

The Economic Performance of SAARC⁷ Member Countries

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Abstract

This paper attempts to examine the impact of trade liberalization over the macro economic structure of four SAARC member countries –Pakistan, India, Bangladesh and Srilanka during 1985 to 2006. The data set consists of a 21 years (1985-2006) time series data of trade variables of four countries of SAARC named as Pakistan, India, Bangladesh and Srilanka. The data provides the substantial evidence, which shows the benefits of intra regional trade expansion: larger markets and fuller utilization of production capabilities, transfer of suitable production technologies, comparative advantage and complementarities, economies of scale due to expanded markets and better utilization of entrepreneurial capabilities, capital, manpower and natural resources. In addition to that such an arrangement is also expected to foster closer economic ties among member countries and enhance their bargaining power with respect to other countries and economic blocs.

INTRODUCTION

This paper is an attempt to understand the incentives for and progress towards greater economic integration in South Asia. This sub-region comprises seven economies, namely, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka, which are members of South Asian Association for Regional Cooperation (SAARC). However in this paper we try to focus on four main countries of SAARC named as Pakistan, India, Bangladesh and Srilanka. India is by far the largest SAARC economy, while Pakistan and Bangladesh are the second and the third largest (Table 1). Srilanka is another important emerging economy. These four economies are of crucial importance for any sub-regional integration and cooperation plan to operate successfully, India and Pakistan would be the dominant constituents of any formal regional integration agreement. The size of the GNP and per capita income of the seven South Asian economies according to the 2004 available data are as follows:

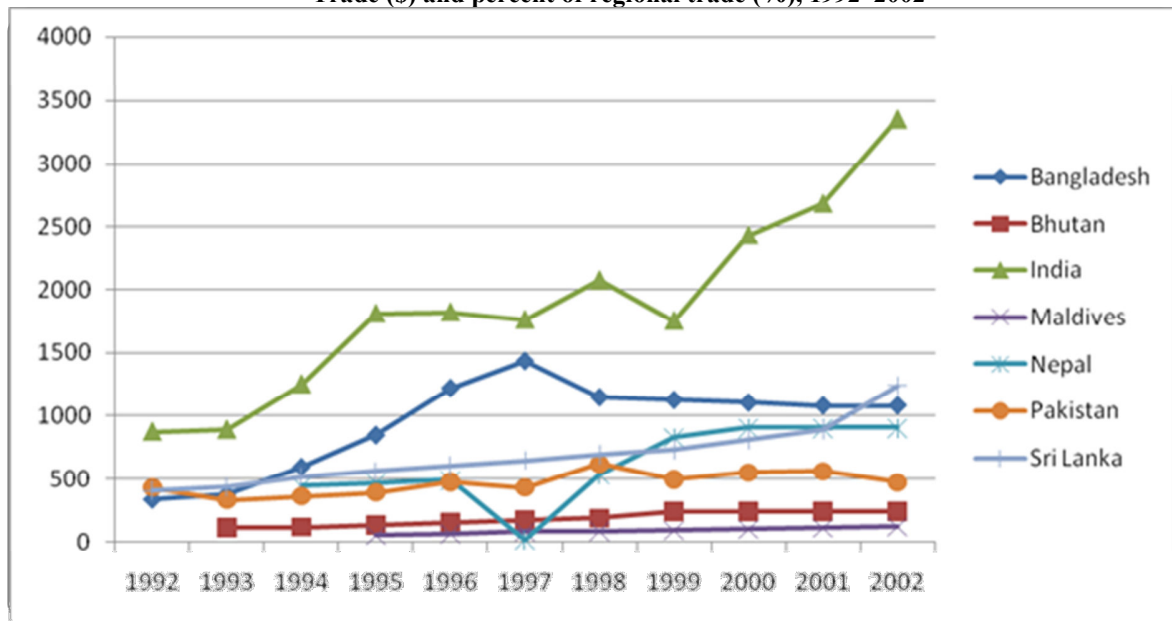
Table 1
Gross National Income (GNI) in 2004

	GNI in Billions Of dollars	GNI Per Capita in dollars
1. Bangladesh	61.3	440
2. Bhutan	0.70	760
3. India	673.2	620
4. Pakistan	90.7	600
5. Nepal	6.6	250
6. The Maldives	N.A.	2300
7. Sri Lanka	19.5	1010

Source: The World Bank. 2006. *World Development Indicators*. Washington DC.

⁷ South Asian association for regional cooperation

Trade (\$) and percent of regional trade (%), 1992–2002



ECONOMY- OVERVIEW OF THE FOUR SAARC COUNTRIES

BANGLADESH

Despite sustained domestic and international efforts to improve economic and demographic prospects, Bangladesh remains a poor, overpopulated, and inefficiently-governed nation. Although more than half of GDP is generated through the service sector, nearly two-thirds of Bangladeshis are employed in the agriculture sector, with rice as the single-most-important product. Major impediments to growth include frequent cyclones and floods, inefficient state-owned enterprises, inadequate port facilities, a rapidly growing labor force that cannot be absorbed by agriculture, delays in exploiting energy resources (natural gas), insufficient power supplies, and slow implementation of economic reforms. Reform is stalled in many instances by political infighting and corruption at all levels of government. Opposition from the bureaucracy, public sector unions, and other vested interest groups also has blocked progress. On an encouraging note, growth has been a steady 5-6% for the past several years.

PAKISTAN⁸

Pakistan, an impoverished and underdeveloped country, has suffered from decades of internal political disputes, low levels of foreign investment, and a costly ongoing confrontation with neighboring India. However, IMF-approved government policies, bolstered by generous foreign assistance and renewed access to global markets since 2001, have generated solid macroeconomic recovery the last five years. The government has made substantial macroeconomic reforms since 2000, most notably privatizing the banking sector. Poverty levels have decreased by 10% since 2001, and Islamabad has steadily raised development spending in recent years, including a 52% real increase in the budget allocation for development in FY07, a necessary step toward reversing the broad underdevelopment of its social sector. The fiscal deficit - the result of chronically low tax collection and increased spending, including reconstruction costs from the October 2005 earthquake - appears manageable for now. GDP growth, spurred by gains in the industrial and service sectors, remained in the 6-8% range in 2004-06. Inflation remains the biggest threat to the economy, jumping to more than 9% in 2005 before easing to 7.9% in 2006. The central bank is pursuing tighter monetary policy - raising interest rates in 2006 - while trying to preserve growth. Foreign exchange reserves are bolstered by steady worker remittances, but a growing current account deficit - driven by a widening trade gap as import growth outstrips export expansion - could draw down reserves and dampen GDP growth in the medium term.

INDIA

⁸ Sood , K, 1989. Trade and economic development :India, Pakistan, Bangladesh. Raghavan. SN. 1995. Regional economic cooperation among SAARC countries

India's diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of services. Services are the major source of economic growth, accounting for more than half of India's output with less than one third of its labor force. About three-fifths of the work force is in agriculture, leading the government to articulate an economic reform program that includes developing basic infrastructure to improve the lives of the rural poor and boost economic performance. The government has reduced controls on foreign trade and investment. Tariffs averaged 12.5% on non-agricultural items in 2006. Higher limits on foreign direct investment were permitted in a few key sectors, such as telecommunications. However, tariff spikes in sensitive categories, including agriculture, and incremental progress on economic reforms still hinder foreign access to India's vast and growing market. Privatization of government-owned industries remained stalled in 2006. The economy has posted an average growth rate of more than 7% in the decade since 1996, reducing poverty by about 10 percentage points. India achieved 8.5% GDP growth in 2006, significantly expanding manufacturing. India is capitalizing on its large numbers of well-educated people skilled in the English language to become a major exporter of software services and software workers. Economic expansion has helped New Delhi continue to make progress in reducing its federal fiscal deficit. However, strong growth - more than 8 percent growth in each of the last three years - combined with easy consumer credit and a real estate boom is fueling inflation concerns. The huge and growing population is the fundamental social, economic, and environmental problem.

SRI LANKA

In the nineteenth and twentieth centuries, Sri Lanka became a plantation economy famous for its production and export of cinnamon, rubber and Ceylon tea, which remains a trademark national export. The development of modern ports under British rule raised the strategic importance of the island as a centre of trade. However, the plantation economy aggravated poverty and economic inequality. From 1948 to 1977 socialism strongly influenced the government's economic policies. Colonial plantations were dismantled, industries were nationalized and a welfare state established. While the standard of living and literacy improved significantly, the nation's economy suffered from inefficiency, slow growth and lack of foreign investment.

From 1977 government began incorporating privatization deregulation and promotion of private enterprise. While the production and export of tea, rubber, coffee, sugar and other agricultural commodities remains important, the nation has moved steadily towards an industrialized economy with the development of food processing, textiles, telecommunications and finance. By 1996⁸ plantation crops made up only 20% of⁹ export, and further declined to 16.8% in 2005 (compared with 93% in 1970), while textiles and garments have reached 63%. The GDP grew at an average annual rate of 5.5% during the early 1990s, until a drought and a deteriorating security situation lowered growth to 3.8% in 1996. The economy rebounded in 1997-2000, with average growth of 5.3%. The year of 2001 saw the first recession in the country's history, as a result of power shortages, budgetary problems, the global slowdown, and continuing civil strife. Signs of recovery appeared after the 2002 ceasefire. The Colombo Stock Exchange reported the highest growth in the world for 2003, and today Sri Lanka has the highest per capita income in South Asia.

Review of Literature

Jacob Viner (1950) was the first one to examine the impact of regional groupings on the welfare and introduced the concept of trade creation and trade diversion. However, he made restrictive assumptions of zero demand and supply elasticities. Subsequently Meade (1955) relaxed the of zero price elasticity of demand. Lipsey (1957) relaxed the assumptions of zero supply elasticity as well. The main finding of these studies has been that if trade creation and trade expansion exceeds the trade diversion, regional integration would be welfare promoting and vice-versa.

The analysis presented by Viner, Meade and Lipsey has been static and it may be argued that dynamic advantages may be even stronger. However, the estimates of dynamic gains have been subject to controversies as well¹⁰. Many international economists have come up with different definitions of integration. According to Balassa (1961), integration has been said to progress through the freeing of barriers to trade (trade integration), the liberalization of factor movements (factor integration) the harmonization of national economic policies (policy integration), and the

⁹ Anand, R.P., 1991. South Asia in Search of Regional Identity, Bangan Pubs., New Delhi. Arndt, S.W., 1968. "On Discriminatory vs. Non-Preferential Tariff Policies", *Economic Journal* 78(4): 971-79.

¹⁰ (See Bhagwati (1993), Helpman (1995), Baldwin and Venables (1995), and Srinivasan (1997).

complete unification of these policies (total integration) (Balassa, 1976). Kitamura (1966) however criticizes these definitions on the grounds that they conform to the principles of classical economic doctrines but do not apply to the present day market economies, which are characterized by a considerable degree of state intervention, and apply even less to developing and to socialist economies.

Pinder (1968) proposed to define economic integration as both the removal of discrimination as between the economic agents of the member countries, and the formation and application of co-coordinated and common policies on a sufficient scale to ensure that major economic and welfare objectives are fulfilled. His definition was criticized by Vajda (1971) for its excessive generality. Vajda introduced the distinction between market integration and production and development integration. The former is defined as 'the guarantee of unhindered sale of each other's product within the framework of the social system of participating countries'. The later is on the other hand said to involve 'raising to an international level and programming the production of those branches of industry, which cannot be developed to an optimum size within national boundaries'.

Vamvakidis (1998) in one of the early attempts tried to answer the question whether regional trade agreement held any impact on growth. His empirical evidence showed that there was a case for smaller economies entering into such arrangements with larger economies for growing faster

DATA AND METHODOLOGY

The comprehensive econometric models required large pool of macroeconomic data and the tremendous efforts are used in the collection of such data set. The data set consists of a 21 years (1985-2006) time series data of trade variables of four countries of SAARC named as Pakistan, India, Bangladesh and Srilanka. The major sources of the data include annual issues of World Development Indicator and UNCTAD Hand book of statistics 2008. Other sources are SAARC official web site, "UN Commodity Trade Statistics Database (UN Comtrade)", Asian Development Bank Data Base, IMF and different issues of Direction of trade statistics. For regression single source data has been used for all countries in order to make the time series comparable. Simple OLS techniques are used. In order to find out the bilateral weightage of SAARC countries simple percentage formula has been used to show the share of SAARC countries and the rest of the world.

It is important to mention some important points related to the limitations of available data. There are some missing observations in a required data for all countries specially Nepal, Maldives and Bhutan. The linkage among SAARC countries has been established through trade. Another problem is that there is lack of uniformity in the different sources of the data even some times the same source book, in different year's publication, show different values of the same variable for the same year. Different international source book contains some variable for some years but the same variables are not given for all countries. For example in the IMF source, government financial statistics, the monetary data of Bangladesh are not available after the year 1989.

This research follows the work of Naqvi et al (1988) and Guru-Gharana (2000) with different estimation method. The study tries to overcome some drawbacks of these earlier two studies. For example, Naqvi et al (1988) studied with time series data of 1959-60 to 1978-79 when till 1971, Bangladesh was the part of Pakistan. So before 1971, trade between Pakistan and Bangladesh was in fact inter country trade, rather than international trade. That is why in this research the time period has been chosen from 1985-2006.

$$M=f(Y, X)$$

M= Total imports of goods and services in percentage term

Y= GDP growth rate in percentage term

X= total exports of goods and services in percentage term

$$M= \beta_0 + \beta_1 Y + \beta_2 X + \mu$$

The μ is the error term. In above equation β_1 and β_2 are coefficients and expected to be positive in most of the cases. The research indicates that total import of the country depends on its GDP growth rate and volume of its total exports of goods and services.

Estimation Results of Model

The model provides the trade link among four countries of SAARC. For this purpose import of goods and services of each country is used as dependent variable while GDP growth rate and exports of goods and services are used as independent variable. All values are taken in percentage form. The estimation is based on time series data of 21 years from 1985-2006. Within the severe limitations, the models, with few exceptions, provide satisfactory fit. This is

evident from R^2 , adjusted R^2 and F values. It is important to note that R^2 and F values are for model fit, and T-ratios for individual coefficient. As mentioned above Ordinary Least Square (OLS) estimation technique is used for individual country model. It is observed that some of the trade equations do not exhibit good fit. The main reason may be that trade in SAARC region is largely determined by non-economic bilateral relations rather than economic logic of comparative advantage (SAARC LINK 1992). The economic variables are unable to capture the fluctuations of trade data here. In Pakistan imports there is some unsatisfactory fit indicating non economic factors are dominating factors of bilateral trade.. India Bangladesh and Srilanka are showing relatively good results. NAFTA countries results are good fit and satisfactory.

Pakistan

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	20.91097	7.574658	2.760648	0.0129
Y	0.254139	0.335492	0.757513	0.4585
X	-0.17999	0.463278	-0.38852	0.7022
R-squared	0.044281	Mean dependent var		19.35686
Adjusted R-squared	-0.06191	S.D. dependent var		2.895626
S.E. of regression	2.983914	Akaike info criterion		5.155912
Sum squared resid	160.2673	Schwarz criterion		5.30513
Log likelihood	-51.1371	F-statistic		0.416994
Durbin-Watson stat	0.819939	Prob(F-statistic)		0.66523

India

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.30394	0.415373	-0.73174	0.4737
Y	0.168564	0.06585	2.559827	0.0197
X	1.049563	0.030974	33.8851	0
R-squared	0.988651	Mean dependent var		12.75123
Adjusted R-squared	0.98739	S.D. dependent var		5.136741
S.E. of regression	0.576818	Akaike info criterion		1.868983
Sum squared resid	5.988937	Schwarz criterion		2.0182
Log likelihood	-16.6243	F-statistic		784.0455
Durbin-Watson stat	0.794725	Prob(F-statistic)		0

Y=GDP GROWTH RATE%

X=EXPORTS%

M=IMPORTS%

Srilanka

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	16.2023	2.615218	6.195394	0
Y	0.290989	0.171655	1.695203	0.1073
X	0.74237	0.080935	9.172437	0
R-squared	0.846408	Mean dependent var		41.9065
Adjusted R-squared	0.829342	S.D. dependent var		3.730499
S.E. of regression	1.541099	Akaike info criterion		3.834432
Sum squared resid	42.74973	Schwarz criterion		3.983649
Log likelihood	-37.2615	F-statistic		49.59668
Durbin-Watson stat	1.440316	Prob(F-statistic)		0

Bangladesh

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.894695	0.901253	7.65012	0
Y	0.004216	0.26675	0.015805	0.9876
X	0.919172	0.072512	12.67612	0
R-squared	0.951084	Mean dependent var		16.96524
Adjusted R-squared	0.945648	S.D. dependent var		3.999953
S.E. of regression	0.932526	Akaike info criterion		2.829725
Sum squared resid	15.6529	Schwarz criterion		2.978943
Log likelihood	-26.7121	F-statistic		174.9872
Durbin-Watson stat	1.143048	Prob(F-statistic)		0

All these results show that there are some real possibilities of economic co-operation or, more accurately, economic integration in the region. And this collaborative and supportive effort should have an expansionary effect both on the national GNP and on their regional trade ratios.

Estimation Results of Model

The model provides the trade link among four countries of SAARC. For this purpose import of goods and services of each country is used as dependent variable while GDP growth rate and exports of goods and services are used as independent variable. All values are taken in percentage form. The estimation is based on time series data of 21 years from 1985-2006. Within the severe limitations, the models, with few exceptions, provide satisfactory fit. This is evident from R², adjusted R² and F values. It is important to note that R² and F values are for model fit, and T-ratios for individual coefficient. As mentioned above Ordinary Least Square (OLS) estimation technique is used for individual country model. The estimated foreign trade equations, which link SAARC countries of the region their results, are presented below.

It is observed that some of the trade equations do not exhibit good fit. The main reason may be that trade in SAARC region is largely determined by non-economic bilateral relations rather than economic logic of comparative advantage (SAARC LINK 1992). The economic variables are unable to capture the fluctuations of trade data here. In Pakistan imports there is some unsatisfactory fit indicating non economic factors are dominating factors of bilateral trade. India Bangladesh and Srilanka are showing relatively good results.

CONCLUSION

Though there exists certain differences among SAARC member states, such as, geographical and population imbalances, they have many factors in common - rural economies, low income, population pressure, unemployment, geographically neighbor states and dependence on external debt, to name a few.

Even though diversification was mooted as a remedy for low level growth of exports, SAARC nations dependence on exports of manufactured goods are back in a situation of low growth. Therefore, benefits of export expansion may have to be evaluated against the present level of protectionist tendencies. Thus, high nominal tariffs on a variety of non-tariff barriers such as quantitative restrictions, fiscal charges and discriminatory practices and outright ban on imports has to be avoided among SAARC members. Also, SAARC must deal with the world's major trading blocks as a composite unit in order to maximize the gains of trade for both sides.

SAARC countries can perform much better by increasing cooperation among them for the betterment of their trade and economic wellbeing. SAARC countries have to remove all trade barriers to promote trade relations. These relations are greatly affected due to political and terrorism acts, especially the relations between India and Pakistan, as 80% of GDP of SAARC is based on their trading activities, and now a days these countries are trapped in many political and terrorism issues and blaming each other, and due to this the trade acts are suffering a lot and GDP is badly affected. So in short all countries have to work for mutual benefits and solve all these issues in a friendly manner, so that trade between these countries can blossom more in future. India has the largest and fastest growing economy in the region, and it also holds a big trump card for resolving the major issues that have afflicted the region. As a big brother, India has a great responsibility to steer SAARC countries in the direction of economic integration. By doing so, India will expedite its own growth and ensure its stability as well. If India needs a convincing argument for this, it should only examine the circumstances that led to the creation of the EU and NAFTA.

An efficient and better communication network, among SAARC partners, which can give information in terms of export potentials, import needs, domestic economic policies, tariff and non-tariff barriers, infrastructural facilities, demand and supply situation and investment opportunities, will help for a better economic co-operation and regional development.

A proper financial and institutional framework such as, for instance, a bank for the countries of the region or the establishment of capital markets of regional importance will lead to a better financial flow among SAARC economies.

Regional economic co-operation (REC) can help in optimum utilization of capabilities and resources available in the member states, reduction and dependence on external world; opening up avenues of industrialization for smaller countries; and strengthening of negotiating capabilities vis-à-vis rest of the world. Thus, SAARC members should agree to follow, and follow an economic policy with more realistic attitude and with strong political will to boost up the economic development and peace of the region. After the formation of the SAFTA the member countries like India is growing more as compare to other countries. It has a raising trend in its inter regional trade the % of over all inter regional trade of India 40% to 45% which is highest in the region.

The formation of SAFTA has great impact on export¹¹ and imports on grown member countries to which many member countries found its favorable foe. Them like India whose export has been increase by 51% and Sri Lanka whose export is increase by 57.43% and its remain steady for other countries.

Comparatively as compare to export, imports are also getting affected. The formation of SAFTA is more favorable in imports for Bangladesh that its imports have been decreased by almost 14.50%. I

The formation of SAFTA has affected many sectors of the member countries in which service sectors is also included... In the same way the services sector of the Bangladesh has been increased by 2.50% and the service sector in India increased by 3.30%, In Nepal increased by 1.60% and it is same in Sri Lanka. In Pakistan service sector showed negative trend.

The data provide the evidence that there are inter-country differences in production and consumption pattern in SAARC countries. The opportunities of investment are also different in our selected five SAARC countries. In addition to that the tax and non tax structure of these countries are entirely different. So there is a considerable scope for trade expansion among the SAARC countries based on comparative advantage. The policy prescription may be that all countries must be "positive" in their actions with regard to the policy formulation and execution for regional trade expansion. Economic and non economic factors should always get priority for regional trade in order to obtain maximum possible gains. The data shows that currently SAFTA trade accounts for close to 5 percent of the total trade of SAFTA member countries. Intra SAARC trade is also showing increasing trend from the year 1991 to 2001 along with the SAARC world trade, which is the result of successful process of trade liberalization. In future SAARC trade has more chances to grow if prudent macro policies such as increased bank credit to private sector,

¹¹ The GDP of the SAARC countries increased by 1% to 2% which is expected to grow more and could reach around 3% in 2010.

increased FDI (Foreign Direct Investment), harmonious developmental strategies and region-oriented policies are pursued.

Table one is showing the key economic indicators in South Asia, more than one fifth of world population (22 percent) is housed in South Asia but its total GDP is only 2 percent of the world output according to the statistics in 2002. Despite various initiatives to liberalize trade between member countries under the SAARC framework, intra-regional trade has remained very low in South Asia compared to other similar regional trade blocs; approximately 2.4% of total SAARC trade in 1990. It increases only to 4.1% by 1995 with almost 96% still accounting for extra regional trade (Table 2). This indicates that there is substantial growth potential in intra-regional trade provided right measures and instruments are applied to boost the trade in the region.

Table 1

Key economic indicators of SAARC countries 2002

Economic Indicators	COUNTRY				
	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Surface area (Thousands sq km.)	144	3287	147	796	66
Population (millions)	136	1048	24	145	19
GDP per capita US\$	360	480	220	410	840
PPP per capita US\$	1720	2570	1350	1940	3390
% GDP growth (2001-2002)	4.4	4.4	-0.6	4.4	3.0
Gini Index	33.6	37.8	36.7	31.2	34.4
% Population > \$2 a day	77.8	86.2	82.5	84.7	45.4

Survey years: *Bangladesh, Nepal (1995-96), India (1997), Pakistan (1996-97), Sri Lanka (1995)

**Bangladesh, Pakistan (1996), India (1994), Nepal, Sri Lanka (1995)

Table 2

SAARC Intra-regional Trade						
Year	Intra SAARC Trade	USD million	SAARC World Trade	USD million	Percentage	
1991	1914		63435		3.0	
1992	2488		71149		3.5	
1993	2458		72211		3.4	
1994	2937		82839		3.5	
1995	4263		103878		4.1	
1996	4928		110962		4.4	
1997	4447		115370		3.9	
1998	6001		123144		4.9	
1999	5511		131152		4.2	
2000	5884		146924		4.0	
2001	6537		143443		4.6	

Source: Direction of Trade Statistics Yearbook 1997, 2002 (International Monetary Fund)

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