

# Bilateral Cooperation Destabilised through Multilateral Agreements in South Asia: SAFTA, Evolution and Challenges

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## Abstract

In the era of the globalising world, there are now an increasing number of multilateral agreements in the political, economic as well as in the socio-cultural arena. The South Asian Free Trade Agreement (SAFTA) is one such attempt at ensuring the development of the South Asian sub-region. This agreement was a corrective measure after the failure of the erstwhile South Asian Preferential Trade Agreement (SAPTA). Has this agreement ensured the development of this region as a whole? Are bilateral ties predominant over such multilateral attempts? What are the challenges faced by SAFTA in its smooth functioning? The paper seeks to answer such questions by using a historical perspective and an explorative method. Apart from examining the agreement from various theoretical perspectives, this paper also delineates some of the benefits of SAFTA along with the challenges faced by it. Comparing various scholarly critics, the paper also compiles some of the drawbacks of the agreement which is quite useful from the policy perspective. In the international political realm, where globalisation can no longer be termed as a 'new' development, this paper reveals some of the complexities in dealing with such trends.

## Introduction

Trade is the exchange of goods and services, and International Trade is the trade between countries. According to the proponents of globalisation, this type of trade leads to a world economy. It is then that the demand, supply and the prices impact and in turn is also impacted by global events. Liberals believe that International trade allows countries to use their resources (labour, technology, capital) more efficiently, because different countries are endowed with different natural resources and assets and some countries may be able to produce the same good more efficiently (specialisation), and therefore sell it more cheaply than other countries. For those countries that cannot produce the same goods efficiently, they can obtain it by trading. Thus, international trade not only increases but also allows countries to participate in global economy, encouraging foreign direct investment (FDI). Thus economies can grow more efficiently and become competitive economies. Economists further believe that this has a triggering effect raising employment levels and growth in the gross domestic product. One disadvantage of international trade (as put forth by Dependency theorists) is that countries that are technologically and/or economically far behind other [so-called advanced] countries and lack specialisation in their tradable goods, as is the case with a large number of developing countries, they are naturally disadvantaged in international trade with the advanced countries. Regional trade amongst such countries within a region helps in substantially reducing or eliminating this disadvantage. Such a trade (regional trade) is normally the result of suitable **Regional Trade Agreements**, and this instead leads to the development of a healthy regional economy, leading to an inclusive development of the participating countries with a region.

The purpose of Regional Trade Agreements (RTAs) is restructuring and rationalising industries to promote trade on a more efficient basis so as to exploit the economies of scale *within* a region. Regionalism also helps to protect internal markets by putting a common external tariff. They also promote political cooperation, and provide balanced and equitable benefits to countries belonging to small and less developed regions.

The idea of RTAs had come into being in North America, Latin America and other regions. When this happened the region of South Asia appeared to be greatly marginalised in the world economy, as there was as yet no such trade agreement in this region. This region (South Asia) included countries of India, Pakistan, Bangladesh, Nepal, Bhutan and the Maldives, and the state of Afghanistan was later added to the region (in 2007).

In December 1985, the governments of these countries (except Afghanistan, which joined South Asia region much later, in 2007) came together to form an association called the **South Asian Association of Regional Cooperation** (SAARC). Its aim was to ensure cooperation that would help in promoting economic and social progress, cultural development, friendship and cooperation within the region. Over the years, there was a realisation that the political conflicts in the region were preventing the member states from co-operating economically and thus prevented the development of the region as a whole. After the Sixth SAARC summit in Sri Lanka (1991), an Inter-Governmental Group was set up to prepare an agreement to establish a South Asian Preferential Trade Arrangement (SAPTA). The framework agreement on SAPTA was approved in 1993 and implemented in December 1995.

SAPTA, a preferential trading arrangement, aims at promoting and sustaining mutual trade and economic cooperation by exchange of concession within the South Asia region. Four rounds of trade negotiations were concluded under SAPTA by 2002, where after the SAARC countries signed the next trade agreement, the framework agreement on South Asian Free Trade Area in 2004, and the South Asian Free Trade Agreement (SAFTA) finally came into effect at the beginning of 2006.

SAFTA includes far reaching trade and investment liberalisation measures and a simplification of many procedures for businesses to remove various impediments and enable expansion of intra regional trade. But all along it has been a roller-coaster journey for the Region and the SAARC countries, as they have been trying to iron out differences between them on different fronts, and cooperate for the development of the region amidst trust, mistrust and differences.

### Free Trade versus Protectionism

There are contrasting views about the level of control that must be placed for international trade, the opposing ends of which are known as *free trade* and *protectionism*.

In *free trade* there are no restrictions on trade, and trade follows a laissez-faire approach. The demand and supply operating at a global level ensure efficiency in production and nothing special needs to be done to either promote or protect trade, as market forces automatically take care of that. That is, benefits accrue automatically in free trade, resulting from efficient markets.

*Protectionism*, in contrast, is based on the belief that regulation of international trade is important to ensure that the market functions properly. It is believed that market inefficiencies might hamper the benefits of cross-country trade, unless suitably guided by laws and agreements. This 'protectionism' can exist in many forms, but the common forms are things like controlled tariffs, quotas, and subsidies, which attempt to correct the inefficiency, if any, in the regional (or global) market.

### Liberalising protectionist regimes

At the end of the Second World War, most of the South Asian nations due to a significant protectionist sentiment resorted to an inward oriented economy by means of Import Substitution Industrialisation (ISI). ISI tended to limit trade, especially intra-regional trade.

While intra-regional trade was not a new concept, the South Asian economies nevertheless were new to the ideas of regionalism and regionalisation. But there were several factors which when combined pointed towards a poor viability for short-term free trade agreement, and therefore this model actually discouraged trade, especially intra-region trade, in South Asia. It may be noted that most South Asian countries maintained an anti-export bias, a thrust towards public sector, and a controlled private sector.

A notice at the pre-1990 tariff rates of India, Pakistan and Bangladesh are demonstrative of this. It was only post-1990 that the South Asian economies began opening up. In spite of this, South Asia continues to be a region marked by close economies next only to the socialist states. It was only gradually that these economies began to liberalise themselves. The reason was, as these economies grew and economic complementarities began to develop (albeit slowly), the South Asian countries found that SAFTA can offer substantial potential for their progress.

### Financial Sector Liberalisation

South Asia failed to open its economy and attract any substantial degree of foreign investment. The Maldives are an exception in this regard, as it has attracted substantial degree of FDI in its tourism sector.

But despite all attempts there has not been enough intra-regional trade in South Asia. As a share in GDP, relative intra-regional trade in South Asia was amongst the lowest in the world, as may be seen from the

Table 1 below where figures for the year 2004 has been presented.

Table 1: Intra-Regional Trade as % GDP (2004)

REGION	INTRA-REGIONAL TRADE	(AS % OF GDP, IN 2004)
East Asia and Pacific		26.5%
Europe and Central Asia		15.3%
Latin America		6.4%
Sub-Saharan Africa		5.3%
Middle East and North Africa		3.5%
<b>South Asia</b>		<b>0.8%</b>

(Source: The World Bank Report, 2005: 43)

There are many reasons for low intra-regional trade in South Asia. First, there has been in the past a low scope of mutual trade as there were less complementarities. However, the most important reason(s) for lack of intra-regional trade in the region has been persistent protectionism, long-standing conflicts amongst the countries of the region, and transportation constraints. The lack of supply capabilities by the smaller economies (as

opposed to huge import demands) has also been a reason for import demands.

These however cannot be the only reason because there has been twice the amount of informal trade than formal ones. However, the level of intra-regional trade is increasing due to the growth in the economies of the SAARC countries, and interestingly, intra-regional trade has doubled during the period 2003 to 2006.

### Terms of SAPTA

In December 1991, the Sixth Summit held in Colombo approved the establishment of an Inter-Governmental Group (IGG) to formulate an agreement to establish a SAARC Preferential Trading Arrangement (SAPTA) by 1997. Given the consensus within SAARC, the Agreement on SAPTA was signed on 11 April 1993 and entered into force on 7 December 1995, well in advance of the date stipulated by the Colombo Summit. The Agreement reflected the desire of the member states to promote and sustain mutual trade and economic cooperation within the SAARC region through the exchange of concessions.

The basic principles underlying SAPTA are:

- a. Overall reciprocity and mutuality of advantages so as to benefit equitably all Contracting States, taking into account their respective level of economic and industrial development, the pattern of their external trade, and trade and tariff policies and systems;
- b. Negotiation of tariff reform step by step, improved and extended in successive stages through periodic reviews;
- c. Recognition of the special needs of the Least Developed Contracting States and agreement on concrete preferential measures in their favour; and
- d. Inclusion of all products, manufactures and commodities in their raw, semi-processed and processed forms.

A Positive list approach was followed by SAFTA. According to this approach each of the member states specified which commodity would be traded under the liberal tariffs.

Four rounds of trade negotiations have been concluded under SAPTA. At the conclusion of the first round of talks, about 200 articles were covered. After the second round the list increased to 1,200. This increased to 2,700 commodities by the end of the third round. Finally, about 5,000 commodities were resolved by the end of the fourth round. Each Round contributed to an incremental trend in the product coverage and the deepening of tariff concessions over previous Rounds (SAARC Website).

### How and why did SAPTA fail?

SAPTA appeared to be very ambitious with its objective of increasing trade. Some problems (as enumerated below) however emerged which proved SAPTA to be practically unworkable (Weerakoon, 2001).

**First**, while countries were generous with their concessions, the actual trade coverage of those preferences was very low.

**Second**, in many cases the limit of the tariff cuts offered under the preferential agreement were limited.

**Third**, many of the goods offered under the concessions were not amongst the import interests of the South Asian countries, and were thus of no use.

**Fourth**, many of the countries had still stuck on to their protectionist policies.

**Fifth** (and finally), domestic crises and tense relations were amongst the other reasons for the failure of SAPTA.

### WTO rules regarding RTAs

World Trade Organisation has specified certain standards for Regional Trade Agreements (RTAs). We need to understand its basic principles in order to specify whether SAFTA adheres to the WTO standards.

There are three basic clauses. **First**, the member countries must have substantial amount of trade. The article must provide for mutual/reciprocal trade concessions. **Second**, a fixed period of time must be specified for attaining the given concessions. **Third**, the attainment of trade liberalisation must not place barriers towards third parties, higher than those existing before the formation of the RTA.

There is also an enabling clause added as a sort of an exception. The enabling clause authorises in its paragraph 2(c) that WTO developing members can depart from the MFN (Most Favoured Nation) clause while concluding treaties between themselves, or at a regional or global level containing mutual concessions on lower or zero tariffs, and non-tariff barriers subject to WTO guidelines.

The enabling clause is only an option for developing countries.

### Rise of the Concept of SAFTA

SAFTA was first initiated and adopted by the SAARC member states in January 2004. The key areas of tariff liberalisation were discussed on schedule by January 2006. It was meant that SAFTA would be implemented by July 2006. This was agreed to in the Islamabad declaration.

A negative list approach was adopted this time. The prior arrangement of the positive list had proved too

time consuming and impractical. The negative list and the sensitive list approach would make the formulation easier.

According to the schedule, the agreement would be fully implemented amongst the non-LDC (Least Developed Countries) member states by 2013 and for the LDC member states by 2016. The LDC member states were given a greater time to reduce tariff barriers. The non-LDC member states were given a period of two years to reduce the tariff barriers to 20 percent and another four years to reduce the tariffs to the range of 0-5 percent. The LDC member states were given a time of three years to reduce their tariffs down to 30 percent and another eight years to reduce them further to 0-5 percent.

As we may thus observe, the WTO clause of giving a fixed time period to liberalise tariffs was well adhered to. Moreover, the enabling clause regarding the flexibility for Less Developed Countries was also given due consideration.

A Dispute Settlement Mechanism was also laid in place. Any of the member countries could bring their economic disputes to the forum. The forum would settle the dispute and give its judgment latest by 330 days. The concerned party (or parties) would have to adhere to the judgment latest by 90 days.

### **Goals of SAFTA**

If we see theoretically, the lines on which SAFTA was built is based on the idea of profits gained by means of *complex interdependence*. The idea of complex interdependence is a neo-liberal conception, first put forth by Keohane and Nye.

There is an inherent belief in the neo-liberal conception, that states and their fortunes are inextricably tied together. Their idea was to show how international politics is transformed by means of interdependence. According to the theorists, in today's scenario, as the transactions are increasing, military dependencies are reducing but still remain important (Keohane and Nye, 1997). The theorists also differentiated between interdependence and dependence to show the role played by power in international politics.

Secondly, with the advent of SAFTA, there is a possibility of working upon the *confidence building measures*. Greater economic co-operation would lead to lesser primacy of the military policy as a tool (as contended by Keohane and Nye). There are chances that the existing political conflicts would take a back-seat given the economic interdependence of the countries. In the case of South Asia, India has had conflicts with many of the South Asian countries, mainly Pakistan. The creation of SAFTA intended to lighten the conflicts given the greater number of transactions.

### **Myth of free trade – presence of the sensitive list**

It was, however, understood that some items should be excluded from increased competition, even from the Less Developed Countries. Such items were placed under the *Sensitive List* of items. Initially it was decided that under the Tariff Liberalisation Programme, a liberal approach would be adopted and the sensitive list would be limited to 10 percent of the tariff lines. The final decision, however, was to retain a sensitive list of 20 percent of the tariff lines for the non-LDC member states, and a list of similar approximation for the LDC member states (Weerakoon and Thennakoon, 2006).

Under such circumstance, the trade coverage of items under sensitive list may be fairly high. Unlike ASEAN Free Trade Agreement, there is no provision in SAFTA to bring down the list of items covered in the sensitive list. The only provision provided by SAFTA is a 'review' of the sensitive list every four years 'with the view of reducing the list'. In fact, the existing bilateral FTAs have much lower limits of sensitive lists than SAFTA.

SAFTA had begun with a limited approach to liberalising trade than had been anticipated. This can be seen by the fact that 53 percent of the import trade amongst the South Asian countries by value in 2004 has been excluded from the SAFTA liberalisations.

In spite of the large negative list, Pakistan has excluded only 17 percent of its import from SAARC countries from the tariff liberalisation process. In contrast, India and Sri Lanka have restricted about 38% and 52% of their total imports from SAARC countries by means of the sensitive list. The LDC states have restricted about 65-75 percent of their imports.

The imbalances in the trade of SAFTA are very clear. A large proportion of the items in the export list of the SAARC countries, fall in the negative list of other SAARC countries. Pakistan, for instance, may have restricted only 17 percent of imports, but 34% of its exports fall into the negative lists of India and Pakistan. Same goes for the export list of India and Sri Lanka. The LDC member states of SAFTA have received better treatment in this regard. The percentage of export trade restricted by negative lists of other SAFTA members is substantially lower than in the case of other non-LDC member states.

### **Case of India and Pakistan**

One of the brighter sides of SAFTA is to see that India and Pakistan have been quite liberal towards each other.

Only 14.5 percent of Pakistan's current imports from India are subject to its negative list, while the Indian negative list excludes a similar share of 16.4 percent of Pakistan's exports to India.

Converting Kashmir Valley into a Free Trade Economic zone has proved to be a bridge between the two countries rather than a 'bone of contention'. It seems that New Delhi and Islamabad have gone a step closer in this regard as a means of confidence building measures (TNN *The Times of India*, 7 April 2007).

### **Impediments to the success of SAFTA**

One of the primary impediments to the successful progress of SAFTA is the set of nuclear tests performed in India in 1998.

A time period of ten years has been stipulated by SAFTA to get down the tariffs. Given the level of conflicts within the region, this time period is too long to ensure the practicability of agreement. Compared to all other Free Trade Agreements, the one provided by SAFTA is the longest and thus the most impractical.

SAFTA has had a very narrow coverage. Different countries have put a wide range of commodities under the purview of negative or sensitive list. Around 58.5 percent of India's exports are subject to the sensitive list. The proportions of other countries include 22 percent for Bangladesh, 57.6 percent for Maldives, 46.4 percent for Nepal, 34 percent for Pakistan and 47 percent for Sri Lanka. This does not support the proposal for regional integration, of course.

Non-tariff barriers and para-tariff measures have been set up by most of the SAARC states. These barriers nullify the effect of Tariff Liberation Programme. Though it has been stated that these barriers would be subsequently removed, no time frame has been specified. Had there been a time frame, of say 3 years or so, then it would have induced immediate action on the part of the SAARC states (The United States Agency for International Development, 2005).

SAFTA has a Dispute Settlement Mechanism (DSM), but it does not follow the best practices. It is time bound, but the time period specified is so long that may lengthen the execution of any decision and may even render any practical decision ineffective. The entire process in SAFTA can take up 330 days as compared to 290 days taken up by ASEAN and 310 days taken up by NAFTA. The time period for compliance in SAFTA is 90 days, while for NAFTA and ASEAN is 30 days. This reduces the effectiveness of DSM as a speedy method to redress economic disputes.

Trade facilitation in the SAARC countries does not compliment tariff liberalisation. The transits are very slow. There is no Single Window for SAARC trading. The delay in transit often leads to perishable goods being reduced in quality on the way. Moreover, all these countries have different standards of health, environment and safety rules. This prevents the chances of a common market within the region. There are also different standards for testing, import inspections, product certification and systems certification.

A major drawback as regards the success of SAFTA was the low supply capabilities of the LDCs. Many of the countries lacked capital. The measures in SAFTA were not ample to induce greater investments in the LDCs. Investments would have strengthened their supply capabilities and thus promoted intra-regional trade. After the India-Sri Lanka FTA, Indian investments in Sri Lanka increased and thus facilitated India-Sri Lanka trade. If such measures would have been in the SAFTA provisions, it would have surely increased intra-regional trade.

Another concern is whether the bilateral trade agreements between various SAARC countries would undermine the importance of SAFTA. The coexistence of these bilateral trade agreements along with SAFTA raises the issue as to whether the former should be incorporated within the latter or not. In case of a conflict between the two, which one is to be accepted? Indo-Nepal FTA there is no negative list, which would probably not be accepted by any of the other SAARC members.

If bilateral agreements and SAFTA coexist, then there would be the problem of what the economists call: the 'spaghetti bowl' of overlapping trade agreements which can cause a lot of confusions.

The rise of BIMSTEC which involves five of the SAARC countries, may also pose a problem in the near future.

### **Does SAFTA have a potential of an Economic Union?**

There is tremendous scope for the liberalisation of the service sector amongst the SAARC countries. The New Delhi Summit in 2007 stressed on the liberalisation in trade for the services and called for the finalisation of an Agreement for the Service sector in the near future.

### **Analysis in terms of schools of thought**

#### **Realist contention**

The economic-realists believe that all nation-states are self-interested and opportunists. They further believe that all associations and agreements can be viewed as interests defined in terms of 'power'. It is in this context that SAFTA has often been viewed (Jones, 1992).

India is geographically and economically the most powerful country in this region. There is thus a lot of suspicion regarding the hegemonic role played by India in the region. Given that India is the most developed

country in the region, other countries in South Asia are skeptical that their markets might be flooded by Indian goods.

The economic realists do not accept the fact that the agreement can be equally beneficial to all the countries in the region.

### **Marxist view**

The Marxists are against the concept of free market and free trade. They believe in the success of closed economies where the working class is protected from the competition and exploitation of the free market.

For agreements like SAFTA, the Marxists believe that if at all there are any benefits reaped by means of comparative advantages and low cost of production, it would be reaped only by the capitalist class. Since the labour availability is high in the South Asian countries, the market forces of demand and supply would pull down their wages. They will always continue to be under-paid. The cycle of poverty would continue, and the poor would always remain poor.

Marxist scholars further argue that while FDI would induce investment and new firms, the traditional industries have chances of being competed out of the market. This would add to the problem of joblessness in the South Asian regions. Only big businessmen and at times the middle class would reap the benefits of cross-border free trade.

### **Conclusion**

We may thus conclude that SAFTA was a fine attempt by the South Asian countries to establish a Free Trade Area. It was a more practical arrangement as compared to the previous attempts of SAARC and SAPTA. The shift from the positive list approach to the negative list was a pragmatic one. The setting up of a Dispute Settlement Mechanism also was a good development taking into account the fact that there are a number of political clashes which impinge upon the economics of trade.

The project of SAFTA, is however slow in progress. The lethargy in progress is mainly due to the structural drawbacks of the agreement itself which has a few loopholes. Moreover the time provided for implementing the agreement is too long. This puts a question on the seriousness of the project.

There is a lot of suspicion in the air regarding the hegemonic role played by India, economically being the most powerful country in the region. While India is quite satisfied with the project, other countries are worried that their markets may be soon flooded by Indian products. There are other scholars who are skeptical regarding the very idea of free trade and its implication on the marginalised sections of the society.

If we consider the success of SAFTA vis-à-vis other Free Trade Agreements, the performance of SAFTA is quite poor indeed. Locating the data of intra-regional trade and benefits reaped from FTAs, SAFTA shows quite slow progress mostly because of the larger time frame, lack of complementarities of trade, less provisions for revisions and many other reasons. Intra-regional trade in South Asia is amongst the lowest as compared to other regions.

There is however a lot of scope, especially if one considers the idea of free trade in the service sector. Proposals regarding this had been accepted in the 16<sup>th</sup> summit of SAARC held in Bhutan. Facilitating trade by means of common standards is also a means of improving the efficiency of SAFTA. Lack of continuous revisions was also an issue which is in the way of progress. While the time period of revisions of tariffs has not been specified in the SAFTA charter, yet the next round of revisions is said to be held in November 2012.

After the successful experience of NAFTA and ASEAN FTA, SAFTA is thus underway to a successful integration.

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