

# **THE POLITICAL ECONOMY OF TRADE FACILITATION AND REGIONAL CONNECTIVITY IN SOUTH ASIA**

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## Introduction

This is the moment of reckoning in South Asia. A seismic change in the global economy is shifting its centre of gravity, for the first time in three centuries, from the West to Asia<sup>1</sup>. The economic dynamism of South Asia and the innovativeness of its people can enable them to play a leadership role in the global economy of this century. Yet at the same time the region is threatened by religious extremism which can rupture the social fabric and at the same time bring nuclear armed India and Pakistan into military conflict. This religious extremism is fueled by persistent mass poverty in the region on the one hand and by continued failure of states to institutionalize peace through economic and political cooperation.

In my brief remarks I will focus on India and Pakistan whose continued tension is a major constraint to regional economic cooperation and the associated immense gains from regional trade and investment. I will first indicate the strategic dimension of the political

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<sup>1</sup> (i) This phenomenon was first identified and elaborated in a paper, Akmal Hussain, A Vision for South Asia, presented before the Parliamentarians from South Asian countries at the SAFMA Conference on Evolving a South Asian Fraternity, Bhurban, (May 16, 2005). Later published in, *Whither South Asia?*, Imtiaz Alam (ed.), SAPANA: South Asian Studies, Volume I, South Asian Policy Analysis Network, June 2006, Lahore, Chapter, Akmal Hussain: A Vision for South Asia, pages 54 to 61.

(ii) Also see, Akmal Hussain, A Vision for South Asia, *Indian Journal of Politics and International Relations (IJPAIR)*, Vol.1, No.1, January-June 2008, Faculty of the School of International Relations and Politics, Mahatma Gandhi University, Kerala, India.

economy of India and Pakistan within which both the constraints and the drivers of regional trade and economic connectivity can be examined. In this context, I will identify the role of free trade in achieving sustainable growth with equity on the one hand and sustaining democratic structures, on the other. I will then indicate that inspite of recent progress in tariff liberalization, intra SAARC trade continues to remain at an extremely low level. In this regard I will mention some of the factors behind the slow implementation of the SAFTA Agreement in Islamabad in 2004. Finally, I will conclude with some of the specific measures that can be initiated to accelerate the process of trade facilitation and economic connectivity in South Asia.

### **I. The Political Economy of India and Pakistan: The Strategic Dimension<sup>2</sup>**

Let us start with the strategic dimension of the political economy of India and Pakistan respectively, within which both the constraints to and the drivers of trade facilitation and the peace process can be examined. India's economic strength lies in the fact that having established a heavy industrial base during the Nehru period in the 1950s, and a reconfiguring of India's policy framework in the 1990s to play a role in a globalized economy, India's economy has been launched on a high growth trajectory. With a domestic technological change capability, international competitiveness in selected cutting edge sectors like software and electronics and large capital inflows India has achieved impressive GDP growth over the last two decades. Yet it has been predominantly based on the home market with India's exports as a percentage of world exports, still less than 1 percent. Continued growth in the future will require acceleration in export growth. To sustain GDP growth India will need to establish: (a) Markets for its manufactured exports in South Asia and abroad. (b) An infrastructure for the supply of oil, gas and electricity.

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<sup>2</sup> (i) For a more elaborate discussion of this issue, see, Akmal Hussain, Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan, The Asia Foundation, (Mimeo), Islamabad, 14<sup>th</sup> April 2008.

(ii) Also see, Akmal Hussain, The Challenges and Drivers of Regionalism in South Asia: The India Pakistan Peace Process, paper presented at the Asia-Pacific Research Centre, Stanford and Observer Research Foundation of India, Conference on South Asian Visions of Regionalism, 19-20 June 2008.

It is in this context of sustaining GDP growth that three strategic imperatives for India become apparent: (i) Achieving a regionally integrated economy through an early implementation of the Islamabad SAARC Summit Declaration on SAFTA (January 2004). (ii) Securing oil and gas pipelines and rail and road transportation routes from Central Asia to India through Pakistan, and (iii) Overcoming political disputes with Pakistan and other South Asian neighbours to establish a political framework of lasting peace that would be integral to economic union.

Peace and economic cooperation with Pakistan is necessary for India not only to secure its strategic economic interests but also to maintain its secular democratic polity. A high growth, open economy framework for India today is inseparable from a liberal democratic political structure. Therefore the existing social forces of Hindu nationalism, intolerant of minorities will undermine India's secular democratic structure as much as its economic endeavour. Continued tension between India and Pakistan, will only fuel extremist religious forces in both countries, to the detriment of their economy and polity.

Pakistan by contrast is faced with an economic crisis whereby it is unable to sustain high GDP growth due to an aid dependent economic structure, inadequate export capability, and recurrent balance of payments pressures. The persistent high levels of poverty, and continued tension with India fuels the forces of religious extremism. Armed militant groups have now emerged as rival powers to that of the state within its territorial domain, thereby threatening the structure of the state as well as the fabric of society. Peace with India can enable joint efforts in fighting the common enemy of terrorism. It will also mean a substantially improved environment for the much needed foreign and domestic investment. This could play an important role in accelerating and sustaining GDP growth and poverty reduction in Pakistan.

It is clear that through peace, both India and Pakistan can reap economic benefits for their people, and secure their respective democratic structures against the forces of religious extremism. The national security of both countries is threatened not by the neighbour across the border but internal social forces of intolerance, violence and poverty. A new structure of peace would reduce for their respective nations the danger of cataclysmic

destruction from nuclear war, and also provide them economic and political stability. Thus national security in both countries will be enhanced, by providing increased security of life and livelihood to their respective nations.

## **II. Trade Facilitation as a Driver of Change**

Trade and investment have historically been both the cause and consequence of institutional change within the polity. So it can be for Pakistan, India and indeed South Asia as a whole. The strategic objectives in this process are:

- (a) To implement the Islamabad SAARC Declaration<sup>3</sup> of 2004, with respect to SAFTA (South Asian Free Trade Area). Pursuant to SAFTA, Pakistan and India ought to follow the stipulated timelines of SAFTA implementation by reducing tariffs annually by 5 percent so as to achieve trade liberalization by 2013.
- (b) Address the problem of non-tariff barriers, and establish a time-bound implementation mechanism to identify and remove them by 2013.
- (c) Establish the institutional framework for facilitating investment by South Asian countries within the region.
- (d) Ease travel restrictions within the region for the people of South Asian countries, as an integral part of the process of trade facilitation and in particular, mutual economic gains from the tourist trade.

Free trade and investment within South Asia and particularly between India and Pakistan could be a driver of change in the institutional structure of the economy, polity and society respectively, in the following ways:

- (i) It would be a powerful economic stimulus.

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<sup>3</sup> Islamabad SAARC Declaration, January 2004.

- (ii) It would create stakeholders for peace and the demilitarization of the polity in Pakistan, which would strengthen and sustain the democratic structure in Pakistan.
- (iii) It would help build a tolerant and pluralistic democratic culture.

Let us briefly examine each of these dimensions of institutional change resulting from an India-Pakistan peace settlement<sup>4</sup>:

### II.1 *Free Trade and Sustainable Growth with Equity*

An economic opening up with India would sharply accelerate GDP growth in Pakistan through increased investment by Indian entrepreneurs. Moreover, import of relatively cheaper capital and intermediate goods from India could reduce capital output ratios in Pakistan and thereby generate higher GDP growth for given levels of investment. At the same time import of food products during seasonal shortages could reduce food inflation and thereby improve the distribution of real income in Pakistan. Easing of travel restrictions would give a massive boost to Pakistan's tourism, services, and retail sectors, which could stimulate growth. At the same time it would increase employment elasticities with respect to GDP growth (since the tourism sector is labour intensive), and hence increase employment and improve income distribution. Thus free trade relations with India would enable Pakistan to achieve a higher and more equitable GDP growth.

### II.2 *Free Trade and Civilian Supremacy*

As free trade and investment bring substantial economic dividends to the middle and lower middle classes a large constituency will be created in Pakistan to change the existing perspective of Pakistan as a 'National Security State' which is presumed to be 'threatened by India' and hence requires the dominance of the military in the polity and national policy. Shifting from the ideology of a National Security State to a democratic perspective will make it possible to acknowledge that the security and welfare of citizens

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<sup>4</sup> Akmal Hussain, *The Challenges and Drivers of Regionalism in South Asia: The India Pakistan Peace Process*, op.cit.

is primarily achieved through peace and development. This change in the national perspective can be an important factor in strengthening and sustaining civilian supremacy within the polity.

### II.3 *Free Trade and Democratic Culture*

An important constraint to the building of a democratic polity and the principal threat to state structures in South Asian countries, arises from internal conflicts such as: religious extremism, ethnic, communal, and caste conflicts, and linguistic sub-nationalism. Containing these conflicts requires the building of institutions for a pluralistic society. In such a society not only diverse identities between individuals can coexist but at the same time multiple identities can be maintained by each individual<sup>5</sup>. Thus not only for example, Muslims and Hindus should be able to live in peace but also a particular individual can be a Muslim, a Balochi, a Karachite, a Pakistani, a South Asian and a Commonwealth citizen at the same time.

### II.4 *Pluralistic Democracies: The Self and the Other*

Underlying the cultural diversity in South Asia is the unity of shared wellsprings of human civilization. It is a unity that is nurtured by its diversity. Thus national integrity is strengthened not by the denial of multiple identities but by creating a democratic polity within which they can blossom. Essential to the building of pluralistic democracies in India and Pakistan respectively is the opening up of new economic and cultural spaces within which the people of the two countries can encounter the 'other'. In so doing citizens of the two countries can experience the diversity and richness of the self<sup>6</sup>.

In the past state sponsored mutual demonization has sustained inter-state conflict. Demonization involves a narrowing of the mind and a constriction of the identity that

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<sup>5</sup> For a discussion on multiple identities, see, Amartya Sen, *Identity and Violence: The Illusion of Destiny*, Allen Lane, London, 2006, pages 3 to 5.

<sup>6</sup> Akmal Hussain, *The Challenges and Drivers of Regionalism in South Asia: The India Pakistan Peace Process*, paper presented at the Asia-Pacific Research Centre, Stanford and Observer Research Foundation of India, Conference on South Asian Visions of Regionalism, 19-20 June 2008. pages 10 and 11.

places the self and the other into a mutually exclusive and conflictual dichotomy. Nurturing one's richness requires a human relationship within which the other is experienced as a vital fertilizing force in the growth of the self. Liberating the dynamic of such a human contact, could be vital to the enrichment of identities and the building of pluralistic democracies in Pakistan and India<sup>7</sup>.

### III. SAARC Trade and the Challenges to Facilitation

#### III.1 SAARC Trade as a percentage of World Trade

In spite of a gradual increase in SAARC trade the total level of SAARC trade is still abysmally low: SAARC trade as a percentage of trade of South Asian countries with the rest of the world is still about 5 percent. However, for individual South Asian countries there is considerable variation in this percentage: In the case of the low end group of countries, the figure is 2.9 percent for India, 6.1 percent for Pakistan and 8.6 percent for Bangladesh. For the mid range group of countries, SAARC trade as a percentage of trade with the rest of the world is, 16.6 percent for the Maldives and 17.1 percent for Sri Lanka. Finally in the high end group of countries, the figure is 42.8 percent for Afghanistan and 63.7 percent for Nepal, since both these countries depend predominantly on the SAARC region for both their exports and imports<sup>8</sup>.

#### III.2 The Problem of Implementing the Free Trade Objective

From its inception, SAFTA has been dogged by the problem of implementing the objective of free trade, with respect to the terms of the Agreement and also with respect to the extension of deadlines for implementation of the agreed terms. The Agreement as it now stands requires the "least developed countries" (Bangladesh, Bhutan, Maldives and

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<sup>7</sup> This sub-section is drawn from Akmal Hussain, Human Security, Economic Development and the Peace Process, chapter in the book titled: Non-Traditional and Human Security in South Asia, Collection of papers presented at an international seminar, jointly organized by the Institute of Regional Studies and National Commission for Human Development in Islamabad on 31 October – 1 November 2006, Institute of Regional Studies, Islamabad 2006, pages-233 to 234.

<sup>8</sup> Deshal De Mel, Taking SAFTA Forward, Paper contributed to the SACEPS/IPS Seminar on Strengthening Economic and Social Integration in South Asia (Mimeo), 30-31 May 2008, Colombo. Table: Intra-SAARC Trade 2006, page 2.



Nepal) to achieve trade liberalization by 2016. For the non-LDCs (India, Pakistan and Sri Lanka) the stipulated date for full trade liberalization is 2013. One of the institutional constraints to trade liberalization is the failure to implement the GEP (Group of Eminent Persons) of 1988, which proposed the elimination of the negative list by 2008<sup>9</sup>. However the present Agreement allows countries to maintain extensive negative lists even after the SAFTA Agreement is fully implemented by 2016. Although there is a maximum ceiling on the number of items in the negative list, with the provision to review this number, yet countries have no binding commitment to reduce the items on the negative list, in contrast to the ASEAN Free Trade Agreement.

The magnitude of the negative lists as a constraint to free trade is indicated by the fact that almost 53 percent of the trade amongst South Asian countries (in terms of value), has been excluded from the tariff liberalization programme of SAFTA<sup>10</sup>.

There is a similar problem with non-tariff barriers (NTBs) in SAARC. It is now well established that non-tariff barriers even in the absence of formal tariffs, can be a major constraint to trade liberalization. In this regard the Group of Eminent Persons report had proposed the elimination of non-tariff barriers within seven years of the signing of SAFTA. Yet despite the fact that NTBs are quite high in South Asia, the SAFTA Agreement has not adequately addressed this issue. The Agreement merely stipulates that member countries “inform” the SAARC Secretariat of all “non-tariff and para-tariff measures” which would be reviewed by the SAARC Committee of Experts and recommendations made to reduce such trade restrictions. Yet there is no binding commitment for countries within the terms of SAFTA to eliminate non-tariff barriers.

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<sup>9</sup> (i) Institute of Policy Studies of Sri Lanka, GEP Report – Progress To Date and the Way Forward, South Asia Centre for Policy Studies, Kathmandu, May 2008.

(ii) Also, see Jayasekera, D, (2001), ‘Group of Eminent Persons (GEP) Report: Critical Evaluation of Economic Aspects, in S. Kelegama (ed.) in *Impediments to Regional Economic Cooperation in South Asia*, FES, Colombo.

<sup>10</sup> Weerakoon, D. and J. Thennakoon, (2006), ‘SAFTA: Myth of Free Trade’, Economic and Political Weekly, September 16, cited in Institute of Policy Studies of Sri Lanka, GEP Report – Progress To Date and the Way Forward, South Asia Centre for Policy Studies (SACEPS), Kathmandu, May 2008, page 5.

#### **IV. A Seven-Point Action Agenda for Trade Facilitation**

To some extent progress on regional economic cooperation in general and trade facilitation in particular is constrained by the recent cessation of the Composite Dialogue between Pakistan and India. If the people of South Asia are to reap the immense economic benefits from trade and build sustainable structures of peace and democracy, it is essential to resume the Composite Dialogue. Only such a resumption of the peace process can accelerate its vital element of trade and economic connectivity in South Asia. The peace process between Pakistan and India and thereby the future of their peoples, should not to be allowed to be held hostage by terrorist groups who tend to cross national boundaries precisely with the objective of undermining peace between these two neighbours.

After the resumption of India Pakistan peace process, the SAARC endeavour requires undertaking immediate action by all SAARC countries for the following seven objectives:

1. Accelerated implementation of the SAFTA Agreement with an institutional framework for monitoring tight timelines for implementation. In this regard the stipulation of reaching 0 to 5 % tariffs must be implemented on a fast track basis. Speed is of the essence because there is a danger of SAFTA losing relevance due to competing bilateral trade agreements (BTAs) and regional trade agreements (RTAs).
2. The Pakistan-India trade which is based on a specified positive list should be replaced by a negative list and urgent measures undertaken by SAARC countries to reduce the negative list to an absolute minimum, meeting the same standards as ASEAN.
3. Constitute a SAARC Committee consisting of experts in the government as well as the private sector, to identify the existing non-tariff barriers in South Asia and recommend a fast track mechanism for removing these trade restrictive barriers. The SAARC members in the next SAARC Summit ought to take up these recommendations and undertake immediate country level action within a

- specified time frame. The SAARC Committee can be made responsible for monitoring the implementation and helping to overcome bottlenecks if and when they arise.
4. At the moment, value added in services contributes about 40 percent to GDP in South Asia. If trade liberalization is to be meaningful, immediate measures must be undertaken to liberalize trade in services. Of particular importance in this regard are: (i) Telecommunications, (ii) Road and Rail Transport, (iii) Aviation, (iv) IT, (v) Medical Services, (vi) Education and Vocational Training.
  5. Since travel facilitation is integral to trade facilitation, it is necessary to eliminate visa restrictions for citizens of South Asian countries when traveling in the region.
  6. Facilitate pro actively, an agreement between airlines of South Asian countries as well as other international airlines to develop new flight connections linking the capital cities of South Asian countries directly and on a daily basis. This should be for both passengers and cargo.
  7. (a) Initiate immediate time bound measures to achieve connectivity of the electrical grids of the various South Asian countries to enable better utilization of South Asian electricity generation capacity during seasonal fluctuations of demand.  
  
(b) Facilitate private sector collaboration in South Asian countries to invest in hydro electric power generation that feeds into the integrated grid in order to ease the problem of electricity shortages in some South Asian countries.

## **Conclusion**

As a historic shift is occurring in the centre of gravity of the global economy from the West to Asia, a unique window of opportunity has opened for the people of South Asia to build a better future through regional economic cooperation. If we grasp this moment, we can establish the basis of sustainable peace and democratic structures in the countries of South Asia.

Inspite of recent progress the level of trade in South Asia is still lower than perhaps any other regional grouping in the world: intra-SAARC trade is only 5 percent of trade with the rest of the world. Therefore if SAARC is to become meaningful for its people it is necessary to accelerate sharply the process of trade liberalization. This requires rapid liberalization of not only tariffs but also non-tariff barriers through a new implementation mechanism, within a short time frame.

Trade liberalization is an essential element in the dialectic of peace in South Asia. As the peace process resumes between India and Pakistan a new action agenda for economic cooperation needs to be undertaken. At the same time as the economic benefits of trade and investment for the people of the region become manifest, new stakeholders will emerge to deepen and sustain the structures of peace and democracy.

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