

SOUTH ASIA DEVELOPMENT AND COOPERATION REPORT

2015

Economic Integration *for* **Peace-Creating Prosperity**

Executive Summary



RIS

Research and Information System
for Developing Countries

South Asia Development and Cooperation Report 2015

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Foreword



Ambassador Shyam Saran
Chairman, RIS

Progress in South Asia in terms of economic integration and the performance of SAARC as an institution have remained debatable. While there is no denying the fact that South Asian economic integration has to travel a long and winding road, it must be acknowledged that the region has also achieved certain milestones. These include progress made in the realms of free trade in goods and services, establishment of the SAARC Development Fund, commencement of the South Asian University and Convention on Cooperation on Environment, among others.

What is more, the region has emerged as the fastest growing region in the world with an average rate of growth of 7.4 per cent expected to be sustained through 2016, according to the latest World Bank estimates. This is particularly significant as a higher economic growth trajectory in South Asia will contribute towards the region's ability to fight the scourge of poverty and unemployment.

The challenge for South Asia lies in ensuring inclusive growth at the national level but also balanced growth at the regional level. However, in this endeavour, South Asia as a region and SAARC as an institution have been unable to leverage the drivers for such growth through cooperation and synergy among the member countries themselves. South Asian countries remain better connected with partners outside the region than with their own neighbours. This has to change if regional integration has to make progress.

The twin challenges faced by the South Asian region include achieving peace and prosperity. The *South Asia Development and Cooperation Report 2015* explores various dimensions of economic integration in terms of achieving these two objectives. This becomes particularly important since the 18th SAARC Summit in Kathmandu, Nepal had its central theme as: 'Deeper Integration for Peace, Progress and Prosperity'.

I hope that the analysis and the conceptual framework presented in this Report coupled with important policy suggestions would be found useful by leaders, policymakers and thinkers not only in the region but also by interested observers in other countries as well.

June 2015
New Delhi

A handwritten signature in black ink, which appears to read 'Shyam Saran'. The signature is fluid and cursive, written in a professional style.

Shyam Saran



Prof. Sachin Chaturvedi
Director General, RIS

Preface

Efficacy and effectiveness in our regional cooperation pursuits are extremely important for retaining our collective competitiveness in the global economy. The regional outlook of South Asia is showing a remarkable upturn compared to the rest of the world. The regional macroeconomic situation is gradually improving with partial recovery of the global economy in recent time.

Presently, the challenges before the SAARC member countries are to identify ways and means of achieving regional integration on a fast track basis with full implementation of SAFTA. The move from SAPTA to SAFTA and now the proposal for South Asia Economic Union are pragmatic approaches towards the next stage of cooperation. At the same time, we also need to move further from trade liberalisation measures alone to regional investment cooperation strategy, production integration, technology cooperation etc. In the pursuits of economic union and common market; macro-economic coordination would also assume greater significance.

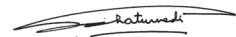
RIS is always at the forefront in promoting economic integration in the region and has conducted several studies in the past on its different aspects. It is pertinent to highlight here that RIS had also contributed to preparing the initial draft texts of the South Asian Free Trade Area (SAFTA) Treaty as well as the SAARC Agreement on Trade in Services (SATIS).

This *South Asia Development and Cooperation Report 2015* is the fifth in the series of reports launched by RIS since 1999. These reports have created a niche in the region and beyond, in terms of providing the conceptual and empirical basis for the South Asian economic integration process. This flagship Report of RIS has focused the theme *Economic Integration for Peace-Creating Prosperity* which is in consonance with the central theme of the 18th SAARC Summit, which was held in 2014 in Kathmandu, Nepal. This theme is very important as the Report argues. Rather than waiting for peace to descend in the region and holding back economic integration initiatives that have rich potential for achieving prosperity in the

region, the Report argues for a reverse causality by way of focusing on achieving prosperity in the region through economic integration which, in turn, could prove to be 'peace-creating'. This can run parallel to the ongoing peace process. Global perception about South Asia is that it is a small and low performing regional grouping in the world. The Report essentially argues that South Asia is one of the largest, dynamic and fastest growing regions in the world. It has got strong productive capacity to grow, having significant savings-investment ratio, and expanding fixed capital formation in many economies in the region. It is one of the highest recipient of personal remittances from the rest of the world. However, it is considerably lacking in terms of receiving inward FDI from the rest of the world. Time has come that we should reckon and understand the strength of South Asia so that growth vibrance can be recreated in the region with the existing productive forces through mutual cooperation.

The Report has been prepared by the RIS research team with extensive consultations that included noted outside experts as well. I would like to add my words of appreciation for all those who have contributed to this flagship Report of RIS which presents newer insights into the issues and makes certain important policy recommendations, all geared towards the central theme of the Report. I must also acknowledge with thanks the dynamic efforts of Prof. Ram Upendra Das of RIS for bringing out this Report well in time. I am also grateful to the editorial and publication team of RIS for so very efficiently facilitating the publication of this Report.

June 2015
New Delhi



Sachin Chaturvedi

Acknowledgements

The *South Asia Development and Cooperation Report 2015* with the central theme as *Economic Integration for Peace-Creating Prosperity* is a result of collective efforts made by a research team led by Prof. Ram Upendra Das. The core team comprised Prof. Sachin Chaturvedi, Prof. S.K. Mohanty, Dr. Beena Pandey, Dr. Priyadarshi Dash, Mr. T.C. James, Dr. K. Ravi Srinivas, Mr. Amit Kumar, Ms. Shalini Taya, Mr. Anup Kumar Jha, Mr. Monu Singh Rathore, Ms. Sunakshi Jain, Ms. Gamika Takkar, Ms. Vrinda Seksaria and Ms. Aastha Gupta. A special mention must be made of the research support provided by Ms. Surabhi Agarwal and Ms. Nitya Batra. Important contributions to different chapters were made by Dr. Kasturi Das, Dr. Arindam Banerjee, Dr. Kaushik Bandyopadhyay and Mr. Rajeev Malhotra.

From time to time, the Report has benefitted from valuable guidance received from Ambassador Shyam Saran, Chairman, RIS and the overall dynamic leadership of Prof. Sachin Chaturvedi, Director General, RIS.

Inputs were also provided by Prof. Manmohan Agarwal; Prof. Milindo Chakrabarti, Dr. Balakrishna Pisupati and Dr. Nitya Nanda; and by Prof. Ramgopal Agarwala, Prof. Biswajit Dhar and Prof. I.N. Mukherjee and Prof. Prabir De at the initial stages of the Report. Thanks are also due to Dr. N Chandra Mohan and Dr. Saikat Sinha Roy.

The Report benefitted immensely from various brain-storming sessions held with the officials of the Ministry of External Affairs (MEA) and the Ministry of Commerce and Industry (MOC&I), Government of India as well as the SAARC Secretariat, Kathmandu, Nepal. In particular, thanks are due to Dr. A.M. Gondane (Joint Secretary, SAARC, MEA), Mr. Amrit Lugun, earlier Director and Ms. L. Savitri, the current Director of the SAARC Secretariat. Special thanks are due to Mr. Arvind Mehta (Joint Secretary, SAARC, MOC&I), Government of India. Discussions were also held with Dr. Ulrich Volz, German Development Institute, Bonn; Mr. Shekhar Bonu of the Asian Development Bank, Manila; and Prof. R.S. Ratna of UNESCAP, Bangkok. Support received from the Embassy of India, Kathmandu and Mr. S.C. Sharma of the SAARC Secretariat is gratefully acknowledged.

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Executive Summary

The twin challenges in South Asia are achieving peace and prosperity. While both reinforce each other and therefore have a dual causality, the Report argues in favour of strengthened economic integration initiatives for creating prosperity that, in turn, would create peace in the region. This happens through enhanced economic activity and employment generation as a result of effective economic integration. In this endeavour, trade becomes peace-creating by stepping up the profiles of all the sectors, viz. agriculture, industry and services. For this and more to happen, enabling conditions like macroeconomic stability, connectivity including digital connectivity, trade facilitation, and environment-friendly economic activities providing impetus through S&T collaborations and development cooperation would be imperative. These could well be the best antidotes to poverty and development deficits in the region.

PEACE-CREATING PROSPERITY THROUGH ECONOMIC INTEGRATION

The causality between peace and prosperity runs in both the directions. While the obvious narrative has remained where peace precedes prosperity, it may be time that the ‘reverse causality’ is focused whereby enabling condition for economic prosperity is created through economic integration to achieve peace. It may be argued that underdevelopment and unemployment could be the origins of instabilities and violence. Unemployed and under-privileged, especially the educated youth may be prone to adopting unfair means to earn a livelihood. Providing productive employment opportunities to them through scaling-up economic activities with the help of economic integration could well ensure prosperity that is peace-creating.

Therefore, keeping the broader objectives of South Asian economic integration, viz. peace via prosperity in which trade plays a crucial role

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and making South Asia as a *hub* of economic activities within the larger canvas of pan-Asian economic cooperation, the Report dwells upon the present status of cooperation, identifies challenges and lays down the future outlook by way of some policy recommendations, in several crucial areas of trade in goods, services, investment, trade facilitation, connectivity, food security, energy security, climate change, science and technology, development cooperation and social infrastructure. Different chapters of the Report while heralding the successes of South Asian initiatives, quite objectively, identify the issues to be further discussed and present ways to make forward movement towards South Asian peaceful co-existence through economic integration.

SOUTH ASIAN MACROECONOMIC DYNAMISM

From a macroeconomic point of view, the South Asian region is not a non-performing region. Led by India, the South Asian region is now the 'fastest' region in terms of GDP growth rates. It is projected to grow at an average growth rate of 7.4 per cent and 7.6 per cent in 2016 and 2017, respectively – as per the recent World Bank estimates. This is a considerable feat given that the South Asian region, like other regions, was impacted by the global financial meltdown. Its size in terms of real GDP is much larger than some of the notable regional economic groupings including ASEAN, MERCOSUR, SACU, SADC, COMESA, GCC, CARICOM, among others. In 2013, real GDP of South Asia was larger than the combined GDP of ASEAN, ECOWAS, EAC and CARICOM or those of MERCOSUR combined

with CARICOM. Region's share in the Gross World Product in PPP terms has been growing faster during the last two decades as compared to other regional groupings. Further, growth potential of the region has remained robust given the scope to increase its savings and investment ratios.

Two important insights are worth-mentioning: first, in relation to other RTAs inward FDI has been relatively lower than that of outward FDI of the region during the last decade and secondly, South Asia has emerged from being a low recipient of personal remittances in 2003 to one of the highest recipient regions of the world presently, whereby personal remittances have emerged as significant and greater contributors to foreign exchange reserves as compared to inward FDI. This can possibly be explained with the fact that the region is mostly perceived as lacking in macroeconomic dynamism. With a change in the mind-set and perceptions about the region that it is capable of displaying macroeconomic dynamism, led by India, positive impact on various FDI index rankings and global credit-ratings could be possible. This, in turn, would impact inward FDI positively.

The growth momentum in South Asia needs to be sustained and one of the ways to achieve this is through trade-augmentation which in turn is dependent on trade finance. Deepening of capital markets with prudence is also imperative, including strengthening of local and regional currency markets. Considering that macroeconomic instabilities and crises have led countries to situations of unemployment and even social unrest, sustainability of macroeconomic environment becomes a pre-condition for achieving peace.

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....effects of augmented trade result in higher levels of economic activities; and contribute to employment generation; and, therefore, prosperity through income generation becomes peace-creating.

ECONOMIC BASIS OF PEACE VIA TRADE

Market access provides an additional demand impulse facilitated by a more liberalised trade regime on a regional basis. This, in turn, contributes to scale expansion in various sectors including manufacturing. Scale expansion is often the effect of trade creation as well as trade diversion. However, while the former is an efficient way of regional trade restructuring, the latter is presumed to be efficiency and welfare-reducing. It can be argued that even trade diversion can be an efficient proposition in a dynamic setting and could be trade-creating and consumer welfare enhancing. The former may happen when market access leading to scale expansion makes the manufacturing process inherently price competitive via the effects of economies of scale. Overall, these effects of augmented trade result in higher levels of economic activities; and contribute to employment generation; and, therefore, prosperity through income generation becomes peace-creating. There are two more channels through which trade contributes to peace. These include regional value chains and rules of origin. Regional value chains can be private sector-driven as in the case of South East Asia, if enabling conditions like SAFTA are utilised for freer movement of goods on a regional basis. On the other hand, rules of origin, by making substantial transformation of inputs to a distinct output, contribute to local value addition which is used to pay wages and salaries to labour, interest to capital, rent to land and profits to entrepreneurs. In this way, including the backward and forward linkages that rules of origin generate, greater employability of all

factors of production and not just labour gets ensured with the whole process potentially becoming a profit generating endeavour. In this sense, rules of origin help all factors of production by opening newer employment opportunities and contribute to peace especially relevant in the context of 'jobless growth'.

In sum, trade liberalisation has two effects on employment, viz. scale effect and technological effect. With expansion in scale of production there will be a higher demand for labour and trade liberalisation and the ensuing market access will thus boost employment. Also, as trade is liberalised countries get a chance to become specialised in certain products on the basis of their comparative advantages. This can be an important channel for employment generation. With increase in levels of production activity there is also an increase in technological innovations and capital-intensive investments that generate productivity growth. The impact of such productivity growth on employment is generally negative in phased out industries and positive in expanding industries. Thus, peace via trade can be thus achieved.

AN INTEGRATED APPROACH TOWARDS ECONOMIC INTEGRATION

Conceptually, emphasis is often given to trade integration or investment integration in isolation. What is needed is to adopt an integrated approach towards trade in goods, trade in services and investment flows, recognising their inter-linkages while assessing any potential for economic integration in a particular region. That this is not understood is manifested in the fact that while trade in goods FTA through SAFTA is in place,

There is a need to adopt an integrated approach towards trade in goods, trade in services and investment flows, recognising their inter-linkages while assessing any potential for economic integration in a particular region.

South Asian region would have to learn to confront the 'challenges of asymmetry' and 'proximity'. Economic integration in a more meaningful way could be the best answer as this may result in economic growth convergence - a phenomenon unfolding silently in the South Asian region.

negotiations on request-offer in sectors for trade in services under the SATIS remain incomplete; and the draft SAARC Agreement on Promotion and Protection of Investment still remains inconclusive.

ECONOMIC ASYMMETRY AND GROWTH CONVERGENCE

The South Asian region is characterised by economic asymmetry. Thus, it is often argued that due to tariff liberalisation in the region, the relatively bigger countries would gain more in terms of their exports and would be able to capture the markets of the smaller and lesser developed countries. This may not be true. The bigger countries are already having larger presence in terms of exports to the smaller countries. Thus, with regional trade integration, the bigger countries would not be able to expand their exports due to limits on the size of the markets in the smaller countries. Furthermore, the smaller and lesser developed economies would gain much more than relatively bigger economies on account of enhanced market access for the former in the latter. This is quite evident from the experience of Sri Lanka's gains vis-à-vis India under the India-Sri Lanka FTA.

On a different plane of argument and analysis, one may argue that the South Asian region would have to, in some respects, learn to confront the 'challenge of asymmetry' as well as challenges of proximity. Economic integration in a more meaningful way, especially between India and other neighbours in the South Asian region, could be the best answer. This may result in economic growth convergence in South Asia as it happened in the case of the EU. Some econometric explorations do provide a glimpse of such a phenomenon unfolding silently in the South Asian region.

TRADE INTEGRATION NEITHER LOW NOR SLOW

The South Asian region under the aegis of SAARC has moved much faster than often perceived in terms of trade integration. Since economic cooperation was included on the agenda of SAARC in the early 1990s, SAARC launched a preferential trade agreement, i.e. SAPTA in 1995. It deepened trade cooperation by moving towards a free trade area in the form of SAFTA in 2004 which became effective in 2006. A much deeper level of trade integration was envisaged through signing a trade in services agreement, i.e. SATIS in 2010. Apart from the fact that the trade integration has moved at a fast pace, the intra-SAARC trade has hovered around 5-6 per cent or so as a proportion of SAARC's trade with the rest of the world. This only means that intra-SAARC trade has been expanding at the same pace as extra-SAARC trade, keeping the ratio of the two constant. In fact, the success of SAFTA lies in the fact that the intra-SAARC trade has doubled since the region implemented the SAFTA Treaty. The intra-regional exports have increased from US\$ 10 billion in 2006 to about US\$ 22 billion in 2013. What is more, the individual SAARC countries' intra-SAARC trade is very high, going up to the extent of 70 per cent, as a proportion of their total trade with the rest of the world. In reality, the intra-SAARC trade without India and Pakistan turns out to be 20 per cent. The average intra-SAARC trade goes down by including India and Pakistan, given their asymmetric trade linkages with the SAARC countries. Thus, it is safe to assume that intra-SAARC trade has been a victim of statistical anomaly. Even further, if we include

The intra-SAARC trade has doubled since the region implemented the SAFTA Treaty. The intra-regional exports have increased from US\$ 10 billion in 2006 to about US\$ 22 billion in 2013. In some SAARC countries intra-SAARC trade is as high as 70 per cent.

The informal trade in South Asia, with different estimates ranging from two to three times the formal trade, the total trade in South Asia would stand in the range of US\$ 44 to 66 billion.

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the informal trade in South Asia, with different estimates ranging from two to three times the formal trade, the total trade in South Asia would stand in the range of US\$ 44 to 66 billion. It is also observed that there exists enormous trade potential that remains to be tapped to the tune of US\$ 80 billion by 2018 if adequate measures on sensitive lists, NTBs and completion of SATIS negotiations are ensured. In addition, within the realm of SATIS, visas for health care emergencies and student visas need to be facilitated under Mode IV targeting the social sectors like health and education through trade liberalisation.

TRADE PROFILES, COSTS OF NON-COOPERATION AND EXTERNAL DEBT

The trade profiles in South Asia suggest that countries often import products from extra-regional sources when the very same products are being exported by other South Asian countries to the rest of the world but not to the other South Asian country. What is more, countries are importing higher unit value products from outside the region as compared to the unit values of exports of the same products emanating from other countries in the region. This results in incurring an additional cost of imports due to not sourcing those products from within the region but from outside the region. Earlier estimates suggested that Sri Lanka and Pakistan imported many items at higher unit values than that would have prevailed if they imported from within the SAARC region. On this account Sri Lanka lost US\$ 266 million and Pakistan lost US\$ 511 million. For Sri Lanka the unit values of imports from outside the region were on an average twice the unit values

associated with regional import of same items. Illustrative examples of the price comparison of Kawasaki- Bajaj two-wheelers imported from India by Sri Lanka with its original Japanese Kawasaki brand can be highlighted. Most recently, estimates on cost of non-cooperation suggest an enormous jump touching on occasions billions of US dollars for individual countries. For instance, in cases of Pakistan and Sri Lanka the costs of non-cooperation turn out to be in the range of US\$ 1-2 billion per annum. These figures need to be seen in a proper perspective. The costs of non-cooperation in SAARC countries emanating from not conducting trade on an intra-SAARC basis can be equal to levels of their external debt servicing. In other words, foreign exchange earnings through intra-SAARC exports can not only reduce costs of non-cooperation but can also reduce the external debt burden denominated in hard currencies.

TRADE POTENTIAL

Recent estimates suggest that the formal trade can grow to a range of US\$ 44 billion and US\$ 66 billion by 2018, in a Computable General Equilibrium (CGE) Modelling scenario which includes full tariff liberalisation by all members, trade facilitation and productivity improvements. In terms of distribution of trade gains estimates suggest that smaller and least developed economies like Bangladesh, Nepal and Sri Lanka would gain more than relatively bigger economies like India and Pakistan due to access to larger markets. The intra-SAARC trade experience in 2012 provides for counterfactual trends to this effect.

Estimates suggest that the formal trade can grow to a range of US\$ 44 billion and US\$ 66 billion by 2018... In terms of distribution of trade gains, smaller and least developed economies would gain more than relatively bigger economies.

The region may have more points for facilitating trade for integration with Punjab in Pakistan. India may consider more ICPs. In case of India-Bangladesh the two governments have moved in this direction.

INFORMAL TRADE: SAFTA AT WORK

The existence of informal trade of SAARC countries with India is estimated to be multiples of formal trade, which is nothing but a manifestation of natural comparative advantage; existence of trade complementarities; and supply-demand gaps across countries in the region. Adding the formal and informal, the intra-SAARC trade would be much higher. While formal intra-SAARC trade stands at around US\$ 20 billion, the informal trade estimates turn out to be US\$ 25 billion. The intra-SAARC formal trade increased by 270 per cent between 2003 and 2012; however, informal trade increased by only 112 per cent between 2005 and 2012, while it increased by 285 per cent between 1990s and 2005. This augurs well for the region and possibly gives some positive indications towards the benefits and efficacy of SAFTA. Overall, intra-SAARC trade after combining formal and informal trade stands at US\$ 45 billion, which is by no means insignificant. The region may have more points for facilitating trade for integration with Punjab in Pakistan. India may consider more ICPs. In case of India-Bangladesh the two governments have moved in this direction.

TOWARDS A SAARC INVESTMENT AREA

Recent times have witnessed increase in intra-SAARC FDI and projects. However, their volumes, sectoral- and country-coverage can be augmented further. Investment is one of the major determinants of growth. This needs to be viewed as a vehicle to build a manufacturing and services base for meeting the employment generation objectives and, in turn, peace. Its relevance gets heightened when situated in the context of trade-FDI nexus.

Given that South Asian countries are highly import dependent, the regional investment becomes crucial to expand the export supply capacities, especially to address the foreign exchange constraints imposed by severe and rising trade deficits. Some of the areas that warrant attention include power, telecom, construction, agribusiness and processing, wool and carpets. Note should also be taken of the provisions that could be developed under Mode III of the already existing SAARC Trade in Services (SATIS) agreement.

The SAARC Investment Area would serve the purpose of generating investment flows not only within the SAARC region but would also attract foreign investment, as Foreign Direct Investment (FDI) can come in to take advantage of the growing and liberalised market opportunities of the entire SAARC region. By declaring the SAARC region as a SAARC Investment Area, the smaller members would be able to take advantage of the higher credit ratings of the bigger nations and also the assurance of large markets in the region. Further, promoting local currency bond markets, especially corporate debt markets, to reduce dependence on external commercial borrowings should be considered. The conception of the SAARC region as a single investment area would encourage the business community of the SAARC region and also the investment community of the rest of the world to explore the possibilities of finding optimum locations for their investment activities in different countries of the region. The SAARC Investment Area would also contribute towards evolving SAARC-level corporate sectors which can emerge as global competitors by taking full advantage of the material and human resource complementarities of

By declaring the SAARC region as a SAARC Investment Area, the smaller members would be able to take advantage of the higher credit ratings of the bigger nations and also have the assurance of large markets, including capital markets in the region.

An early conclusion of the Regional Investment Promotion and Protection Agreement would be imperative to harness trade-investment nexus.

the SAARC member countries. To this, an early conclusion of the Regional Investment Promotion and Protection Agreement would be imperative. The Agreement under negotiation could be revised and concluded by including some of the newer considerations of value chains and evolving South Asia as a manufacturing hub, achieved through creating a SAARC Investment Area. Promoting intra-regional investments in the region will, hence, strengthen trade linkages and value chains existing between the economies of the region and will eventually lead to higher output, income and employment.

LOGIC OF TRADE IN SERVICES INTEGRATION IN SAARC

With the SAFTA Treaty, the process of SAARC economic cooperation reached a milestone. However, in order to realise fuller benefits of SAFTA, a developmental and integrated approach towards trade in goods is needed. This stems from the fact that trade in goods and trade in services could be used to reinforce each other. More broadly, trade and investment linkages need to be strengthened. All these together, bring the developmental focus to regional trade and investment cooperation, especially in South Asia. It is in this context, that efficiency-seeking regional restructuring becomes important and achieving a South Asian Economic Union becomes realistic. These only highlight that the SAARC regional economic integration process needs to adopt extensive and intensive approaches, simultaneously. The former may entail expanding the scope of SAARC economic cooperation to include trade in services within its ambit. This would help integrate the region in the realms of

factors of production including long term capital flows in the form of investment and movement of natural persons, leading to a South Asian Economic Union. The latter would mean expediting these economic integration processes. Thus, the economics of neighbourhood becomes relevant in this context.

The services sector has already assumed considerable importance across the SAARC countries vis-à-vis their GDP and trade with important implications for potential prosperity and peace in the region. The sector has immense potential for cooperation at the intra-SAARC level in various sectors, with tourism, IT, education and health being just a few. Given this, the businesses would get a boost in all the countries of the SAARC both from the point of view of export interests and import interests, provided negotiations under the SATIS are completed at the earliest. For effectiveness of the SATIS, focus would have to be on fast-pace regulatory cooperation on mutual recognition and harmonisation of professional qualifications, licensing certification, technical standards, information exchange, health visas and provisions for labour mobility, among others.

The services sector has already assumed considerable importance across the SAARC countries vis-à-vis their GDP and trade; with important implications for potential prosperity and peace in the region.

SAARC NEARING SOUTH ASIAN ECONOMIC UNION (SAEU)

A regional Economic Union entails freer flows of goods, services, capital and labour. With the implementation of SAFTA, much freer flows of trade in goods in the SAARC region are ensured. Recent initiatives to address sensitive lists and non-tariff barriers, with a unilateral special and differential treatment accorded by India to the LDC members of the SAARC also provide further scope for even freer flows of trade in goods under SAFTA. The regulations governing trade in services

Considering that Mode III of the SATIS focuses on intra-regional FDI movement and Mode IV tackles freer movement of natural persons, SAARC is well on its way to achieving what is known as the South Asian Economic Union.

are also being negotiated under SATIS to make trade in services much faster and easier in the region. Considering that Mode III of the SATIS focuses on intra-regional FDI movement and Mode IV tackles freer movement of natural persons, SAARC is well on its way to achieving what is known as the South Asian Economic Union. At this stage, it may be imperative that South Asia focuses on real and effective implementation of SAFTA and SATIS and does not venture into a Customs Union, spreading itself a bit too thin. What is possibly more important is to address some of the policy-induced challenges like the NTBs, investment protection, etc., on one hand and structural constraints like inadequate trade facilitation and connectivity, on the other.

CONNECTIVITY: INFRASTRUCTURE AND BEYOND

The issue of connectivity has to be situated in a broader context. As is evident, it has an external or regional dimension but it is also linked to developing the domestic connectivity. In other words, the domestic and regional connectivity are interlinked. While the domestic connectivity improvements would contribute to better productivity in different sectors of the economy, including the manufacturing sector, it would also help bridge not only the supply-demand gaps within the domestic economy, but also in the external context by way of trade-augmentation. But for domestic connectivity to be improved, we need regional cooperation. For example, FDI even from extra-SAARC regions, such as from the East Asian region, most notably Japan and other countries in the ASEAN like Singapore or Malaysia

to name a few, given that these countries have well-developed connectivity and expertise, could be shared with India. Again, the domestic and external get intertwined. Then, there is the issue of regional connectivity, by itself. This requires more strengthened and cohesive regional cooperation as these regional connectivity projects would involve addressing varied regulatory and legal systems in several countries simultaneously. While these open up plethora of opportunities, they are challenging propositions too. One way forward is to have a blue-print of converting the challenges into opportunities. Some efforts have been made but they have not yielded the desired results at a pace that is warranted. We need to identify the reasons for the lack of adequate progress in several of the connectivity projects recommended.

Connectivity is a also multidimensional term. It may include physical connectivity like transportation, including in a multimodal framework of air, road, rail, river, ocean – hard infrastructural connectivity. Soft connectivity has come to be known as areas that facilitate trade and business links through improved ease of doing business, including customs procedures and IT-enabled processes, among others. However, even trade itself is a form of connectivity between suppliers and consumers of two countries. Similarly, connectivity could be viewed in an even larger perspective. For instance, we could focus on electricity and energy connectivity through investing in regional grids. Telecommunications, mobile networks, internet, etc., are all different modes of connectivity. In terms of transport, connectivity efforts need to be made on creating two corridors with eventual objectives of converting them into economic corridors.

Connectivity is a multi-dimensional term.

In terms of transport, efforts need to be made on creating two corridors converting them into economic corridors.

Financing is the major constraint ...the South Asian region should thus collaborate with the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank of the BRICS in order to fund its vast infrastructural deficits.

The Electronic Data Interchange (EDI) initiative needs to be strengthened, as developed by India, which is successful and cost effective.

Some of the areas that could be focused include: (a) SAARC East-West Economic Corridor between Dhaka and Kabul via Kolkata; with intersection in Kolkata, Nepal and Bhutan also get linked along with Bangladesh, India, Pakistan and Afghanistan, and (b) SAARC South-North Economic Corridor linking the Maldives, Sri Lanka, India, Pakistan and Afghanistan. These need to be studied in the context of creating South Asian value chains, making South Asia as a production network in the wider economic interlinkages across East-Southeast-South-Central-West Asia. For this to happen, SAARC Regional Transit and Motor Vehicles agreements would need to be made operational aiming at seamless movement of goods, vehicles and people. In this context, the recent signing of the Motor Vehicles Agreement among the BBIN countries augurs well for the same on a regional basis. Similarly, connectivity through railways from Kabul to Dhaka via Delhi is a feasible project provided a railway line between Kabul and eastern border town of Torkham is built, which is approximately 235 km long. Additional entry/exit points need to be made operational. The inland container depots/warehouses and computerised customs land stations would be other areas for action. In addition, the Electronic Data Interchange (EDI) initiative needs to be strengthened, as developed by India, which is successful and cost effective along with Common Trade Documents and Harmonised Customs Procedures. SAARC countries lack cooperation miserably even in sharing of data on trade and economic variables in a common template within SAARC must be made available at a larger scale than before,

whether WTO's Trade Facilitation Agreement makes actual progress or not. While efforts have been made on these dimensions they have not led to satisfactory outcomes. The South Asian region should seriously think of collaborating with the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank of the BRICS in order to fund its vast infrastructural deficits along with existing options like the ADB and the World Bank.

FOOD SECURITY AND FOOD SAFETY

Food security is one of the serious problems that the region is currently grappling with. The region is characterised with low per capita availability of food as compared to world; high import share of consumption; low productivity; and complex state of food safety standards. Given the rich biodiversity and agricultural base of the region, there is ample scope for cooperation among the SAARC countries on this front. Collaboration in the domain of agricultural research accompanied by both financial and infrastructural commitments can substantially overhaul the food and agricultural production system in the region. This will also augment returns for the large number of people who depend on the agricultural sector for their livelihoods, simultaneously improving the access to food in the rural countryside. On the other hand, cooperation in terms of building a regional food grain stock will shield the region from the short-run shocks that originate in the global and regional food markets and also provide the much required improvement and stability in the food security situation in South Asia. The Report recommends enhancing food production and productivity; strengthening the mechanism for

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In order to ensure food safety, capacity building at the regional level is very important.

The share of loan repayment in net ODA from traditional donors has been increasing significantly among most of the South Asian countries.

a South Asia Food Bank by better management of food-grain stocks and establishing proper storage, stocking and transportation facilities to increase reach and effectiveness; speedy operationalisation and effective functioning of a SAARC Seed Bank and establishment of a Regional Vaccine Bank and Regional Livestock Gene Bank. In order to ensure food safety, capacity building at the regional level is very important. Regional initiatives in the form of increased number of Mutual Recognition Agreements (MRAs) to help in minimising the costs; and strengthening food trade in the region by formalising the cooperation with a memorandum of understanding to address the difficulties in terms of quality products is crucial.

DEVELOPMENT COOPERATION

Almost all the economies of South Asia have been major recipients of development aid for the last fifty years or so. The quantum of aid has varied over the years but has gone up in all the cases. Unpredictability of foreign aid has continued to be a major concern for the South Asian economies, particularly in cases where foreign exchange is a constraint. The share of loan repayment in net ODA from traditional donors has been increasing significantly among most of the South Asian countries, barring Afghanistan and Pakistan, especially since the beginning of the present millennium. In case of India, this share increased from 52 per cent in 1990 to more than 90 per cent in 2013. The rise is sharper in case of Sri Lanka from around 10 per cent to 121 per cent during the same period.

South Asia accounts for a major share of global flows in terms of aid for trade. Several countries have come forward to finance projects on aspects of development assistance pertaining to trade. There is no separate fund for supporting aid for trade related activities but there are allocations which are identified under this category. This assistance is grouped under five major activities: (a) technical assistance for trade policy and regulation, which is basically to support countries to develop negotiating abilities and wherewithal to support trade strategies; (b) trade related infrastructure, which covers all trade facilitation related measures like building of roads, telecommunication networks, etc.; (c) productive capacity-building, which basically covers support to private sector for enhancing their ability to export; (d) trade related adjustment, which is basically to provide support to the developing countries; and lastly (e) other trade related needs which may be subject to the national priorities.

It is observed that apart from India, other South Asian countries like Pakistan and Sri Lanka have also initiated efforts in contributing to South-South Cooperation. For instance, Pakistan has extended development assistance to Sri Lanka, and other developing countries. Similarly, Sri Lanka has assisted the Maldives, Uganda and Ethiopia.

It is recommended to set up regional platforms for exchanging experiences and sharing of the best practices in terms of development impact. This underscores the urgent need for launching a SAARC Development Forum to discuss development issues. Further, identification of viable projects, and their adequate implementation to make economic and infrastructure windows of SDF functional, need serious considerations.

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For exchanging experiences and sharing of the best practices in terms of development impact, launching a SAARC Development Forum is imperative.

S&T cooperation can be utilised for addressing emerging challenges in energy security and climate change while playing a key role in the transition to low-carbon growth.

Cooperation in newer areas of traditional knowledge and traditional medicines and capacity building in emerging technologies like nanotechnology and biotechnology will benefit all countries in the region.

S&T DRIVERS

Science and Technology (S&T) has been among the sixteen areas identified for cooperation under the SAARC umbrella. S&T cooperation can be utilised for addressing emerging challenges in energy security and climate change while playing a key role in the transition to low-carbon growth. The countries in the region have embarked upon major changes in S&T policies and also in investing in emerging technologies although most of them lag behind in terms of S&T indicators. The new initiatives in emerging technologies should be supplemented with more regional cooperation in S&T. Establishing a South Asian Regional Information Network (SARIN) would help the SAARC nations to identify various problems faced by them, particularly the sharing of river, mountains and forest areas, and also find out amicable solutions. The share of high-technology in exports of the countries is increasing and this can be enhanced further through cooperation. More cooperation in traditional knowledge and traditional medicines will benefit all countries in the region as will the cooperation in responding to Nagoya Protocol under Convention on Biological Diversity. Another important issue is capacity building in emerging technologies like nanotechnology and different streams of biotechnology. The SAARC framework for S&T cooperation has been instrumental in taking cooperation in this sector forward. But due to constraints, like lack of demand for such cooperation among countries, full utilisation of the framework is not taking place. SAARC can learn from successful South-South cooperation in health biotechnology and from S&T cooperation in IBSA

(India, Brazil and South Africa). In this context, this Report puts forth an agenda for regional cooperation in S&T which would include a mega project in S&T at the regional level for disaster management.

CLIMATE CHANGE

South Asia, with its high levels of poverty and population density, is also prone to impacts of climate change and disasters. The vulnerability of the region to environmental threat is unprecedented. All nations of the region are threatened by the effects of climate change, though in varying ways and degrees. South Asia's climate is as diverse as its landscape. The region's geographic expanse covers a variety of climate zones and ecosystems, ranging from lush tropical forests to arid deserts and high-altitude forests and lakes. Given such a diversity, climate risks in the region also vary widely from one part to another. The impacts of climate change result not only from gradual changes in temperature, glacier melting and sea level rise but also, in particular, from an increased variability of monsoon and a greater frequency of extreme climatic events like floods, droughts, cyclones and heat/cold waves. Climate change will compound the pressures on natural resources and the environment and have enormous impact on the economic performance of the South Asian countries and the lives of their peoples, particularly millions of poor. The cascading effects of higher temperatures and more variable rainfall could impact most aspects of productivity and development. Livelihoods and economic activities in South Asia are closely tied to the natural resource base, and hence are highly sensitive

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SAARC common position at the UNFCCC COPs is an important step forward in raising a regional voice. However, it is important that the SAARC does not stop at it. The countries of the region must come together to keep pressure up on the developed countries with the aim of arriving at a just deal that not only would be climate-friendly, but also development-friendly.

to changes in the climate. Agriculture and aquaculture will be threatened by a combination of thermal and water stresses, sea level rise, increased flooding, and strong winds associated with intense tropical cyclones. Freshwater availability and biodiversity, which are already under pressure due to population growth and land use variability change, will be further impacted by climate change. Warmer and wetter conditions will increase the potential for a higher incidence of diseases. By adversely impacting sectors like agriculture, water resources, human health, and infrastructure, climate change, *inter alia*, has the potential to compound existing development problems in the region and increase pressures on key resources needed to sustain future growth, urbanisation, and industrialisation.

On the other hand, although South Asia is highly vulnerable to climate change, the contribution of the region to the global emissions of GHGs is still quite low as compared to developed countries.

The countries of the region are able to cooperate individually as members in various international fora, unfortunately together the region does not have a voice it should and could have in the global polity, including the climate change negotiations. The presentation of a SAARC common position at the UNFCCC COPs is an important step forward in raising a regional voice. However, it is important that the SAARC does not stop at presenting a common position only. The countries of the region must come together to keep pressure up on the developed countries with the aim of arriving at a deal that not only would be climate-friendly, but also development-friendly.

The Report recommends establishment of an International Adaptation and Research Centre which could help implement the SAARC Convention on Cooperation on Environment. It further calls for establishment of a Low Carbon Research and Development Centre to foster research and learning in renewable energy, clean technologies and low carbon development. The Report reiterates the need for the development of a SAARC Satellite, as proposed by the Prime Minister of India, for providing real time scientific data in the need of the hour for preventing natural disasters.

ENERGY SECURITY

The South Asian region is witnessing quantum jumps in its energy needs. This is primarily a result of economic growth. The region is a net importer of energy which makes it susceptible to global price shocks. Thus, energy security assumes critical importance in the region and regional cooperation on this front is of paramount importance. Exploiting the scope for energy cooperation is not only desirable and mutually beneficial but is also feasible. This is on account of the fact that there exists immense resource-complementarity in the region. It is by now common knowledge that even trade complementarities in energy on a pan-South Asian basis are possible due to availability of hydropower in Nepal and Bhutan; natural gas in Bangladesh and Pakistan, and coal and petroleum products, especially refined, in India. Apart from reiterating the need for adopting a SAARC Energy Charter Treaty to provide the legal basis and level playing field to all stakeholders for regional trade and investment in the energy sector, the Report also recommends developing a regional risk pooling

Exploiting the scope for energy cooperation is desirable, mutually beneficial and feasible..... tapping trade complementarities in energy on a pan-South Asian basis is possible.

Adopting a SAARC Energy Charter Treaty to provide the legal basis and level playing field to all stakeholders for regional trade and investment in the energy sector is highly recommended.

The region confronts enormous developmental challenges. Thus, it is imperative to pursue a strategy that sustains high growth, creates employment opportunities and raises capabilities of poor to participate productively in the economic mainstream.

mechanism by making inter-governmental and institutional arrangements for jointly procuring oil and natural gas; developing strategic reserves at the regional level as oil shock contingencies; developing a mechanism for research, development and demonstration (RD&D), sharing geological and other relevant data, knowledge, expertise, and technology; promoting capacity building at the regional level, especially in energy demand management measures (conservation and energy efficiency), improving energy sector governance and in developing alternate sources like renewable energy (hydro, solar, etc.); and promoting electricity trading and establishment of a regional grid for gas and electricity.

POVERTY AND HUMAN DEVELOPMENT

South Asia accounts for nearly 23 per cent of the world population, but its share in global GDP is around 3 per cent. The region is home to half the world's poor, which means that one in every third person of the region lives below the most basic measures of the poverty lines. Overall, the state of human development in South Asia lags behind other regions.

Thus, it is imperative to pursue a strategy that sustains high growth with rapid expansion in the employment opportunities for the people along with raising the capabilities of the poor to participate productively in the economic mainstream. For this, strengthening governance and service delivery to ensure inclusive development are essential. Further, considering that health and education are the two important social infrastructural sectors where investment and capacity building would be

required, investment in building modern hospitals and mobile health clinics could be important policy responses. Trade in medical equipment and pharmaceuticals would have to be focused under SAFTA. Capacity building initiatives for high-quality doctors, nurses and para-medical staff would could be stepped up. For this, the movement of professionals under the SAARC Trade in Services (SATIS) agreement under Mode IV would have to be facilitated. Similarly, in the area of education, the entire spectrum from primary to secondary to higher education would have to be covered. This too has implications for facilitating trade in goods such as in construction materials, furniture, electrical appliances and equipment, computers, etc. under SAFTA and movement of teaching professionals under SATIS so that opportunities could be generated for Sri Lanka, Bangladesh, Nepal, Pakistan, etc.

On a different note, one of the major achievements in SAARC has been setting up of the South Asian University (SAU) in 2010 in New Delhi – which is an international university. Its vision to enhance learning in the South Asian community is a mega successful project and a notable symbol of SAARC cooperation in the realm of higher education. However, more and faster efforts are needed to make the university fully operational.

SUMMING UP

In a nutshell, the Report provides a framework which calls for a change in mindsets, addressing the perception gaps on SAARC as an institution and economic integration in the region as a process. There have been perception gaps also in terms

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of the role of India in the region. The dilemma has been whether unilateral initiatives by India are perceived as the 'big brother syndrome' or countries of the region in reality wish that India should play indeed a more substantive role contributing to regional prosperity and peace. The answer to the perception gaps and the dilemma lies in addressing the unfair bias that induces us to see the reality not as it is but as we wish to perceive due to a variety of factors. The time has come to look at South Asian economic integration with a more balanced perspective and a positive attitude for building *a bridge over peaceful waters* and create an *Arc of Peace-creating Prosperity*, where *a la* Tagore '...the mind is without fear...'.

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"We do not see things as they are, we see them as we are."

-Anonymous

About the Report

The South Asia Development and Cooperation Report 2015 makes a departure from the way South Asian economic integration has been viewed until now. This Report is an economic summit of ideas and approaches. It presents a paradigm of 'reverse causality' running from regional prosperity to peace. It presents a more balanced perspective with newer insights with considerable degree of objectivity, so very crucial for academic and policy-oriented studies and the research methodologies used for conducting those studies. The Report highlights that the South Asian region is not the 'least-integrated region'. It also underscores that the approach to glorify the successes of other regional economic groupings and only find faults with the South Asian economic integration is to be changed. This entails also acknowledging the successes of the South Asian economic integration initiatives while at the same time learning lessons from the failed initiatives of other regional groupings as well.

The central theme of SADCRC 2015 viz 'Economic Integration for Peace-Creating Prosperity' is also a new way of looking at the South Asian economic integration process outcomes, the imperatives of achieving peace in the region; and the potential for making South Asia a prosperous region. While the causality between peace and prosperity may run in both the directions, the Report emphasises on making prosperity the prime objective, achieved through South Asian economic integration, which, in turn is 'peace-creating'. In this endeavour the Report is novel in its approach and rich in its content, which may be found useful to different stakeholders within the SAARC region and beyond.

About RIS

Research and Information System for Developing Countries (RIS) is a New Delhi-based autonomous policy research institute that specialises in issues related to international economic development, trade, investment and technology. RIS is envisioned as a forum for fostering effective policy dialogue and capacity-building among developing countries on global and regional economic issues.

The focus of the work programme of RIS is to promote South-South Cooperation and collaborate with developing countries in multilateral negotiations in various forums. RIS is engaged across inter-governmental processes of several regional economic cooperation initiatives. Through its intensive network of think tanks, RIS seeks to strengthen policy coherence on international economic issues and the development partnership canvas.

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