europe paved the way for regional trade fairs and intensity of exchange across the borders. Such regional fairs enable an SME producer or whole-seller takes its wares to the buyer next door, across the frontier without the involvement of an importers & exporter and Customs. The value is added by the removal of middlemen, seasonality and taste preferences. With a zero-distance between the two culturally close communities, the national governments should be able to allow these exchanges to take place in a context of Domestic Commerce than International Trade. If the farmers and artisans can create value through these exchanges, the role of big capital would somewhat decrease. Addition of value within a locale without much involvement of middlemen and government agencies may have emancipator development impacts and pave way for the emergence of new/new kind of development nodes. We may, in due course of time see the emergence of ‘regionalism from below’. Some of the limitations of the ‘Regionalism from above’ could be overcome with the help of Regionalism from below’.

In the medium term, the ‘hopeful’ sectors need to be given adequate policy attention. But the ‘hard nuts’ such as regionalization of ‘Sugar Sector’ should also be studied in depth. Who knows, the politicians decide a South Asian identity makes good sense and decide to set aside the ‘historical’ conflicts and wish a good future to the coming generations of all the South Asian countries.

What is the relevance of regional integration for the medium term development objectives in South Asia? As the potential of globalization in meeting the expectations of citizens is being questioned more and more people, all the governments need innovative approaches, involving more and more citizens, to shape the experience of globalization which is becoming multi-faceted. the problem of long-term. The challenges and opportunities of globalization could be responded at a regional level

too. India considers itself unto a region and hopes to becoming a global power horse. It would have only a limited effect on global governance if the rising expectation of its people are not met. Likewise, its regional ambition would not get a fill-up if it was not able to transform its economic power into a regional leadership. Regions as building blocks of a global governing system are not a formal requirement yet. EU members through their collective weight would be more that their individual contributions, they gave to chair to EU at WTO high table. It is a matter of time that ASEAN would also be represented as a Regional Block. Regional and even interregional governance are evolving towards more cohesive forms, liberating tremendous cultural energies necessary for sustaining life beyond mere subsistence. India however compares itself more with US and China and would like to be at the high table with them in its individual nation state capacity. The Indian strategies however are markedly different from China.

Traditionally the levels of factor movement are considered a good indication of trade integration. In South Asia, the factor movement is very low and is subject to many restrictions. India and Pakistan have taken a giant step forward, at least on paper, to allow investment in each other's country. The benefits of inter-SAARC FDI are well documented in the context of enhanced Indian investments in Sri Lanka following Indo-Sri Lanka FTA. The Inter-SAARC FDI however remains very limited in absolute terms as well as in comparison to FDI from outside in SAARC area.

The movement of professionals is also at a very low level. SAARC members are engaged in South Asian Agreement on Trade in Services but the pace is rather slow. Labour markets in almost all the South Asian countries even have internal problems with mobility. A labourer from Peshawar may not be welcome in Karachi, what to talk about a worker coming from Kathmandu to work in Karachi, the commercial capital of Pakistan! Increasing role of quotas in job markets---both public and private--- is adding further complications. Political Economy of the free movement of Capital and labour may be very different and has not yet been studied under some efficient theoretical and methodological framework in South Asia.

In terms of the long term regional integration in South Asia, can we imagine a region, which is developing and at the same time, its member countries live in peace with each other? While speaking about the 'long term' of regional integration, one tends to think of deeper integration models such as EU style common market. The decision of the policy makers to move ahead on the road to deeper integration would potentially depend on the perception of regional integration

leading to convergence and growth among the member countries. Usually the smaller countries would give more weightage to the convergence in standard of life whereas the larger countries would also give weight to a convergence in strategic interests. The regional integration literature does not establish a clear positive relationship between robust growth effects and regional integration. [Velde 2008]. There is now a growing literature which shows significant dynamic effects of trade integration on firm level productivity. Such studies are almost absent in the South Asian context. There is a need to undertake research to examine the effects of trade integration in South Asia up to now on regional incomes, income disparities and on firms on the one hand and simulate the possible effects of different 'models of deeper integration' on the convergence issues. A World Bank study focusing on the impact of regional integration on Food Security in South Asia has simulated the effects of a SAFTA Plus, SAFTA Sub and SAFTA Ban. There is a need to do studies on the effects of having or not having Common External Tariff after the reduction of SAFTA duties from 0% to 5%. Studies are also needed to simulate the effects of liberalization of capital and Labour. As the SAARC members negotiate SATIS, it is highly important to simulate the possible effects of liberalization of investment and services sector including Mode 4. RTAs can affect growth through dynamic output and productivity effects such as through competition and scale. Many argue that important effects of RTAs are dynamic, with competition creating a more efficient industry and growth. Lower intra-regional tariffs would lead to increased competition (Neary, 2001). The new trade theory emphasizes long-run productivity effects of trade (Grossman and Helpman, 1991). Productivity spillovers can occur via importing and exporting (Coe and Helpman, 1995; Coe, Helpman and Hoffmeister, 1997). Not only does a country's efficiency increase due to allocation effects, trade helps actors to learn from each other and appropriate R&D spillovers. These learning effects can be translated into long-run efficiency gains. Blomstrom and Kokko (1997) argue that regional integration leads to efficiency gains and higher growth. Increased FDI can actually be such a catalyst through spillovers in terms of technology transfer and other linkages with local firms. There can thus be long-lasting effects on growth and productivity in addition to a one-off effect based on a more efficient allocation of resources.

Coming to the Services Sector, including capital markets, the divergences amongst the South Asian countries are very wide. The 'openness of Bilateral Investment Treaties signed by Pakistan and the Bilateral Investment and Cooperation Agreement signed by Indians is a good example. Capital

Markets in India are much more developed as compared to its neighbours. The Services Sector usually survives from international competition with the help of massive subsidies and it is believed that the policies towards factor mobility are a result of active lobbying by interest groups. In such a scenario, it should be possible to rank the protectionist policies, both from a normative perspective as well as from the point of view of the political viability of the different instruments. Such a model should help us better understand the economic policy formulation processes and the relationship between the domestic politics and regional and international negotiations over the liberalization issues. This may help us better understand the kind of roadblocks the decision makers would come across if they like to move towards a deeper Economic integration in South Asia.

## **6. Concluding Reflections**

### **6.1 Regional Integration at multiple speeds in South Asia**

Agriculture is the sector which is said to have strong political economy aspects. It is believed that the integration of agricultural market would be very hard. In other words, the South Asian economies, which are all having a very strong agricultural base, employing more than half of the work force in all the countries, can integrate only to a limited extent without agriculture. The story though has interesting internal nuances. Bangladesh has bound tariff in agriculture, which are nine times of its applied tariff. Bangladesh is a net food importer and has negligible export surpluses, except in Jute and Beetle Leaves and Tea. This is not the case with India and Pakistan. Both are willing liberalizers. The important position of the trade of agricultural and agro-based products between India and Pakistan reveals certain complementarity with each other with variable sectoral competitive strength. Regional integration is neither trade diversion nor replacement of a local sector with imports. It is about gaining efficiencies at the sectoral and overall economy's level. Both countries have strengths in agriculture. Flow of technologies and investment in a liberalized environment would help them adjust quickly and consolidate efficiency driven competitiveness. As a result they can integrate at a much faster pace and the dynamic effects could create a domino impact. Pakistan being the only country with some comparable strengths vis-a-vis India would not be on defensive all the time like Bangladesh and Sri Lanka. The case of sugar gives an idea of the challenges and promises of regionalization of agricultural markets. According to a recent study, India and Bangladesh would experience some welfare losses as a result of liberalization [tariff reduction as well as removal of subsidies] not Pakistan and Sri Lanka. In other words, there is a

cost of ‘cost’ of not reducing the reduction of tariffs and subsidies for SAFTA members in the form of lost opportunities. There is a need to study the sectoral impacts of liberalization in each of the major sub-sectors of agriculture.

Regional integration is also about –inter-sectoral balances between the member countries. There is a high likelihood that the inter-sectoral balance between India and Pakistan could be achieved if India opens up its agriculture to Pakistan, followed by Pakistan opening up its industrial sector. There are many recent works which highlight the fact that at the time of partition, 95 % of Pakistan’s trade was with India. But this also means that this high mark is an indication that the participation of the areas currently making Pakistan was very low at the time of partition and in the early years. The inverse was not true in case of India. India exported only a small percentage Of its exports to Pakistan. If we look at the consumption pattern of imports from Pakistan, the major regions consuming Pakistan’s exports were the North Indian States. Before the partition, the internal trade in the Indian sub-continent had a strong regional orientation. As the two states had emerged from one ‘market’, the high levels of bilateral trade continued well after the partition. This trade pattern is coming back to an extent. The trade, which is now taking place at the land entry point at Wahga-Attari, between the two countries has a strong sub-regional element i.e., more and more of goods are traded between the Indian (Eastern) Punjab and Pakistani (western) Punjab.

Both countries realize that without having bolder approaches trade integration through Investment and Services liberalization, the gains would remain minimal. In the recent delegation from India to Pakistan, led by Secretary Commerce of India, Mr. Rao, Chief Secretary of Eastern Punjab was a member of the delegation. Sensing that the creation of Trans-Frontier Trade and Investment Zones may not be a pipe dream anymore, Cross-Border Zones, accompanied by innovative Trade Facilitation support such as E-Networking and Cooperation are being talked about at a reasonably high level. In a large sub-continent, with variable levels of development, the regional integration may very well have to pass through growth nodes in contiguous sub-regions. On the eastern side of Indian sub-continent, many efforts are under way to strengthen the sub-regional trade and investment cooperation. Those regions have an advantage over the sub-regional cooperation between two Punjabs due to the fact that Bangladesh, Nepal and India are participating in it and India has advanced the duty free entry from both the countries two years before. Both India and Pakistan have the necessary legislation on Special Economic Zones and can mobilize huge

investments in a Cross-Border Economic Zone from South Asian/Punjabi diaspora too. Duty free import of raw materials and machinery, free movement of labour, cumulative Rules of Origin and duty concessions from third countries like EU or US---interested in regional integration--- can help these zones take off.

This can become another kind of Public-Private Partnership, where the governments facilitate and remain non-intrusive and let the private sector enjoy a free atmosphere to grow and export. Given the sub-regional dynamics of India-Pakistan trade, the Lahore Chamber of Commerce and other business groups from Punjab have taken a leading role in breaking the ice. There is a certain momentum to the whole process. The sub-regional growth nodes can give an equal chance to the market driven regional integration.

At present, the two Punjabs mostly trade in fresh produce/food products. There is a real potential of developing regional food supply chains and even regional food brands. The previous political conditions between the two countries were not conducive but now, the situation has started changing and a bold approach to cross-border cooperation stands a chance focusing on small producers, traders, importers and processors. There is a need to compare and contrast the respective laws, rules and regulations propose the necessary changes to develop a legal and institutional framework for a cross-border special economic zone.

In South Asia Regional Trade Cooperation, usually top-down policies are adopted which have shown at best mixed results. In the wake of raging food prices these days, both India and Pakistan should be interested to develop regional food supply chains. Such supply chains have a high likelihood of making small producers on both sides better of making regional integration a pro-poor process.

Due to ongoing Composite Dialogue between India and Pakistan, people to people contact between India and Pakistan has grown, but not among the small scale businessmen across the border. Both countries can effectively reduce poverty and vulnerability by better governance of agricultural markets in the changing food supply scenarios in South Asia. Currently the RCA studies between India and Pakistan tell us that 83 % of export potential of Pakistan to India is un-realized. As in the coming days, the tariffs are going down due to South Asian Free Trade Agreement [SAFTA], it is a right time to enhance the capacities of small scale producer, trader and processor on both sides of the border. Indian food import bill is shooting up. On Pakistan side, Pakistani produces of fresh fruits and vegetable are a victim of 'double distress' as they are more often than not at the

mercy of middlemen. Better returns by an opening up of exports next door and by having more demand in the processing industry, would reduce the poverty of small scale farmer and would increase productivity by better access to credit and inputs market.

## **6.2 Emulating ASEAN for developing Regional and Global Supply Chains**

There is hardly any dispute on the efficiency and regional integration brought about by the supply chains of multi-nationals. By developing networks of subsidiaries they can on the one hand better manage the demand by ensuring balanced capacity load across subsidiaries and on the other hand easily come over the problems such as shutting down of factories, strikes, capacity shortages, political-economic upheavals as they can easily switch over the production from one subsidiary to another. There is a vast literature available on the causes on MNCs locations or dis-locations. India, for example, scores very high on most of the account. Yet it fares poorly on account of logistics and connectivity. The arrival or emergence of regional supply chains would only be possible in South Asia if the region provides added incentive to them to re-locate. In this regard, South Asia has to compete with China and ASEAN to have global supply chains. Within South Asia, Pakistan, or for that matter, any SAARC member has to match at least Indian conditions if they would like to share in the regional supply chains in a meaningful way. Pakistan has a number of such MNCs which also have operations in India. Until now, none of these MNCs have regionalized their production and distribution. There is some nascent activity in the pharmaceutical sector but of a very limited nature. A significant recent development however is the regional marketing, particularly by the cosmetic sector firms. But that is more of using advertisements produced by sister companies which are shared. At least, this is a beginning. But if we compare the sale of regionalization of supply chains with ASEAN, South Asia has to go really a very long way in developing ten % of today's ASEAN's Global Supply Chains output. In ASEAN, market-led process through the international production sharing of MNCs, reduction of barriers to trade and investment were made possible by the unilateral, bilateral FTAs and multilateral agreements-MTAs, and the rapid development of multi-modal transport and logistic providers, and information and communication technology. As is well known, the integration of ASEAN into the global/regional production network was the result of the industrial restructuring of the newly industrialized economies (NIEs), who were initial hosts of the offshore production of Japanese and American firms. The domestic policies of the ASEAN countries however performed a crucial role

in shaping the member economies' capacity to take part in the global production chain. Generally, the unilateral trade and investment liberalization policies of the member economies fostered domestic efficiency and produced competitive industries. However, the ASEAN experience tells us that after a minimum of outward orientation, a country can have greater openness and liberalization in priority sectors [such as electronics and ICT sectors] while protectionism policies could continue in selected sectors [such as the textiles and garments industry].

The second driver in ASEAN is considered to be the institution-led process through free trade and investment agreements and functional cooperation arrangements. Barriers to intra-regional trade were gradually reduced as the ASEAN Free Trade Area (AFTA) policies attracted the FDI-driven production networks. In reducing the trade barriers across the region, AFTA created an

Environment, where MNCs are freer to locate their cross-border bases. Coupled with liberalization of services, ASEAN has also implemented a number of regional cooperation programmes in industrial cooperation and harmonization of policies and institutions, to make the region more attractive to foreign direct investment. The third driver is considered to be a private-led process in the form of sub-regional economic zones (SREZs) which have the attractiveness of investment combining comparative advantages, and exploiting economic complementarities and economies of scale. Unlike institutionalized arrangements, sub-regional economic zones are private sector-led, with the role of national and local governments being limited to facilitating business through appropriate policy frameworks and investment promotion. The focus of cooperation is mainly on investment and infrastructure provision rather than specifically on trade liberalization. Better known SREZs in ASEAN are (i) Indonesia-Malaysia-Singapore Growth Triangle; (ii) Indonesia-Malaysia-Thailand Growth Triangle; (iii) Brunei-Indonesia-Malaysia Philippines East Asia Growth Area; and (iv) Greater Mekong Sub-region. In South Asia, there are similar initiatives at different stages of development. SAARC Secretariat or SAARC Chamber has not yet devised an institutional framework to give a big and integrated push to these fragmented efforts. There is therefore a need of a huge collective effort to identify some potential champion sectors and give a big push to regional integration at the selected level.

India is making serious efforts to partake in the global or regional supply chains through India-ASEAN FTA or BIMSTECH. It appears unlikely that India would be next station as was the case of Philippines, Vietnam from Singapore, Malaysia core. Nor is there a possibility of MNC re-

locating from China to India at a large scale. Most of the MNCs in South Asia are of European origin. India-EU FTA would see Indian based MNCs integrating with global supply focused on EU. What would be the impacts of India-EU FTA on investment in let us say Pakistan. CARIS Report predicted relocation of investment from Pakistan to India after India-EU FTA. If it happens, it would be a bad news for regional integration in South Asia. But the CARIS report was predicated upon a slower institutional reform in Pakistan as compared to India. By undertaking pro-competition policy reforms, investing in infrastructure and improving economic governance, Pakistan can attract FDI and can benefit from the presence of global supply chains in India to an extent though this would be the second best scenario. The best scenario would be to follow ASEAN model somewhat more seriously.

### **6.3 The Politics and Political Will behind Regional Integration**

This is almost a cliché that the South Asia is not integrating fast enough are well enough due to the lack of ‘political’ will. Any Reform or Development Effort requires ‘political will’ to succeed. The evidence of the effectiveness of its presence is fairly well documented as the ‘political will’ of French and German leadership working together in creating EU, the way we know it or the political will for the unification of Germany. However, the political Will on paper is one thing. From paper to reality, it traverses the implementation process. If I that phase, right kind of steps are not taken, then the outcomes remain weak. SAARC Summits are an expression of political Will; well documented. The weak relation of these declarations could be attributed partly poor strategization and to weak implementation capacity of SAARC Secretariat and national bureaucracies. Or is it possible that the declaratory policies are not backed by a ‘popular will’? The statements at SAARC Summits are more of posturing. That is possible. But, these are the strong stakeholders, who can translate even posturing into concrete development. This way, next time, there would be less posturing.

There is a need to un-pack the ‘lacking’ political will in South Asia for the creation of a regional trade block. SAARC Leaders have been talking about the creation of a South Asian Community [SAC] in five years time. The emergence of such a Community is predicated on the emergence of a regional trade block and a host of other supra-national institutions. The international experience suggests that the South Asian Community [SAC] can take three possible routes: An SAC, which is deeply integrated economic community like EU where nation-states, regions and Brussels are

all important. Some principle features of this Community are as follows; it has ‘outsourced’ its defense to NATO; culture is not a source of conflict; economic governance is a shared responsibility of national governments and the European Commission has upper hand where the economic decisions have regional repercussions. The mere talk of a Community does not conceive of a South Asian integration in any meaningful sense. The trade follows the market and foreign policy/market access decisions and the foreign relations of SAARC member states. In case of South Asia, they remain in low form of flux as the South Asian countries participate in multiple regional configurations and formations with multiple ends and interest and member states bureaucracies remain busy in juggling multitudes of options. In brief, they do not follow a relatively simple formula that the national leaders define the regional objectives, policy interventions lay the frameworks and give a push to factor mobility in the unified direction of regional block and after it was achieved, market takes over and the global market integration follows the opportunities on the basis of efficiencies.

#### **6.4 Hunger in South Asia: A Litmus Test**

The traditional, usually FAO driven, discussions on the Food Security in South Asia have been ignoring the impact of food price inflation on regional trade and the possibility of improving food security in South Asia by liberalizing trade. A recent World Bank study (2010) explored the potential of mitigation of regional food price inflation if SAFTA was ‘fully’ implemented. In this regard, they ran three simulations i.e., full implementation of SAFTA as it was in 2010, Implementation with no Sensitive Lists and implementation with no Subsidies. [They did not run a fourth one with neither Sensitive List, nor subsidies]. The results suggest that the full implementation of SAFTA will only have a minimal impact on world food prices, and only marginally impinge on domestic food prices. Whereas, the impacts in other two scenarios were significant and were highly positive collectively. In other words, large number of products on sensitive lists and the presence of non-tariff barriers and subsidies prevent SAFTA from having a greater impact on domestic food price inflation. One can see the cost of not deepening the regional trade. The ‘trade impact’ could be significantly enhanced by complimentary policies such as coordination among research institutions, operationalizing the SAARC Food Bank, cooperation in Climate Change etc. (Rahman 2012). The ‘pull’ of regional solutions to such an important national problem however has not had significant impacts on the decision makers, forcing the conclusion

that if Hunger could not bring the South Asians together, then, the regional trade integration is a lost cause, in the business as usual scenario.