NUST Institute of Management Sciences

MBA 2002

THESIS

IMPACT OF REGIONAL TRADE AGREEMENT (SAFTA) ON PAKISTAN ECONOMY

Submitted By: **Muhammad Javaid Iqbal**

2002-NUST-MBA-138

Submitted To: **Mr. Muhammad Taslim**

NUST Institute of Management Sciences, Tamiz ud din Road, Rawalpindi Cantt.

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Acknowledgment

I thank Almighty Allah for the courage and perseverance that he bestowed upon me which was instrumental in completion of this task. Then, I am highly indebted to my advisor Brig Muhammad Taslim for his unbounded guidance that he provided me whenever I was stuck during course of completion of this work. His assistance and supervision gave me encouragement to complete my thesis successfully.

I would also like to express my gratitude to the members of my research study for their support and efforts in preparation of this work. Especially, I would grant my sincere vote of thanks to Mr Faheem ul Islam in connection with locating some of the more exceptional material in text and Mr Naukhez Sarwar for the guidance in organizing the material. I am also thankful for the efforts of those people from Industry and Ministry of Commerce and Trade for sharing their experiences and providing with the facts and figures, which helped in creation of this report.

I hope that my effort finalized under your distinguished guidance satisfactorily meets the academic requirements. In the end my thanks to all those people who have contributed in preparation of my thesis work including my family and friends.

Muhammad Javaid Iqbal

Preface

This research work has been undertaken as part of the requirements for completion of Masters Programme. The report that follows has been prepared after extensive research utilizing secondary research methods in material collection phase. Internet was the overwhelming source of input. Then library, periodicals, newspapers and industrial corners were also combed for required information. **M**inistry of **C**ommerce and **T**rade is one of the places that merit a mention especially in this regard.

My thesis on "**I**mpact of **R**egional **T**rade **A**greement (**SAFTA**) on **P**akistan Economy" endeavors to present research and analysis of relevant policies and legislations and the future out comes. **S**outh **A**sian **F**ree **T**rade **A**rea (**SAFTA**) is yet a dream to come true. Given the scope of this evaluation and long time frame of **SAFTA** with presently limited resources available, one cannot expect to have identified all of the issues that need to be addressed and indeed it is possible that I might be unaware of some factors that may invalidate some of the comments that have been made. Nevertheless it is confidently stated that the overall picture presented by this study is fair and a dedicated effort.

Muhammad Javaid Iqbal

Executive Summary

Regional Integration has become an economic imperative for developing countries in view of the emerging trend of trade blocs capturing substantial intra regional trade. It is also a fact that even after two decades of its signing; SAARC could not achieve its purpose. Rather its performance so far has been dismal in comparison with other regional blocs. Though earlier efforts to transform the region into a free trade area could not be materialized but this time efforts seemed to be fruitful with the finalization of Draft Treaty Framework during January 2004. There is a vast scope for trade expansion and cooperation among SAARC countries. Pakistan would have definite impacts on her economy with the implementation of SAFTA. In the short run, there would be serious challenges to our economy from intra-SAARC imports. Hence, we need to concentrate on developing policies to diversify and upgrade our export base and create a favourable climate for private investment. Trade liberalization with SAARC countries will encourage our policy makers to increase efforts for international competitiveness. The studies reviewed in the thesis argue that regional trade liberalization will lead to a restructuring of Pakistan's economy from less to more competitive sectors. I have firm belief that regional economic integration will allow Pakistan to deal more effectively with the challenges of globalization and improve its position in regional and international trade.

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Table 1

Macro Economic Indicators of SAARC Countries – 2002

Country	Population	Surface Area (Sq km)	GDP (Current $)	GDP growth (Annual %) 2001-2002	GDP growth per capita (Annual %)
Bangladesh	144,000	135,683,700	47,327,540,000	4	3
Bhutan	47,000	850,820	594,184,704	8	5
India	3,287,260	1,048,278,528	515,012,395,008	4	3
Maldives	300	286,680	617,734,400	2	0
Nepal	147,180	24,122,310	5,493,179,392	-1	-3
Pakistan	796,100	144,902,416	60,521,492,480	4	2
Sri Lanka	65,610	18,968,480	16,372,709,376	3	2

Source: World Development Indicator, World Bank Report

Chart 1

Macro Economic Indicators of SAARC Countries – 2002

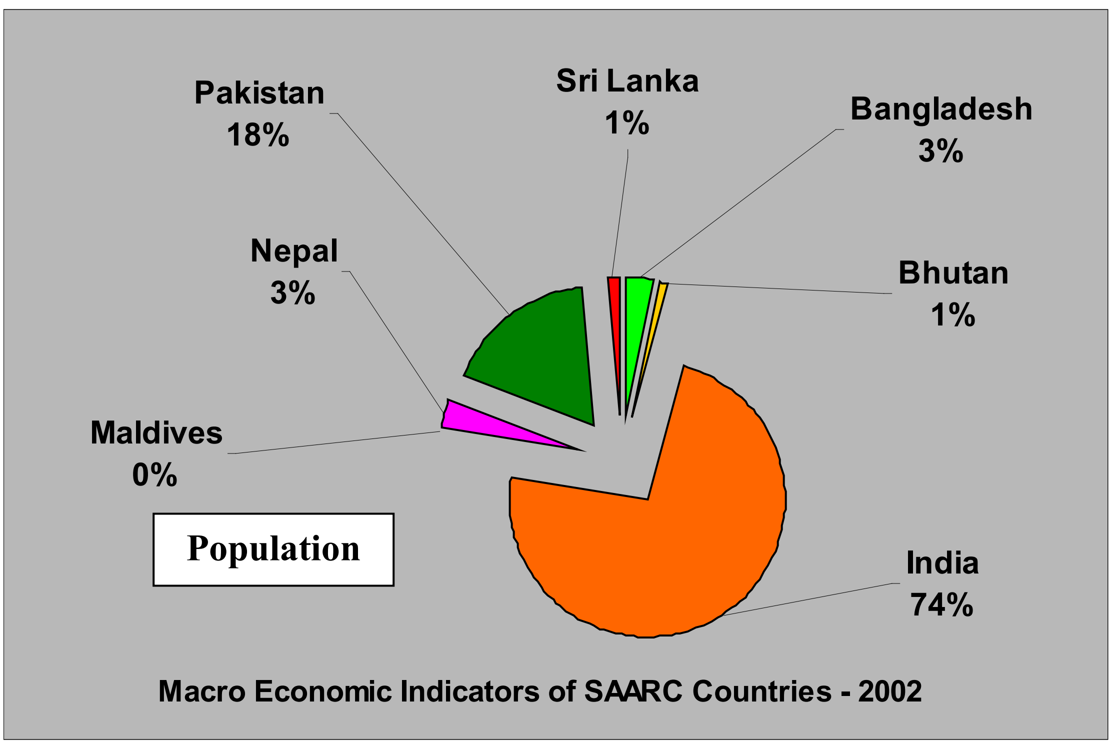
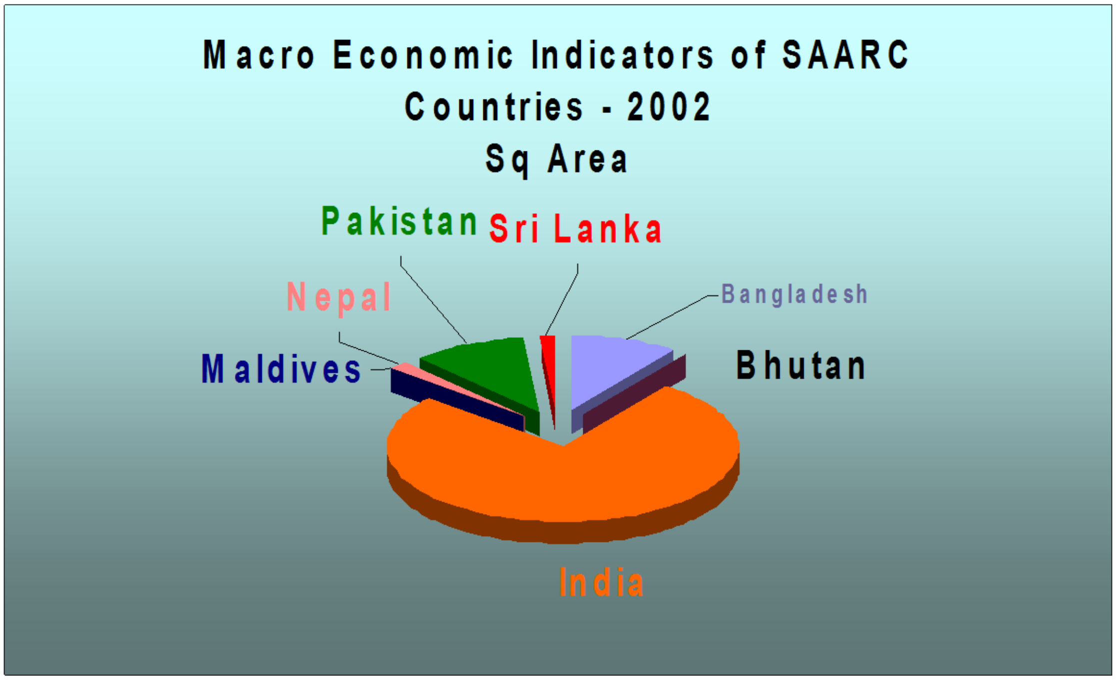


Chart 2



Graph 3

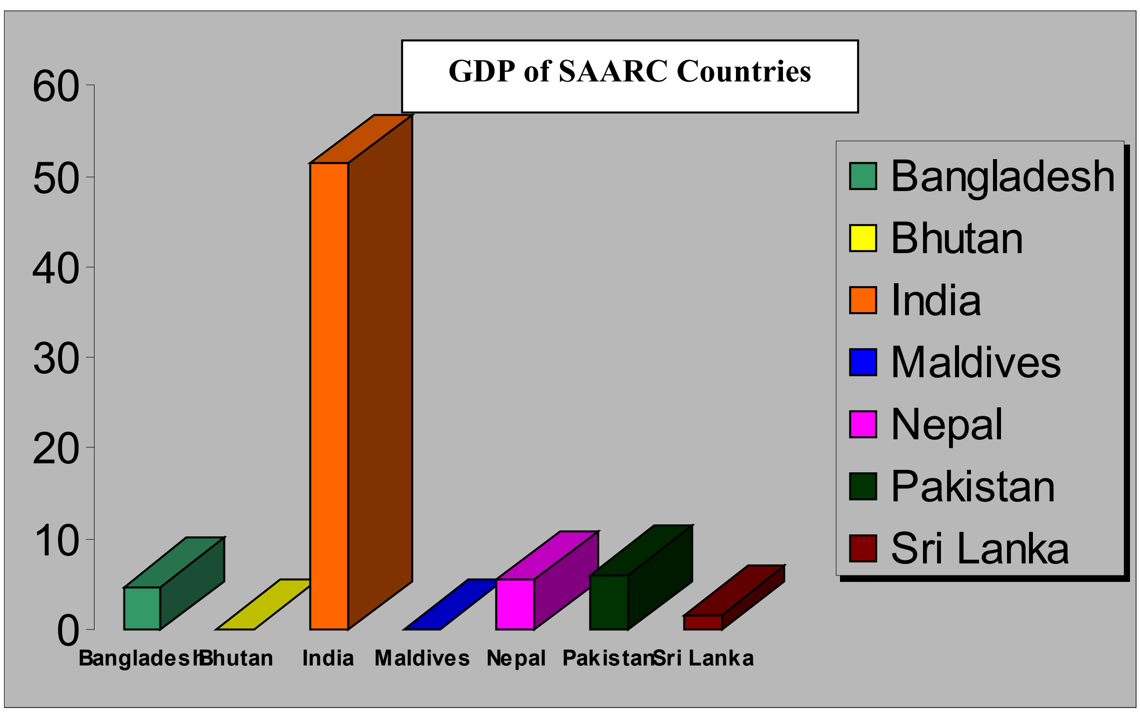


Table 2

Share of Intra Regional Trade within SAARC

(% Exports)

Country	1970	1975	1980	1985	1990	1995	2000
Bangladesh	NA	2.4	9.1	7.7	3.6	2.6	2.2
India	3.9	3.7	3.5	2.9	2.7	5.0	5.5
Nepal	61.9	81.1	38.1	38.5	6.9	8.7	27.7
Pakistan	1.5	6.8	6.3	5.3	4.0	3.3	3.3
Sri Lanka	3.2	9.0	6.8	3.7	3.1	2.7	2.6
South Asia	3.7	5.1	4.8	4.0	3.1	4.4	4.9

(% Imports)

Country	1970	1975	1980	1985	1990	1995	2000
Bangladesh	NA	7.9	3.7	1.3	7.0	17.7	14.7
India	1.4	0.9	1.0	0.7	0.4	0.6	0.9
Nepal	73.6	62.0	48.0	32.5	11.5	9.9	33.4
Pakistan	0.5	2.8	2.1	1.7	1.6	1.3	1.8
Sri Lanka	12.4	6.9	6.3	6.3	6.6	10.3	13.8
South Asia	3.3	3.2	2.3	1.7	1.8	3.6	4.3

Source: Direction of Trade Statistics, IMF, and WTO Trade Statistics

Table 3

Pakistan's Trade Balance with SAARC Countries

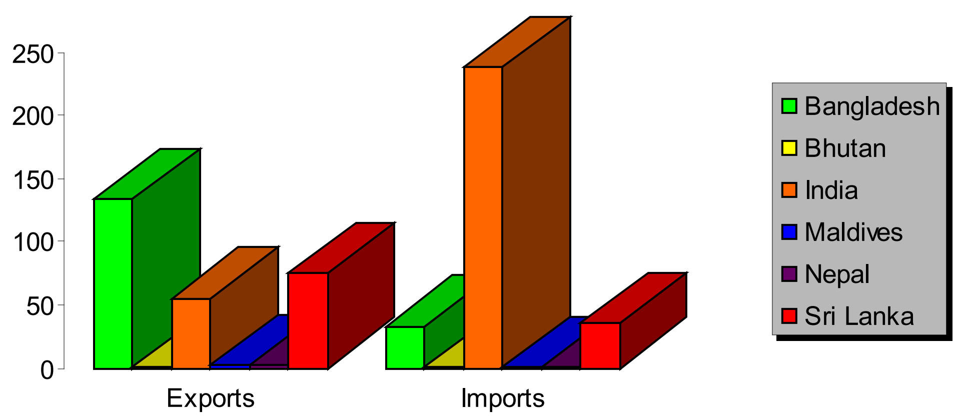
(Value in 000 US $)

	2000-2001			2001-2002			2002-2003		
Country	**Export**	**Import**	**Balance**	**Export**	**Import**	**Balance**	**Export**	**Import**	**Balance**
Bangladesh	133422	33270	100152	101139	27525	73614	114356	32638	81718
Bhutan	282	261	21	320	388	(68)	107	716	(609)
India	55397	238337	(182940)	49227	186891	(137664)	70664	166571	(95907)
Nepal	2269	973	1296	2382	832	1550	3077	1363	1714
Maldives	1760	164	1596	1499	158	1341	3307	72	3235
Sri Lanka	75321	35191	40130	72113	28524	43589	76100	38243	37857

Source: Export Promotion Bureau, Pakistan

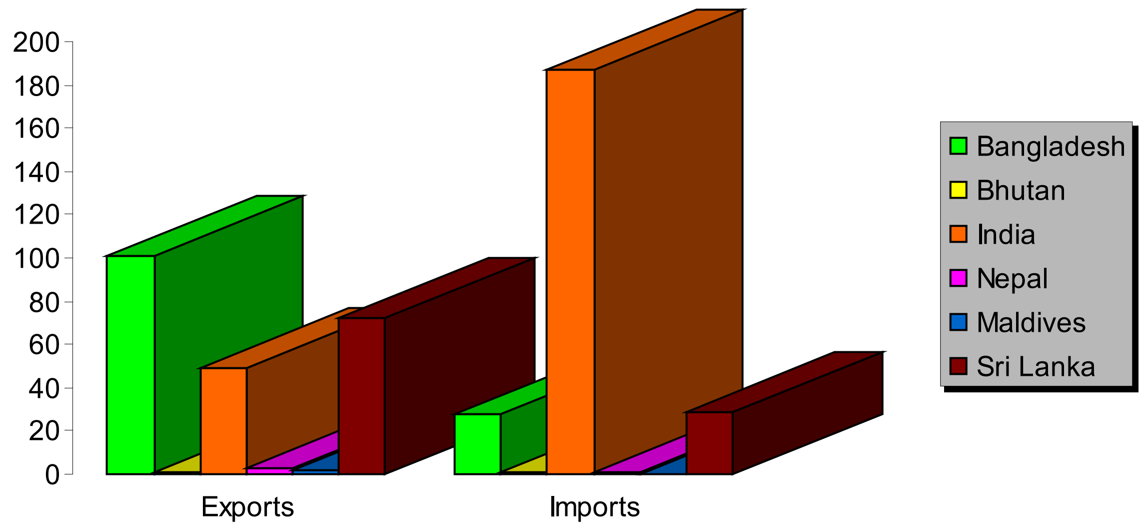
Graph 4

Pakistan's Trade Balance with SAARC Countries 2000-2001



Graph 5

Pakistan's Trade Balance with SAARC Countries 2001-2002



Graph 6

Pakistan's Trade Balance with SAARC Countries - 2002-2003

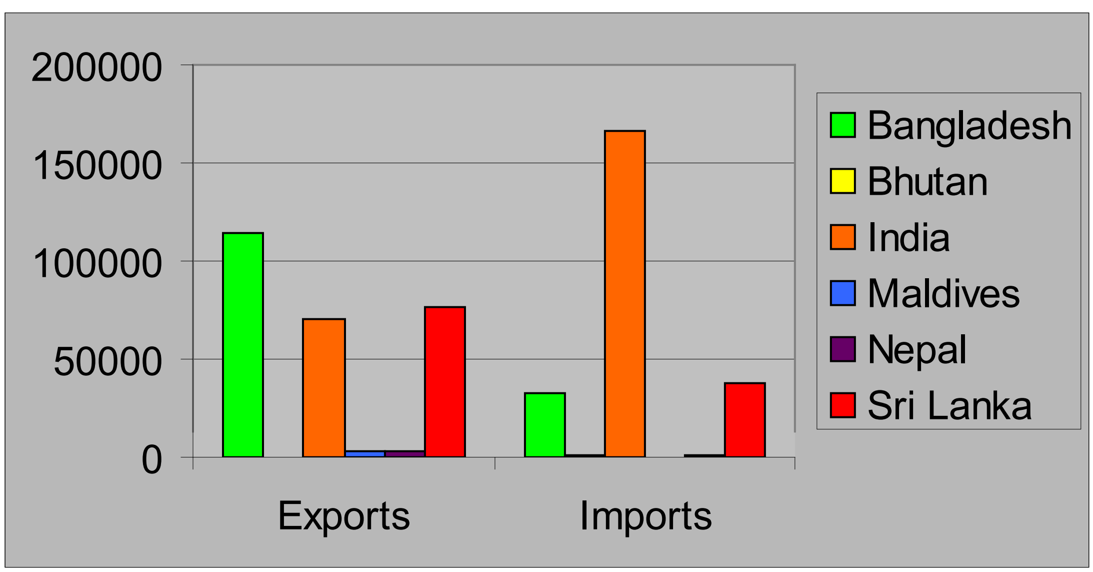


Table 4

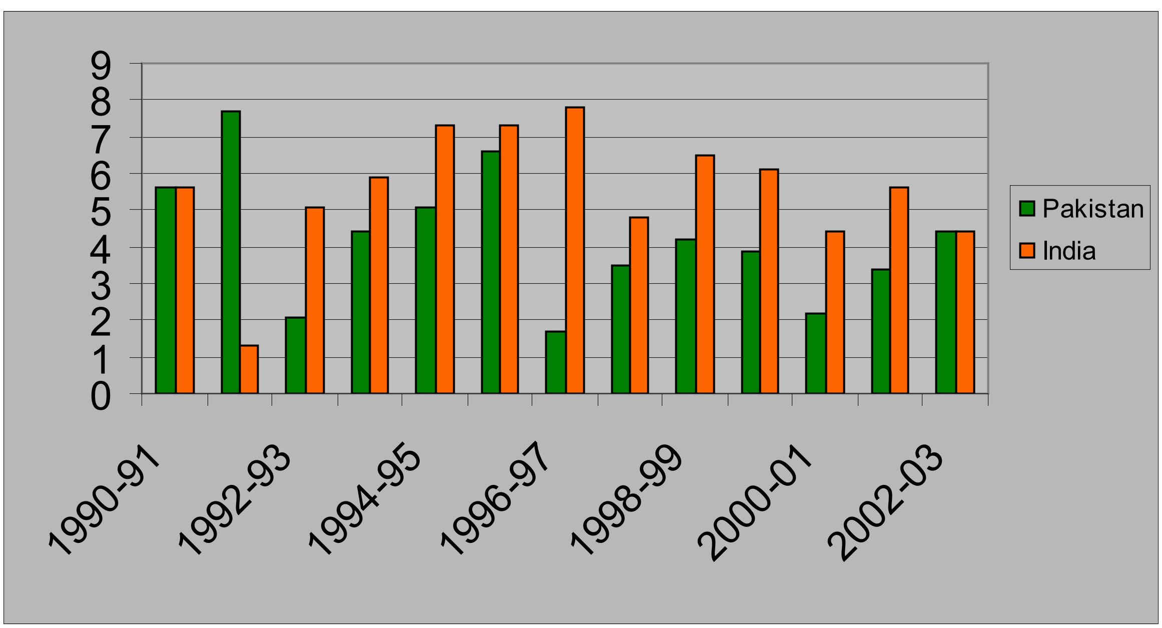
Comparative Growth Rates, 1990-2003
Pakistan and India

	GDP Growth Rate (%)		Per Capita Income (US $)	
Country	**Pakistan**	**India**	**Pakistan**	**India**
1990-91	5.6	5.6	426	313
1991-92	7.7	1.3	439	263
1992-93	2.1	5.1	453	240
1993-94	4.4	5.9	443	270
1994-95	5.1	7.3	508	318
1995-96	6.6	7.3	513	351
1996-97	1.7	7.8	493	382
1997-98	3.5	4.8	473	406
1998-99	4.2	6.5	438	410
1999-2000	3.9	6.1	441	443
2000-01	2.2	4.4	415	457
2001-02	3.4	5.6	419	479
2002-03	5.1	4.4	492	514

Source: Economic Survey of Pakistan 2002-03, Economic Survey of India 2003-03, World Development Indicators 2003

Graph 7

Comparative GDP Growth Rates, 1990-2003
Pakistan and India



Graph 8

Comparative Per Capita Income, 1990-2003
Pakistan and India

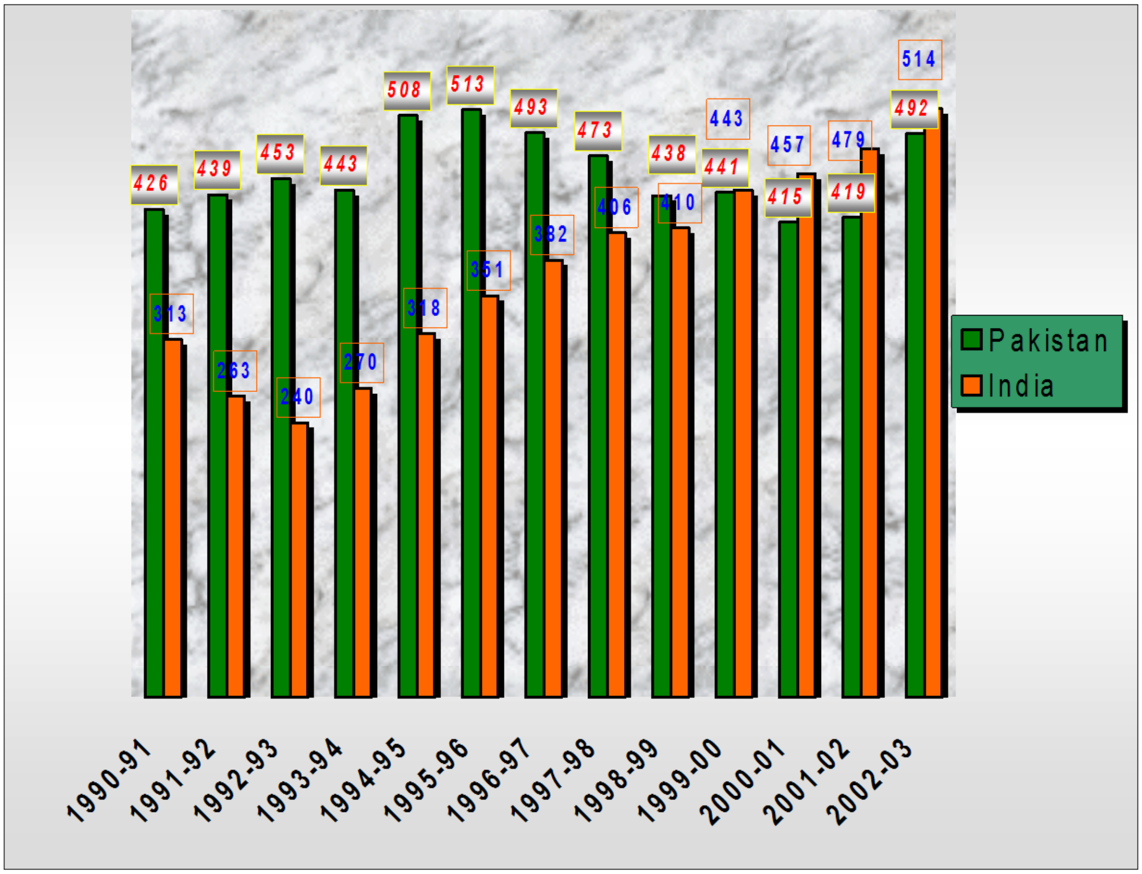


Table 5

Comparative Macro Economic Indicators - 2002

Pakistan and India

Country	Fiscal Surplus/ Deficit (% of GDP)	Gross Domestic Saving (% of GDP)	Gross Domestic Investment (% of GDP)	Debt (% of GDP)
India	-5.3	21.0	22.4	20.2
Pakistan	-6.7	14.4	14.7	59.4

Source: World Development Indicators 2003, World Bank

Table 6

Pakistan's Trade with India 1992-2003

(US $ Million)

Year	92-93	93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01	01-02	02-03
Exports	83	42	42	41	36	89	175	54	55	49	71
Imports	67	70	64	95	197	153	146	127	235	187	167

Source: Annual Report 2003- State Bank of Pakistan

Graph 9

Pakistan's Trade with India 1992-2003

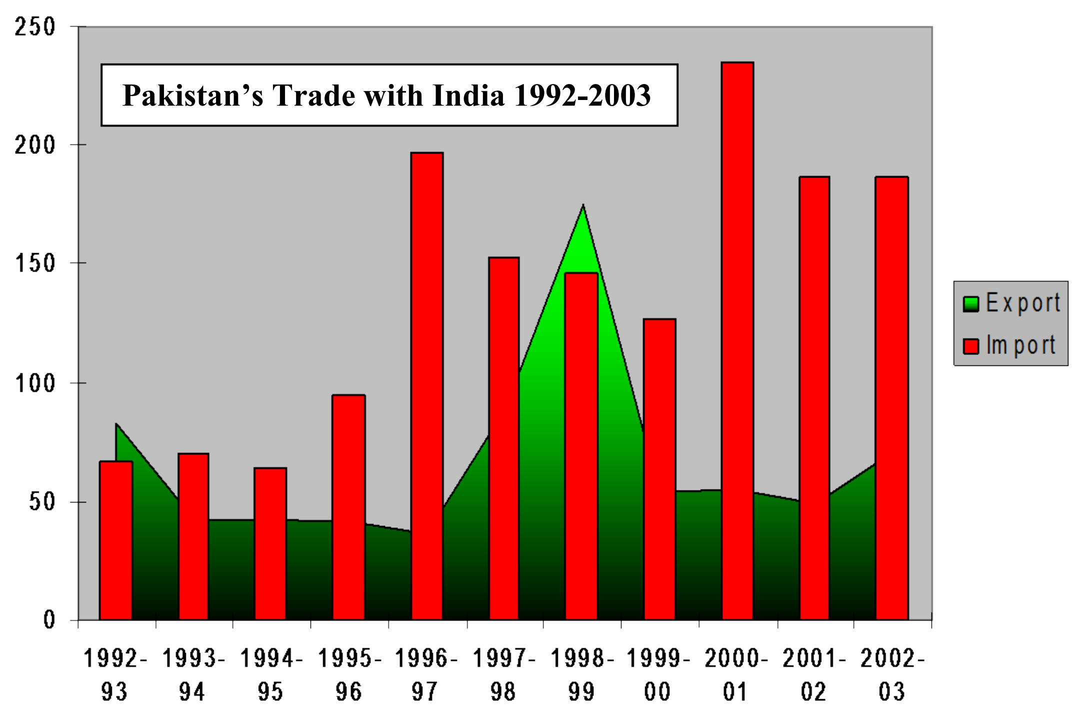


Table 7

Pakistan's Trade with India 2002-03

(Product Categories)

(US $ Millions)

S. No	Major Export items	Exports	Major Import Items	Imports
1.	Fruits & Vegetables	21.345	Chemical elements & Compounds	59.529
2.	Crude vegetable materials	3.864	Tyres & Tubes of rubber	18.439
3.	Cotton fabrics (woven)	3.701	Ores & concentrates of iron & steel	18.267
4.	Cotton yarn	1.431	Chemical materials & products	16.444
5.	Wool	1.282	Dyeing, tanning & coloring materials	10.556
6.	Made up articles of textile materials.	1.083	Crude vegetable materials	6.190
7.	All crude minerals	0.644	Tea & mate	4.763
8.	Articles of plastics	0.619	Machinery & parts	4.059
9.	Synthetic fabrics, silk woolen & flax	0.439	Manufactures of non ferrous metals	3.070
10.	Apparel & clothing of textile	0.222	Coal, cake & briquettes	2.645
11.	Medical/surgical instruments	0.222	Spices	2.372
12.	Pearls & other precious stones	0.175	Ores & content of non metals	2.068
13.	Oil seeds & oleaginous fruits	0.054	Feeding stuff for animals	1.068
14.	Rice	0.046	Medicinal & pharmaceutical products	0.313
15.	Leather	0.019	Yarn & thread of synthetic fibers	0.083
16.	Other	35.520	Others	16.643
	Total	70.664	Total	166.509
	%Age Share in Global Exports	0.6 %	% Age Share in Global Imports	1.4 %

Source: Federal Bureau of Statistics & Ministry of Commerce and Trade

Table 8

Expected Trade in Product Categories in Near Future

(Pakistan and India)

Imports	Exports
Tea	Glass & Glass Ware Incl. Bangles
Coffee	Fertilizers
Oil Meals	Pharmaceuticals
Pesticides	Sports Goods
Paper & Paper Board	Auto Parts
Pharmaceuticals	Sanitary ware
Tyres & Tubes	Carpets
Auto Parts	Electric Fan
Bicycles	Surgical Goods
Iron Ore	Syrup & Squashes
Basic Chemical & Cosmetics	Furniture
Jute Manufactures	Handicrafts
Textile Machinery	Carbon Black
Spices	Cooking Oil & Vegetable Ghee
Betel Leaves & Nuts	Heavy Machinery (Sugar, Cement Plants)
Books, Magazines, Newspapers	Home Textile
Rubber & Glass Products	Transformers
Iron & Steel Products	Salt
Electronics	
Handicrafts	

Source: Own Estimates looking at the Prospects and Trends

Chapter 1

Introduction

"*If hostilities -- between India and Pakistan -- can create nuclear powers in the region, cooperation could create economic super powers*."

'Anonymous'

1.1 Introduction

One of the notable trends in global economy since 1945 has been the movement towards regional economic integration. In most cases, the idealistic goal underlying regional economic integration has been to create a free trade zone in which barriers to trades among member states are removed. Consistent with the predictions of the international trade theory and particularly the theory of comparative advantage, the belief has been that a free trade zone will produce nontrivial gains from trade for all member states.

The move towards economic integration is not without pain. As a result, it has aroused substantial opposition from those whose interest is threatened. In addition, there are fears that the world is moving towards a situation in which a number of regional trade blocs compete against each other. In this scenario of the future, free trade will exist within each bloc but each bloc will protect its market from outside competition with high tariffs.

There are different levels of economic integration; they are **F**ree **T**rade **A**rea, a **C**ustoms **U**nion, a **C**ommon **M**arket, **E**conomic **U**nion and finally a full-fledged

Political **U**nion. The case for regional integration is both economic and political. The integration is not fully accepted by many groups within countries, which explains why in practice most attempts to achieve regional and economic integration have been contentious.

The ideal example of trade blocs is the **E**uropean **U**nion, which has already adopted a single currency and is moving towards a **P**olitical **U**nion. On the lesser scale, there are examples of **N**orth **A**merican **F**ree **T**rade **A**greement (**NAFTA**) and **A**ssociation of **S**outh **E**ast **A**sian **N**ations (**ASEAN**).

The **S**outh **A**sian **A**ssociation for **R**egional **C**ooperation (**SAARC**) comprises **B**angladesh, **B**hutan, **I**ndia, **M**aldives, **N**epal, **P**akistan and **S**ri **L**anka. The basic aim of the Association is to accelerate the process of economic and social development in member states through joint action in the agreed areas of co-operation.

Idea of regional cooperation in South Asia was first mooted in May 1980, following consultation on different aspect in various meetings. First summit held in Dhaka on 7-8 December 1985, adopted the ***Charter of Association*** and as a result **SAARC** came into existence.

SAARC countries are spread over an area of 4.5 million sq. kms and almost a quarter of the world population lives in this region. In spite of this, the value and global trade of **SAARC** countries is extremely low. The area we are lacking right now is the regional trade. At present, our regional trade is about two per cent of the world trade while the **EU** is contributing 17 per cent and **ASEAN** 27 per cent[1]. All the **SAARC** member countries are facing trade deficits and are exporting mainly primary commodities like cotton, rice, tea, jute, leather, spices, fish, and semi-manufactured goods. Textile is an important export product of most of the member states. Oil and petroleum items have significantly raised their import bills. This is definitely not a very healthy picture for the member countries and needs special efforts for increasing trade within the region.

SAFTA will move the region to higher levels of trade and economic cooperation by removing barriers to cross-border flow of goods. It provides **B**hutan, **B**angladesh, **M**aldives, **N**epal, and **S**ri **L**anka; the **L**east **D**eveloped **C**ountries (**LDC**s) a special and differential treatment commensurate with their development needs and bills **I**ndia and **P**akistan as **N**on-**L**east **D**eveloped **C**ountries (**NLDC**s). Starting from January 1, 2006, it will ensure that over the next 10 years **P**akistan, **I**ndia and **S**ri **L**anka will reduce their maximum import duties to 20 per cent, and **B**angladesh, **N**epal, **B**hutan and the **M**aldives reduce to 30 per cent. Additionally, all member states will establish their own **C**ommittee **o**f **E**xperts (**COE**s) that will identify **N**on **T**ariff **B**arriers (**NTB**) and other restrictive measures so that, barring a few sensitive items, all items that are now traded on preferential basis between some of the countries, can move to a completely free trade regime. **SAFTA** is intended to strengthen intra-**SAARC** economic co-operation and maximize the region's economic and social potential through various instruments of trade

[1] Daily Times, 23 June 2004; An Interview with Mr. Humayun Akhtar Khan, Federal Minister for Commerce and Trade

liberalization. The agreement binds all contracting states to reduce tariffs to 0-5 per cent by December 31, 2015[2].

Statistics shows that total exports from the South Asian region had grown from US$ 35.8 billion in 1991 to US$ 76.8 billion in 2001, growing at an average rate of 10.3 per cent annually[3]. Formation of **SAFTA** is likely to impart a fresh dynamism to intra-SAARC trade, which could give the members' industries larger power and opportunities to increase business with other Asian countries. According to estimates, the free flow of trade in the region may increase from current levels of US$ 6 billion a year to US$ 14 billion annually within two years of **SAFTA**'s existence. In the words of an economist, "If hostilities - between India and Pakistan - can create nuclear powers in the region, cooperation could create economic super powers."

1.2 Research Question

On the occasion of ***12th SAARC Summit*** held in Islamabad in 2004, **SAFTA** took a step closer to becoming a reality as the idea received endorsement of all seven-member states though a lot of work remains to be done. I have tried to analyze the reasons **why the countries are moving toward the economic integration and will all the member states equally benefit from it?**

In addition, will the member states be able to overcome their differences especially the two biggest economies **I**ndia and **P**akistan overcome their differences or will it

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[2] Daily Dawn dated 7 January 2004
[3] PTI dated 4 January 2004

remain an illusive dream. Also will the bloc be able to compete against other emerging trade blocs?

What will be the level of economic integration? Whether it will be just a free trade area or aims to become a Political Union with a single currency like **E**uropean **U**nion? What kind of opposition can be expected within the countries and whose interests shall be affected badly?

In addition to it, the research shall include the various political and economic reasons underlying the rationale for **SAFTA**. Will it lead to resolution of the long-standing disputes between the member states or will it result in formalization of status quo or **I**ndian dominance?

1.3 Objective

The objective of the study is to analyze as to "What Effects the **R**egional **T**rade **A**greements would have on economy of **P**akistan. What challenges **P**akistan would face after implementation and what would be potential gains and losses out of it?"

1.4 Research Technique

I have adopted the following research technique/ methodology to conduct research for my thesis: -

1. Extensive Internet search.
2. Literature review.
3. Extracts from newspaper articles (both national/ international).
4. Extracts from books on relevant topics.

5. Formal and Informal Interviews with different Industrialists/ executives in Ministry of Commerce and Industry.

1.5 Organization of Thesis

The thesis has been organized in a way that after introducing the topic, need for the work has been ascertained. Then a brief literature review has been presented in the second chapter. The next section provides a brief overview of the progress of economic integration in South Asia. This section reviews and analysis whether necessary conditions exist in the region for Free Trade Area. Analytical framework of this study is introduced in the next chapter. The final chapter presents some recommendations for the success of **SAFTA** and to achieve maximum benefits for **P**akistan and ends with the concluding remarks.

Chapter 2

Literature Review

In the recent years, **P**akistan has recognized that high protection given to domestic economy has isolated the country from foreign competition. It has generated a strong anti-export bias in resource allocation and increased inefficiency, waste and decline of quality. As a result, **P**akistan's export structure has remained over-concentrated on a small number of agriculture-based products with less value addition. In more sophisticated product areas **P**akistan's export structure has been internationally uncompetitive.

Pakistan is a developing country, whose economy is vulnerable to external trade barriers. A particular feature of **P**akistan's economy is that its leading export product group; textile and clothing, has been subject to a restrictive trade regime for decades. It is thus very important that **P**akistan's trading partners assume their responsibilities through the ratification and consistent implementation of the ***Uruguay Round*** results, in establishing a favourable trading environment that motivate Pakistan to continue and deepen its trade reform and liberalization. But we just cannot wait for any miracle to happen. We have to put our resources and ourselves together in order to survive in this competitive world.

Now question arises that what has made **R**egional **T**rade **A**greements (**RTA**s) so popular? According to a recent World Bank policy research report, this is a period of qualitative and quantitative changes in regional integration, and these changes call for closer cooperation among the nations of a particular area, like South Asia. The strongest argument for removing trade barriers is the recognition that effective integration necessitates more than reducing tariffs and quotas. Many other trade barriers have the effect of segmenting markets and obstructing the free flow of goods, services, investments and development schemes that call for joint efforts. Therefore, wide-ranging policy measures are essential for removing all kinds of tariff and non-tariff barriers.

Moreover, a direct move from closed to open regionalism has the advantage of being more outward-oriented and more committed to liberalizing, rather than controlling world trade and commerce. From the point of view of globalization, this advantage for Asian countries in general and South Asian countries in particular cannot be exaggerated. No wonder the World Bank Experts Group has given special emphasis to this point while examining the economic problems of South Asia.

In a liberal trading regime, South Asia will not only reap the benefits of an increased volume of trade, larger investment flows and a rise in the level of production, but also new technologies that were previously unknown to it. Now coming to some of the definitions and explanation in regard with the international trade and trade theories.

Trade is the voluntary exchange of goods, services, assets or money between one person or organization and other. As it is voluntary so both parties to the transaction must believe that they will gain from the trade or otherwise they will not undertake that exchange. My focus would remain mainly on the trade of goods, which is also called the visible trade.

International Trade is trade between residents of two countries. Why does international trade occurs? The answer flows directly from the definition of trade, which says that both parties to the transaction belief that they benefit from voluntary exchange.

Free Trade occurs when governments exert minimal influence on exporting and importing decisions of private firms and individuals.

Managed Trade is also called ***Fair Trade***. In managed trade governments intervene to ensure that exports/ international business of local firms have equitable share of foreign markets to minimize domestic job losses and market share in specific industries

2.1 Tariffs and Trade Barriers

A tariff is a tax placed on goods involved in international trade. Some tariffs are levied on goods either as they leave the country as *Export Tariffs* or as they pass through a country bounds for another as *Transit Tariff*. However, the most are collected on imported goods as *Import Tariff*. Import Tariffs are sometimes loosely referred as import duties. Historically, tariffs have been imposed for two reasons, which are; tariffs raise revenue for the national government and they act as a trade barrier as tariffs raise the prices paid be the domestic consumers for foreign goods which increase the demand for domestically produced substitute goods.

Non-Tariff Barriers. A second category of government controls on international trade is Non-tariff Barriers. Any government regulations, policy or procedure other than tariff that has the effect of impeding international trade or affecting international investment may be labeled as a **N**on **T**ariff **B**arrier (**NTB**). Normally **NTB**s are; quotas and licenses, numerical export controls and other non-tariff barriers including product and testing standards, restricted access to distribution networks, public sector procurement policies, local purchase requirements, regulatory controls, currency controls, investment and ownership controls etc[4].

In the literature on regional trading arrangements, the effects of removal of trade barriers in terms of export growth are analyzed in the context of static and dynamic gains. For instance, tariff reduction means greater market access to member countries, leading to export growth in a static setting. The scenario of a dynamic framework is different in that due to economies of scale, on account of enhanced market access, the manufacturing processes experience gains in terms of cost reductions and improved product competitiveness. What is more, in a dynamic setting, trade-investment linkages get strengthened whereby capital account surpluses wherein outward **FDI** from bigger to smaller countries takes place compensate trade deficits between bigger and smaller countries of an **FTA**. This kind of linkage helps in improving the export supply capabilities of smaller countries. It is this analytical context in which some preliminary estimates of the

[4] An Introduction to International Business

projected increase in some smaller and lesser-developed **SAFTA** members need to be studied.

Despite skepticism expressed by **P**akistan and other **SAARC** members regarding creation of an ***Economic Union*** and a common currency, unless all political disputes, like Kashmir are resolved, the **I**slamabad **D**eceleration (**ID**) sounds upbeat. The member countries need to reiterate their commitment made at the ***Eleventh SAARC Summit*** at Katmandu in January 2002, for the creation of a **S**outh **A**sian **E**conomic **U**nion (**SAEU**).

In this context, the declaration underlines the need that creation of a suitable political and economic environment will be conducive to the realization of this objective. Indian Prime Minister, Mr. Vajpaee has urged the **S**outh **A**sian leadership to work for greater economic stakes in each other. It will naturally result in greater sensitivity to the concerns of each other. It will also pave the way for more ambitious but entirely achievable goals such as a **F**ree **T**rade **A**rea, an **E**conomic **U**nion, open borders and a common currency for the region[5].

2.2 Regional Economic Integration

Regional Economic Integration gained significant momentum during 50's and 60's. Due to the difficulties in coming to a global agreement, countries are turning more to regional approaches for trade liberalization. We can see that neighboring countries are forming regional groups because of shorter distances, political and

[5] Daily Dawn dated 7 January 2004. Interview of Mr. Vajpaee on the occasion of 12th SAARC Summit at Islamabad

cultural similarities, similarity of distribution systems and ideological and historical similarities.

2.3 Prerequisites For Regional Integration

2.3.1 Economic Reasons. The economic case for regional integration is relatively straightforward. Economic theories of international trade predict that unrestricted free trade will allow countries to specialize in the production of goods and services that they can produce most efficiently. The result is greater world production that would not be possible with trade restrictions. Opening up a country to free trade stimulates economic growth, which in turn creates dynamic gains from trade. **FDI** can transfer technological, marketing and managerial know how to host nations. Given the central role of knowledge in stimulating economic growth, opening up a country to **FDI** is likely to stimulate economic growth.

2.3.2 Political Reasons. The political case for regional integration has also loomed large in most attempts to establish free trade, customs union and the like. Linking neighboring economies and making them increasingly dependent upon each other create incentives for political cooperation between neighboring states. In turn, the potential for violent conflict between states is reduced. In addition, by grouping them together, the countries can enhance their political weight. These considerations certainly underlay the establishment of **E**uropean **C**ommunity (**EC**) in 1957. Europe had suffered two devastating wars in the first half of the century, both arising out of the unbridled ambitions of nation-states. Those who have sought a united Europe have always had, at the forefront of their minds the desire to prevent another outbreak of war in **E**urope. Many Europeans also felt that after **World War II**, the European nation states were no longer large enough to hold themselves in world markets and world politics. The need for united Europe to deal with the United States and politically alien former **USSR** loomed large in the minds of many in EC founders.

2.3.3 Country Similarities. Normally the countries in the regional trade bloc are of similar characteristics. They are of same size, same climate and have same production.

2.3.4 Shorter Distances. The countries in the regional bloc are nearby and at shorter distances with each other. Large amounts of goods can be transported across in short time at minimal costs.

2.3.5 Ideology & History. Normally the countries have common history and more or less similar ideologies. Like in Europe, Christianity is the common bond.

2.4 Forms of Economic Integration

Regional Trading blocs differ significantly in forms and functions. The characteristics of most importance to international business are the extent of economic integration among a bloc's members because this affects exporting and investment opportunities available to firms from member and non-member countries. There are five different forms of regional economic integration and each succeeding level of integration involves greater cooperation among bloc's member countries. These levels are:

2.4.1 Free-Trade Area. Free Trade Area encourages trade among its members by eliminating trade barriers like tariffs, quotas etc. An example of such an arrangement is the **N**orth **A**merican **F**ree **T**rade **A**greement (**NAFTA**), which reduces tariff and non-tariff barriers to trade between **C**anada, **M**exico and the **U**nited **S**tates. Another Free Trade Area in its early years of development is the **ASEAN F**ree **T**rade **A**rea (**AFTA**).

2.4.2 Customs Union. Customs Union combines the elimination of internal trade barriers between its members with the adoption of common external trade policies towards non-members. It's a free trade area plus common external tariff structure towards non-member countries.

2.4.3 Common Market. Common Market is the third step along the path to total economic integration. This goes a step further by eliminating barriers that inhibit the movement of factors of production like labour, capital and technology between its members. The best example of a Common Market is the **E**uropean **U**nion (**EU**), which has achieved this status in 1990s as a result of thirty five years struggle to end barriers to the free movement of labour, capital and technology. A Common Market is the Customs Union plus freedom of movement of factors of production

2.4.4 Economic Union. An Economic Union represents full integration of economies of two or more countries. In addition to eliminating internal trade barriers, adopting common external trade policies and abolishing restrictions on the mobility of the factors of production, an Economic Union requires its members to coordinate their economic policies so as to blend their economies into a single entity. In simple words it is a Common Market plus unification of monetary & fiscal policies.

2.4.5 Political Union. A Political Union is the complete political and economic integration of two or more countries, thereby effectively making them one country. It is the highest level of regional integration. In addition to becoming Economic Union, countries in the bloc adopt common citizenship, foreign, defense, employment, immigration & policing policies. The world's best example of a political union occurred when thirteen separate colonies operating under the ***Articles of Confederation*** grew into a new country- The **U**nited **S**tates of **A**merica.

2.5 Economic Effects Of Integration

There are a number of benefits associated with economic integration of countries. Some of the significant effects of this integration include:

a. Resources shift from less efficient to more efficient producers of goods.

b. Consumers can buy better quality of goods at cheaper prices.

c. More new goods are available.

d. There is trade diversion from one member country to another.

e. Reduction in trade barriers increases demand hence the market grows.

f. Efficiencies also increase due to increased competition & larger markets.

g. Due to discrimination for non-member countries more investments are made to produce goods within the bloc.

2.6 *Relevant International Trade Theories*

2.6.1 Theory of Absolute Advantage. **Adam Smith** forwarded the Theory of ***Absolute Advantage*** in 1776. This theory advocates free trade to maximize citizens' wealth, which enables a country to expand the amount of goods and services available to it by specializing in production of some goods and services and trading of others. As per the theory, a country can have certain advantages (natural and acquired) over other countries. Hence a country should export those goods & services for which it is more productive than others and import those goods and services for which other countries are more productive. One of the flaws with this theory is that it fails to explain what if a country has absolute advantage in all products?

2.6.2 Theory of Comparative Advantage. A British Economist Mr **David Ricardo** developed ***Theory of Comparative Advantage*** in early nineteenth century. The theory says that a country should produce and export those goods and services for which it is relatively more productive than other countries. This theory was the first one, which implemented the concept of opportunity cost *(what a country gives up to get/ produce a certain good)* in determining which goods a country should produce.

2.6.3 Porter's Theory of National Competitive Advantage. **Michael Porter**, a Harvard Business School Professor has developed this most recent international trade theory. In his book titled "**The Competitive Advantage of Nations**" published in 1990, he gave the '***Theory of National Competitive Advantage'***. The theory states that success in international trade comes from the interaction of four country and firm specific elements which are; factor conditions, demand conditions, related and supporting industries and forms strategy, structure and rivalry. He represents these four elements as the four corners of a diamond.

a. ***Factor Conditions***. Factor conditions include land, raw materials, labor, capital, educational level of workforce and country's infrastructure etc.

b. ***Demand Conditions***. Demand conditions are large sophisticated domestic market stimulated development and distribution of innovative products which may also be exported.

c. ***Related and Supporting Industries***

d. ***Firm Strategy, Structure and Rivalry***. Competitive domestic market, efforts in skills training and R&D shapes companies to reduce costs and become competitive internationally

2.7 Role of General Agreement on Tariffs & Trade (GATT)

During 1920's and 30's, industrialized countries imposed high tariffs and other barriers to discourage imports. As a result international trading and investment opportunities dried up. By raising tariffs each country believed that it could help its own industries and citizens even though in doing so it might harm the citizens and industries of other countries. However, when many countries raised tariffs on imports, the cumulative effect was that each was worse off rather than better off.

General **A**greement on **T**ariffs and **T**rade (**GATT**), established in 1947, organized multilateral trade negotiations for reciprocal tariff reduction among its member countries. It also set and regulated a code of international trade conduct and rules.

The cumulative effect of **GATT**'s eight rounds of negotiations has been substantial reduction in tariffs, as imposed by developed countries have fallen from an average of 40% in 1948, to approx. 3% in 1995. This reduction in tariffs has led to dramatic growth in world trade over the past 50 years. To ensure that international trade is conducted on a non-discriminatory basis, **GATT** introduced the "**M**ost **F**avored **N**ation" (**MFN**) principle, which requires that any preferential treatment granted by a **GATT** member country to another country must be extended to all the member countries. It also applies to quotas and licenses.

2.8 Creation of World Trade Organization (WTO)

During 1930's, when the world suffered from the unprecedented Great Depression (Global Economic Recession) and **W**orld **W**ar **II**, many international organizations like UN were created. Amid them, a need for some system in order to trade among the nations was greatly felt. So, in order to cope with the ***1923 Stock Market crash** and **WWII**,* *23 nations of the world* sat together in **G**eneva in 1948, and formulated a **G**eneral **T**rade **A**greement on **T**ariff and **T**rade (**GATT**). The first round resulted in 45,000 tariff concessions, affecting about 10 billion dollars system, contributing to the unexampled growth in trade.

WTO came into existence on ***1 January 1995***, by taking over the role of **GATT** with stronger powers to enforce rules and prevent trade conflicts. Some countries concerned that their national governments will have less control over their trade policies. Bigger trade powers like **US** still threaten to impose unilateral sanctions against the spirit of WTO charter. Many countries are resorting to bilateral agreements to go around WTO regulations. The World Bank experts believe that **GATT/ WTO** policies resulted in US $ 274 billion being added to world's **GDP** by 2000. The governance of WTO has the following major features:

a. A Ministerial Conference, which meets every two years.

b. A general council which turns itself, when needed, into a body to adjudicate trade disputes or to review trade policies of member countries.

Chapter 3

Findings

3.1 Evolution of Economic Integration

3.1.1 South Asia at a Glance

In recent years, South Asia has been the second fastest growing region in the world. Yet it remains as the region with the largest number of people living below the poverty line. Having more than 22 per cent of the world's population living on only 3.8 per cent of the total land area of the world, it is home for more than half a billion poor people or 40 per cent of world's poor (Table 1 shows a comparison of macro economic indicators of all the member countries). Its share in total world trade is even smaller, only about two per cent. Although trade barriers are high, recent economic reforms have lowered some barriers on trade and investment, and have raised economic growth considerably.

With recent economic reforms, countries in the region are promoting economic integration for economic prosperity under the banner of **SAARC**. Table 2 summarizes share of intra Regional Trade in South Asia in terms of exports and imports. There are differences between countries in the region in terms of size of population, area and **GNP**. **I**ndia is the biggest economy in the region in terms of shares of population, area and **GNP**, which are 74 per cent, 76 per cent and 52 per cent, respectively. On other extreme, countries like **B**hutan and **M**aldives are very small and their sizes of population, area and **GNP** are rather negligible. In between these small economies and **I**ndia, only **P**akistan can be identified as an influential country in the region. Economic growth rates of all these countries in recent years have been satisfactory, if not excellent.

3.1.2 Evolution - From SAARC to SAFTA

***3.1.2.1 South Asian Association for Regional Cooperation (SAARC*)**. The establishment of the **SAARC** is not a new concept and, in fact, it is an attempt to restore the economic union that existed between **I**ndia and **P**akistan before their independence in 1947. In early 1980s, **B**angladesh took initiatives to establish regional co-operation, which led to the first South Asian foreign secretaries' meeting, held in April 1981 in **C**olombo. At this meeting it was decided to adopt a gradual confidence building approach by focusing only on non-contentious areas. Initially, five areas (agriculture, telecommunication, rural development, meteorology, and health and population) were selected for technical cooperation, while more complex issues were left out. With the progression of this technical co-operation, countries in the region identified necessity for institutionalizing ad hoc arrangements of technical co-operation. As a result, the first foreign ministers meeting held in 1983 formally launched the **I**ntegrated **P**rograms of

Actions (**IPA**) through adoption of **S**outh **A**sian **R**egional **C**ooperation (**SARC**). Since then foreign ministers of seven member countries began to meet on a regular basis. These meetings and technical co-operations led to the establishment of **SAARC**. Its charter was adopted in 1985 and the first summit was held in Bangladesh capital of Dhaka in December 1985. The evolution of economic integration in South Asia in chronological order is given at *Appendix II.*

3.1.2.2. Objectives. The main objectives of **SAARC** as stated in the charter are:

a. To promote welfare of the people of South Asia and to improve their quality of life.

b. To accelerate economic growth, social progress and cultural development in the region and to provide all individuals opportunity to live in dignity and to realize full potentials.

c. To promote and strengthen collective self-reliance among countries of South Asia

d. To contribute to mutual trust, understanding and appreciation of one another's problem.

e. To promote active and mutual assistance in economic, social, cultural, technical and scientific fields.

f. To strengthen cooperation with other developing countries.

g. To strengthen cooperation among themselves in international forums on matters of common interests.

h. To cooperate with international and regional organizations with similar aims and purposes.

3.1.2.3 South Asian Free Trade Area. SAFTA *Agreement* replaces **SAARC** **P**referential **T**rading **A**greement **(SAPTA**) of 1993 for trade liberalization, on a preferential basis. Compete text of **SAFTA** along with its articles is given at *Appendix 1*. **SAFTA** moves the region to higher levels of trade and economic cooperation by removing barriers to cross-border flow of goods. It provides **B**hutan, **B**angladesh, **M**aldives, **N**epal, and **S**ri **L**anka, the **L**east **D**eveloped **C**ountries (**LDC**s) a special and differential treatment commensurate with their development needs. It bills **I**ndia and **P**akistan as **N**on-**L**east **D**eveloped **C**ountries (**NLDC**s).

SAFTA affirms the existing rights and obligations under ***Marrakesh Agreement***, establishing the **WTO** and other treaties and agreements to which **SAARC** members are signatories. It provides for free movement of goods in the region through elimination of tariffs, para-tariffs that include border charges and fees, and non-tariff restrictions on movement of goods and any other equivalent measures.

SAFTA's **T**rade **L**iberalization **P**rogramme (**TLP**) includes; Tariff reduction by the **NLDC**s, primarily **I**ndia and **P**akistan from the existing rates to 20 per cent. It will be done within two years starting from January 1, 2006. If actual tariff rates on that date are already below 20 per cent, they will undertake an annual reduction on a **M**argin of **P**reference basis of 10 per cent on actual tariff rates for each of the two years. The period of second tariff reduction by **S**ri **L**anka will be six years. Tariff reduction by the **LDC**s from their existing rates will be to 30 per cent within two years. If the actual tariffs are below 30 per cent, there will be an annual reduction of 5 per cent on actual tariff rates for each of the two years. The subsequent tariff reduction by the **LDC**s from 30 per cent or below to 0-5 per cent will be done within a second time frame of eight years beginning January 1, 2008. But the **LDC**s are encouraged to adopt reduction in equal annual installments, no less than 10 per cent annually. Above schedules of tariff cuts will not prevent member countries from immediately reducing their tariffs to 0-5 per cent, or from following an accelerated timeframe of tariff reduction.

The **LDC**s and the **NLDC**s can have separate '*sensitive lists'*. Higher tariffs, agreed between member countries, to protect their domestic products, will apply to these items.

3.1.2.4 Objectives and Principles. The Objectives of SAFTA Agreement are to promote and enhance mutual trade and economic cooperation among Contracting States by: -

a. Eliminating barriers to trade in, and facilitating cross border movement of goods between territories of the Contracting States.

b. Promoting conditions of fair competition in free trade area, and ensuring equitable benefits to all Contracting States, taking into account their respective levels and pattern of economic development.

c. Creating effective mechanism for implementation and application of this Agreement, for its joint administration and for resolution of disputes.

d. Establishing a framework for further regional cooperation to expand and enhance mutual benefits of this Agreement.

3.2 Rationale for SAFTA

3.2.1 Illegal Trade. Despite official barriers to boost trade between two countries that have kept trading volume low to around US$ 237 million annually, illegal trade along the contiguous Indo-Pak border has remained a top secret. Its volume is estimated to be around US$ 1.5 billion annually.

Informal trade through third countries; Dubai and UAE, involving items like pharmaceuticals, cosmetics, chemicals and viscose has been taking place for the past many years. The volume of trade is to the tune of US$ 1 to 1.5 billion annually. There is a wide spread belief among trading communities of the two countries that with introduction of SAFTA rules, trading between India and Pakistan would get boost and may touch around US$ 4.0 billion mark within a few years.

3.2.2 WTO. The **SAFTA** framework agreement is not as likely to be nonstarter as its predecessor, the unimplemented agreement on Preferential Trade. Primary reason for this is that the **SAFTA** move is not an isolated event; it is taking place with less than a year to go before **WTO** comes into effect and can even be seen as a desperate measure to create a defense against this. **WTO** framework accommodates pre-existing regional arrangements like the **E**uropean **U**nion, **ASEAN** and **NAFTA**, but the rules change for those **F**ree **T**rade **A**reas (**FTA**s) that come into existence afterwards. Though **SAFTA** will not be operational by the time **WTO** comes into force on 1 January 2005, its framework agreement's being signed will give it relevant benefits. However, India is getting ahead of itself by mentioning 2015 as a target for **E**conomic **U**nion rather than 2020, which is itself a highly optimistic date.

3.2.3 Political Issues. It is a widely held belief among many in South Asia that trade among the states will lead to peace especially among

India and **P**akistan. Trade will lead to opening up of borders among the member countries leading to increase contact of people among member countries. This will lead to creating a feeling of goodwill among the people and corporate interest shall reduce rhetoric and hostilities.

3.2.4 Economic Issues. In the context with boosting **I**ndo-**P**ak economic relations, knowing a few economic realities of the two countries, will give a better picture of scope of trading between them. India is an emerging giant with a huge market, high economic growth rate of more than 6 per cent for the past few years, exports of around US$ 40 billion and Forex reserve of around US$ 100 billion. The country is producing world-class products of steel, autos, textile, medicine, software and many other items. There is a profound realization among Indian political and business leaders that their policy of remaining somewhat indifferent towards ever changing winds of globalization and regional cooperation has put India in visible economic disadvantage. During past 5 - 6 years, she has tried hard to leap forward to make up for the deficiency of past by increasing bilateral trade with **C**hina. The volume of trade between them stands at US $ 10 billion, which is to grow rapidly. **I**ndia - **ASEAN** trade accounts for around US $ 12.5 billion at present. India is targeting to increase its volume by 250 per cent during next five years.

3.2.5 Personal Bondage. The personal bondage between the people of South Asia transcends the borders and various conflicts among the countries. Many families live both in **I**ndia and **P**akistan; a legacy of the partition in 1947. The family bond surpasses national borders. Many **B**angladeshi students are studying in **I**ndia while the second largest ethnic group in **S**ri **L**anka is linked to the **T**amils living in South India. The language Urdu/ Hindi is spoken and understood in all the seven member states.

Apprehensions have been expressed in some circles that trade prospects under **SAFTA** are limited due to similarities in structure of production in **SAARC** countries. This is a rather myopic approach, as *Customs Union Theory* simply demonstrates that in cases where economies are competitive, individual members, by specializing in the products/ product categories, in which they can produce at comparatively lower cost can enhance total welfare of the region by trade creation. In case where economies are complementary, the productive activity can be accelerated through subcontracting and induction of technology made feasible by extension of market.

India maintains 1 to 4 ratios in her imports-exports to **SAARC** countries. She has overall US$ 2 billion trade surplus with them at present. Her trade surplus with **P**akistan is around US$ 175 million. Will execution of **SAFTA** help increasing trade among the member states, particularly between **I**ndia and **P**akistan? The answer is positive. Keeping in view the illegal and informal trade via third country, and across the border between two countries; achieving US$ 4 billion target within a few years should not be difficult rather could be more. There is a long list of items that show commonality of economies and trading pattern of two countries. Agriculture is pivotal for both countries for achieving higher economic growth rate. Its contribution towards **G**ross **D**omestic **P**roduct (**GDP)** of both the economies is around 25 per cent. This sector is the largest employers in both the countries and contributes substantially towards textile sector. **P**akistan's textile is the main source of foreign exchange i.e. around 66 per cent. **P**akistan's low value textile sector such as gray cloth, yarn, thread and spinning is more developed than value-added textile sector (garments, knitwear, hosiery, apparel) of **I**ndia. The variation in products of textile sector can be mutually beneficial. **P**akistan has been trying during past one year to modernize her value-added textile sector. With the implementation of *WTO regime* from January 2005 and **SAFTA** from January 2006, **P**akistan has nothing to fear but to compete. **P**akistan can import iron, medicine, tea, coffee, and tyres and export fertilizers. It should benefit the consumer. **P**akistan can also benefit from **I**ndia's world-class quality IT software and autos. Our automobile products have been made quite expensive because of protection provided by the government to automobile industry. **SAFTA** and **WTO** will dilute effects of protectionism.

Pakistan's economy is in recovery phase. Her debt burden, though reduced to 90 per cent of **GDP** from 102 per cent around four years earlier, is still a big burden on national economy. Forex reserves position is comfortable (around US $ 12.02 billion) growth rate is expected to be 5.4 per cent of **GDP** this year, and exports are likely to overshoot target of US$ 12.2 billion. But, despite these positive macro economic indicators **P**akistan like **I**ndia attracts less investment. **I**ndia on average attracted around US$ 4 billion **FDI** compared to US$ 45 billion, the average **FDI** attracted by **C**hina during past few years. **P**akistan on the average has attracted US$ 500 - 600 million during past few years. Making **SAFTA** workable would create an environment to attract foreign investment. Large numbers of multinational houses are already stepping into the **I**ndian market and with opening of intra-regional trade, more are likely to step in. **P**akistan and **B**angladesh will also benefit from positive investment environment**.** **SAFTA** is likely to brighten the chances of laying gas pipeline between **C**entral **A**sian **R**epublic **S**tates (**CAR**s) or **I**ran and **I**ndia via **P**akistan, which will benefit all. The project is presently shelved because of political uncertainty that has existed between India and Pakistan.

3.3 Bench Marking for Regional Integration

3.3.1 European Union (EU)

For centuries, Europe was the scene of frequent and bloody wars. In the period 1870 to 1945, France and Germany fought each other three times, with terrible loss of life. A number of European leaders became convinced that the only way to secure a lasting peace between their countries was to unite them economically and politically. So, in 1950, French Foreign Minister Robert Schuman proposed integration of coal and steel industries of Western Europe. As a result in 1951, the **E**uropean **C**oal and **S**teel **C**ommunity (**ECSC**) was set up, with six members; Belgium, West Germany, Luxembourg, France, Italy and the Netherlands. The power to take decisions about the coal and steel industry in these countries was placed in the hands of an independent, supranational body called "High Authority".

ECSC was such a success that within a few years, the same six countries decided to go further and integrate other sectors of their economies. In 1957 they signed the ***Treaties of Rome***, creating the **E**uropean **A**tomic **E**nergy **C**ommunity (**EURATOM**) and the **E**uropean **E**conomic **C**ommunity (**EEC**). The member states set about removing trade barriers between them and forming a '***Common Market***'.

In 1967, institutions of three European communities were merged. From this point on, there was a single Commission and a single Council of Ministers as well as the European Parliament. Originally, the members of European Parliament were chosen by the national parliaments but in 1979, the first direct elections were held, allowing citizens of member states to vote for the candidates of their choice. Since then, direct elections have been held every five years.

The ***Treaty of Maastricht*** held in 1992 introduced new forms of co-operation between the member state governments like defense and in the area of "justice and home affairs". By adding this inter-governmental co-operation to the existing community system, ***Maastricht Treaty*** created the ***European Union*** (**EU**).

3.3.1.1. Integration. Economic and political integration between the member states of the European Union means that these countries have to take joint decisions on many matters. So they have developed common policies in a very wide range of fields - from agriculture to culture, from consumer affairs to competition and from environment and energy to transport and trade.

In early days, the focus was on a common commercial policy for coal and steel and a common agricultural policy. Other policies were added as time went by, and as the need arose. Some key policy aims have changed in the light of changing circumstances. For example, aim of the agricultural policy is no longer to produce as much food as cheaply as possible but to support farming methods that produce healthy, high-quality food and protect the environment. The need for environmental protection is now taken into account across the whole range of **EU** policies.

European **U**nion's relations with rest of the world have also become important. It negotiates major trade and aid agreements with other countries and is developing a ***Common Foreign and Security Policy***.

3.3.1.2. The Single Market - Banning the Barriers. It took some time for the Member States to remove all the barriers to trade between them and to turn their "***Common Market***" into a genuine single market in which goods, services, people and capital could move around freely. The single market was formally completed at the end of 1992, though there is still work to be done in some areas e.g. to create a genuinely single market in financial services.

During 1990s, it became increasingly easy for people to move around in Europe, as passport and customs checks were abolished at most of the **EU**'s internal borders. One consequence is greater mobility for **EU** citizens. Since 1987 more than a million young Europeans have taken study courses abroad with support from **EU**.

3.3.1.3. Single Currency. In 1992, **EU** decided to go for **E**conomic and **M**onetary **U**nion (**EMU**), involving introduction of a single European currency managed by a ***European Central Bank***. The single currency '***the Euro***' became a reality on 1 January 2002, when Euro notes and coins replaced national currencies in twelve of the 15 countries of the **E**uropean **U**nion (**B**elgium, **G**ermany,

Greece, **S**pain, **F**rance, **I**reland, **I**taly, **L**uxembourg, the **N**etherlands, **A**ustria, **P**ortugal and **F**inland).

3.3.1.4 Family Growth. The EU has grown in size with successive waves of accessions. **D**enmark, **I**reland and the **U**nited **K**ingdom joined in 1973 followed by **G**reece in 1981, **S**pain and **P**ortugal in 1986 and **A**ustria, **F**inland and **S**weden in 1995. The **E**uropean **U**nion welcomed ***ten new countries in 2004;*** **C**yprus, the **C**zech **R**epublic, **E**stonia, **H**ungary, **L**atvia, **L**ithuania, **M**alta, **P**oland, **S**lovakia and **S**lovenia. **B**ulgaria and **R**omania expect to follow a few years later and **T**urkey is also a candidate country. To ensure that the **EU** can continue functioning efficiently with **25 or more members**, its decision-making system must be streamlined. That is why the ***Treaty of Nice***, lays down new rules governing the size of the **EU** institutions and the way they work. It came into force on 1 February 2003.

3.3.1.5 European Union and SAFTA. Experience of **EU** suggests that formation of Single European Market led to a substantial restructuring of industry on a pan-European basis and hence enabled it to exploit the economies of scale, scope and specialization. **R**egional **T**rading **A**reas (**RTA**s) are also about investments and have led to concentration of FDI inflows in them. **M**ultinational **E**nterprises **MNE**s have attempted to secure their access to the markets. Hence, the share of **RTA**s in global **FDI** inflows has gone up. So, **RTA**s are not only about trade, they are for investment and industrial restructuring as well.

3.3.2 Association of South East Asian Nations (ASEAN).

Association of **S**outh **E**ast **A**sian **N**ations (**ASEAN**) was established on 8 August 1967 in **B**angkok by the ***five original Member Countries***; **I**ndonesia, **M**alaysia, **P**hilippines, **S**ingapore, and **T**hailand. **B**runei Darussalam joined on 8 January 1984, **V**ietnam on 28 July 1995, **L**aos and **M**yanmar on 23 July 1997, and **C**ambodia on 30 April 1999.

The **ASEAN** region has a population of about 500 million, a total area of 4.5 million square kilometers, a combined gross domestic product of US$ 737 billion, and a total trade of US$ 720 billion.

3.3.2.1 Objectives. The **ASEAN** Declaration states that the aims and purposes of Association are: -

a. To accelerate economic growth, social progress and cultural development in the region through joint endeavors in the spirit of equality and partnership in order to strengthen foundation for a prosperous and peaceful community of Southeast Asian Nations.

b. To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to principles of the United Nations Charter.

In 1995, the ASEAN Heads of States and Governments re-affirmed that, "*Cooperative peace and shared prosperity shall be the fundamental goals of* ***ASEAN***."

3.3.2.2 Fundamental Principles. The ***Treaty of Amity and Cooperation*** (**TAC**) in Southeast Asia, signed at the First **ASEAN** Summit on 24 February 1976, declared that in their relations with one another, the High Contracting Parties should be guided by the following fundamental principles:

a. Mutual respect for independence, sovereignty, equality, territorial integrity and national identity of all nations.

b. The right of every State to lead its national existence free from external interference, subversion or coercion.

c. Non-interference in internal affairs of one another.

d. Settlement of differences or disputes in peaceful manner.

e. Renunciation of threat or use of force.

f. Effective cooperation among themselves.

3.3.2.3 Political Cooperation. **TAC** stated that **ASEAN** political and security dialogue and cooperation should aim to promote regional peace and stability by enhancing regional resilience. Regional resilience shall be achieved by cooperating in all fields based on the principles of self-confidence, self-reliance, mutual respect, cooperation and solidarity, which shall constitute the foundation for a strong and viable community of nations in Southeast Asia. Some of the ***major political accords*** of **ASEAN** are as follows:

a. ***ASEAN*** *Declaration, Bangkok, 8 August 1967.*

b. Zone of Peace, Freedom and Neutrality Declaration, Kuala Lumpur, 27 November 1971.

c. Declaration of ***ASEAN*** *Concord, Bali, 24 February 1976.*

d. ***Treaty of Amity and Cooperation*** *in Southeast Asia, Bali, 24 February 1976.*

e. ***ASEAN*** *Declaration on the South China Sea, Manila, 22 July 1992.*

f. Treaty on the Southeast Asia Nuclear Weapon-Free Zone, Bangkok, 15 December 1997.

*g. **ASEAN Vision 2020**, Kuala Lumpur, 15 December 1997.*

*h. Declaration of **ASEAN** Concord II, Bali, 7 October 2003.*

The **ASEAN** Security Community is envisaged to bring **ASEAN**'s political and security cooperation to a higher plane to ensure that countries in the region live at peace with one another and with the world at large in a just, democratic and harmonious environment.

In 1992, the **ASEAN** Heads of State and Government declared that **ASEAN** should intensify its external dialogues in political and security matters as a means of building cooperative ties with states in the **A**sia-**P**acific **R**egion. Two years later, the **ASEAN R**egional **F**orum (**ARF**) was established. **ARF** aims to promote confidence-building, preventive diplomacy and conflict resolution in the region. The present participants in the **ARF** include; **A**ustralia, **B**runei Darussalam, **C**ambodia, **C**anada, **C**hina, **E**uropean **U**nion, **I**ndia, **I**ndonesia, **J**apan, Republic of **K**orea, **L**aos, **M**alaysia, **M**yanmar, **M**ongolia, **N**ew **Z**ealand, **P**apua **N**ew **G**uinea, **P**hilippines, the **R**ussian Federation, **S**ingapore, **T**hailand, the **U**nited **S**tates and **V**ietnam. Through political dialogue and confidence building, no tension has escalated into armed confrontation among **ASEAN** members since its establishment more than three decades ago.

3.3.2.4 Economic and Functional Cooperation. When **ASEAN** was established, trade among the member countries was insignificant. Estimates between 1967 and early 70s showed that share of intra-ASEAN trade from the total trade of the Member Countries was between 12 and 15 per cent. Thus, some of the earliest economic cooperation schemes of **ASEAN** were aimed at addressing this situation. One of these was the **P**referential **T**rading **A**rrangement of 1977, which accorded tariff preferences for trade among **ASEAN** economies. Ten years later, an Enhanced PTA Program was adopted at the '**Third ASEAN Summit in Manila'** further increasing intra-ASEAN trade.

The Framework Agreement on **E**nhancing **E**conomic **C**ooperation was adopted at the '**Fourth ASEAN Summit'** in Singapore in 1992, which included launching of a scheme toward an **ASEAN F**ree **T**rade **A**rea (**AFTA**). The strategic objective of **AFTA** is to increase the **ASEAN** region's competitive advantage as a single production unit. The elimination of tariff and non-tariff barriers among the member countries is expected to promote greater economic efficiency, productivity and competitiveness. '**Fifth ASEAN Summit'** held in Bangkok in 1995 adopted the *Agenda for Greater Economic Integration*, which included acceleration of timetable for realization of **AFTA** from the original 15-year timeframe to 10 years.

In 1997, **ASEAN** leaders adopted the ***ASEAN Vision 2020***, which called for ASEAN Partnership in Dynamic Development aimed at forging closer economic integration within the region. The vision statement also resolved to create a stable, prosperous and highly competitive **ASEAN E**conomic **R**egion, in which there is a free flow of goods, services, investments, capital, and equitable economic development and reduced poverty and socio-economic disparities. The ***Hanoi Plan of Action***, adopted in 1998, serves as the first in a series of plans of action leading up to the realization of the **ASEAN** vision.

In addition to trade and investment liberalization, regional economic integration is being pursued through the development of Trans-ASEAN transportation network consisting of major inter-state highway and railway networks, principal ports and sea lanes for maritime traffic, inland waterway transport and major civil aviation links. **ASEAN** is promoting interoperability and interconnectivity of the national telecommunications equipment and services. Building of Trans-ASEAN energy networks, which consist of the **ASEAN** Power Grid and the Trans-ASEAN Gas Pipeline Projects, are also being developed.

ASEAN cooperation has resulted in greater regional integration. Within three years from the launching of **AFTA**, exports among **ASEAN** countries grew from US$ 43.26 billion in 1993 to almost US$ 80 billion in 1996, an average yearly growth rate of 28.3 per cent. In the process, share of intra-regional trade from **ASEAN**'s total trade rose from 20 per cent to almost 25 per cent. Tourists from ASEAN countries themselves have been representing an increasingly important share of tourism in the region. In 1996, of the 28.6 million tourist arrivals in ASEAN, 11.2 million (almost 40%) came from within **ASEAN** itself.

Today, **ASEAN** economic cooperation cover areas like trade, investment, industry, services, finance, agriculture, forestry, energy, transportation and communication, intellectual property, small and medium enterprises and tourism. In the desire to build a community of caring societies, the **ASEAN** leaders resolved in 1995 to elevate functional cooperation to a higher plane to bring shared prosperity to all its members. The framework for Elevating Functional Cooperation to a Higher Plane was adopted in 1996 with a theme: "*Shared prosperity through human development, technological competitiveness, and social cohesiveness*." Functional cooperation is guided by the following plans:

a. *Plan of Action on Social Development.*

b. ASEAN Plan of Action on Culture and Information.

c. ASEAN Plan of Action on Science and Technology.

d. ASEAN Strategic Plan of Action on the Environment.

e. ASEAN Plan of Action on Drug Abuse Control.

f. ASEAN Plan of Action in Combating Transnational Crime.

3.3.2.5. External Pressure. The ***ASEAN Vision 2020*** affirmed an outward-looking **ASEAN** playing a pivotal role in the international community and advancing ASEAN's common interests. **ASEAN** has made major strides in building cooperative ties with states in Asia-Pacific Region and shall continue to accord them a high priority. Cooperation with other East Asian countries has accelerated with the holding of an annual dialogue among the leaders of **ASEAN**, **C**hina, **J**apan, and the Republic of **K**orea. In 1997, a joint statement between **ASEAN** and each of them was signed providing a framework for cooperation towards the 21st century. In November 1999, the leaders of **ASEAN**, **C**hina, **J**apan and the Republic of **K**orea issued a Joint Statement on East Asia Cooperation outlining the areas of cooperation among them.

The **ASEAN Summit of 1992** mandated that ASEAN, as part of an increasingly interdependent world, should intensify cooperative relationships with its Dialogue Partners. Consultations between ASEAN and its Dialogue Partners are held at the Foreign Ministers' level on an annual basis. **ASEAN's Dialogue Partners** include **A**ustralia, **C**anada, **C**hina, the **E**uropean **U**nion, **I**ndia, **J**apan, the Republic of **K**orea, **N**ew **Z**ealand, the **R**ussian Federation, the **U**nited **S**tates of **A**merica, and **U**nited **N**ations **D**evelopment **P**rogram (**UNDP**). ASEAN also promotes cooperation with Pakistan on certain sectors and there are bright chances that Pakistan is made a full dialogue partner at **ASEAN R**egional **F**orum (**ARF**).

Consistent with its resolution to enhance cooperation with other developing regions, **ASEAN** maintains contact with other inter-governmental organizations namely, **E**conomic **C**ooperation **O**rganization (**ECO**), the **G**ulf **C**ooperation **C**ouncil (**GCC**), the **Rio Group**, the **S**outh **A**sian **A**ssociation for **R**egional **C**ooperation (**SAARC**) and **South Pacific Forum** (**SPF**).

3.4 Implications for Pakistan

According to the **K**arachi **C**hamber of **C**ommerce and **I**ndustry (**KCCI**), the volume of intra-**SAARC** trade after implementation of **SAFTA** will move to 20 per cent of total trade of member countries. It is believed that regional economic integration will allow **P**akistan to deal more effectively with the challenges of globalization and improve its bargaining position in international trade negotiations. *Table 3* shows that **P**akistan's persistent trade deficit with **I**ndia over 2000-2003. Considering that **I**ndia is the largest economy in the region, and will have the greatest impact on **P**akistan after **SAFTA** comes into force, it is important to look at implications of trading with **I**ndia in detail.

Table 4 provides a macro-economic overview of the two economies. As evident from the table, **GDP** growth rate of **I**ndia has been persistently higher over the period 1992-93 to 2001-02. Its per capita income was lower than **P**akistan's from 1990 to 1999, however it surpassed that of **P**akistan's from 1999 to 2003. The rates of domestic saving and investment are considerably higher in **I**ndia. Macroeconomic indicators are more robust in **I**ndia than in **P**akistan as shown in *Table 5.*

Formal trade between two countries has been very limited, although it is believed that third country trade and smuggling increases total volume by a factor of four or five. This is a significant increase considering **I**ndia as **P**akistan's main trading partner in the **SAARC** region. Over 1992-2003, **P**akistan had a trade deficit with **I**ndia for nine out of eleven years (*Table 6*). Most of **P**akistan's exports to **I**ndia have been in the food and related category. **I**ndia's exports have been in agricultural and allied products, manufactured goods, chemicals and chemical related products.

If we compare the performance of intra-SAARC trade with other regional blocs we find that there have clearly been missed opportunities. Trade within **NAFTA** is 49 per cent, 78 per cent in **EU** and 53 per cent in **ASEAN**, which protects them from major shocks in other parts of the globe. Our regional trade is very low, about two percent of the world trade and weakest area right now is the regional trade

Keeping in view the above mentioned facts, it is important to note that **P**akistan would have to compete with **I**ndia in the longer run for its share in the market. Though **I**ndia currently has a comparative advantage in some industries but increased competition can serve as a stimulant to either increase **P**akistan's competitiveness in these sectors or reorient the structure of domestic industry in favour of more efficient segments. However, if we assume that increased competition will phase out uncompetitive sectors and lead to more specialized and efficient production, we need to be prepared for effects of sectoral unemployment even if it is temporary, especially in the face of rising poverty and lack of social safety nets.

Chapter 4

Analysis

4.1 Impact of SAFTA on Various Sectors

Analysis of regional integration studies shows that it is vital for developing countries to form regional trading blocs in order to take advantages of globalization. International trade theories also prove that long-term benefits of regional trade agreements out weigh short-term costs. However, the benefits from regional trade liberalization depend on whether trade is created or diverted as a result of arrangements. We also find that prior to signing of **SAFTA**, South Asia was the only major world region without a regional economic arrangement. Hence, the motivation for **SAFTA** lies in hope that intra regional economic cooperation will lead to better relations with **SAARC** countries especially with **I**ndia. It will help us to cut our defense expenditures and divert our scarce sources to more productive sectors.

SAFTA has a long time frame like it will be fully implemented in 2015. Due to such a long time frame, the member states should go first for Preferential Trade. It would prepare the markets for eventual free trade and to give the member states enough time to resolve their political disputes. This will also boost inter regional trade which is an important requirement for regional trade bloc. In addition, the member states should work towards reducing subsidies for a level playing field for smooth transforming this agreement into a reality.

If we look at the trend of our trade with **SAARC** countries, we see that it fell from 2.3 per cent in 1994/95 to 2.0 per cent in 1995/96. Then trade picked up from 2.5 per cent in 1996/97 to 2.8 per cent in 1997/98 and 3.5 per cent in 1998/99. Again in 1999/2000 it declined to 2.5 per cent and reached at 2.9 per cent in 2000/2001, 2.4 per cent in 2001/2002, 2.2 per cent in 2003-2/2003 and 3.0 per cent in 2003/04. As we see that our trade is minimal and intra SAARC trade is only 4.7 per cent of the world trade, so we need to promote our own as well as intra SAARC trade.

If we look at current direction of trade of **P**akistan (*Table 2*), only limited volume of trade is directed at **SAARC** region. The only country that figures amongst **P**akistan's top buyers is **B**angladesh, which accounted for mere 1.05 per cent of **P**akistan exports during 2001-03, while **S**ri **L**anka and **I**ndia bought 0.73 per cent and 0.58 per cent, respectively. Again, only **I**ndia figures in the list with 1.56 per cent of our imports during this period. One reason of this could be the similarity in product profile and existence of non-tariff barriers.

The apprehensions regarding limited trade prospects under **SAFTA** are due to similarities in structure of production in **SAARC** countries. However, analysis shows that these apprehensions are not valid rather it is a myopic approach. Individual members can become competitive by specializing in products/ product categories taking advantage of *Customs Union Theory.* By doing so they can produce at comparatively lower cost, which would enhance total welfare of the region by trade creation. It will ultimately lead to extension of market and acceleration of productive activity through subcontracting and induction of technology.

Three principal segments of economy most likely to be affected from trade with India are agriculture, textiles and engineering sector. There will be significant impact on consumers through availability of a wide range of agricultural, textile and engineering goods at lower prices.

4.1.1 Agricultural Sector

It is a difficult question to answer at present that the balance of trade in agriculture sector will go in whose favour when **SAFTA** would be in place from January 1, 2006. Reasons being that all SAARC Nations primarily have agro-based economies with the agriculture sector as either first or second largest contributor to their **GDP**s. This over reliance on low-value agriculture sector with rampant under-employment, the socio-economic indicators of the **SAARC** countries is by and large deplorable. About 1/5th of the world consumers live in these seven countries of South Asia that have an average per capita income of US$ 460 against the world average of US$ 7000. Hence, as much as 40 per cent of 1.4 billion people of South Asian countries are living below poverty line while as much are illiterate.

With the exception of India, the **SAARC** countries mostly fulfill staple food requirements of its population through indigenous resources but they have to import some quantity of wheat to bridge the gap. However, India has not even attained a sustainable position though it exports a sizeable quantity of the commodity as well. Pakistan had produced surplus wheat in 2000 and 2001, but faulty official policies have once again forced the government to import wheat after three years gap.

The intra-regional trade among **SAARC** countries is mere 5 per cent of the total international trade of the member countries and that too comprises mainly on food items and agricultural raw material. Conceptually, **F**ree **T**rade **A**greements (**FTA**s) thrive on complementing mutual needs of the contracting states to achieve overall developmental goals. But, on agricultural front, South Asian countries especially **I**ndia and **P**akistan have very identical features owing to same geo-climatic conditions.

Both **I**ndia and **P**akistan are members of elite club of cotton producing countries on the globe. They export rice and are among the largest wheat producers in the world as well. They also compete with each other in the international market on export of fresh fruit and vegetables with mango at top of the list. However, despite being agricultural countries all the seven **SAARC** members spend huge resources on import of edible oil, mostly from South East Asian countries. Although, **SAARC** countries have yet to release their respective negative list of products that will not be covered under **SAFTA**, but presumably if agricultural produces are on the positive list then Pakistan will have to immediately pay attention to improve the standards of its farm produces to transform them into marketable competitive commodities.

Pakistani cotton is famous for its fiber quality but somehow the government cannot design grading system regarding staple length and micro level. Similarly, contaminations of non-lint content in raw cotton also need controlling. Owing to this deficiency, price of Pakistani cotton is depreciated by 10 to 15 per cent in the international market. This year, local textile millers have imported cotton from India to meet their requirements owing to shortfall in local production. They are reportedly pretty satisfied with the standards of imported cotton.

With **SAFTA** in place from January 2006, Indian cotton can reach anywhere in Pakistan in 48 hours by road with almost the same transportation expenses within Pakistan from ginneries to mills. Even at present there is no bar on import and export of cotton in Pakistan. Therefore, by introducing standardization and a system of grading in cotton trade, farm sector would meet domestic requirements of textile and spinning sector. Cotton is the single largest source of foreign exchange earnings. **B**angladesh and **S**ri **L**anka are potential buyers of lint cotton in the region. **B**angladesh imports around 0.7 million bales of cotton per annum to feed its flourishing labor-intensive garments and apparel industry. However, cotton production of **P**akistan for the last several years has been fluctuating around 10 million bales against local industry's projected demand of 11.5 million bales. There is room to increase cotton production as Pakistan picked a record crop of 12.8 million bales from an area less than currently under cotton cultivation in 1991-92. This clearly shows the failure of country's agricultural research institutes. Although the services sector has not been made part of **SAFTA** but research in farm sector both in crops and machinery will be an area where exchange of knowledge with India can benefit Pakistan.

It has yet to be seen after trade liberalization under both regional and global pacts that whether Indian agriculture sector is really thriving on research or huge subsidies have a role in it. India subsidizes its farm sector to the tune of around Rs 400 billions on fertilizers, electricity, imputed irrigation and other inputs. According to **EU** estimate these subsidies become 2.5 per cent of India's **GNP**. In contrast, agriculture sector in **P**akistan has been heavily taxed under **SAP** on IMF and World Bank dictates. **I**ndia gives its farmers a subsidy of more than Rs150 billions only on fertilizers while **P**akistan has imposed 15 per cent **GST** on all agricultural inputs including fertilizers and pesticides.

Comparing agricultural production with **I**ndia, we find that **I**ndian farmers have achieved higher per hectare yields than **P**akistani farmers in all major crops, with the exception of cotton. Taking into account relative advantage in production and availability of exportable surplus, it is likely that India will export rice, maize, grams, wheat and sugarcane, as well as vegetables, fruits and other perishables, whereas **P**akistan will export Basmati rice, fresh fruit and vegetables, medicinal herbs and dry dates to its partners in **SAARC** while it imports tea, jute, betel leaves and nuts. Currently, **P**akistan is fulfilling more than 60 per cent of its demand for tea by importing from **K**enya and less than one per cent from **I**ndia. With **SAFTA** in place **P**akistan will have to prefer **I**ndia for tea imports. Although in short-run, the balance of trade in agricultural products will be in India's favour, **P**akistani producers will be able to improve their yields and quality in the long run. The greatest benefit to **P**akistani producers will be from access to high yield technologies and research and extension service.

4.1.2 Textile Sector

The main players in textile sector of the region are going to be **P**akistan, **I**ndia and **B**angladesh when **SAFTA** comes into effect from 2006. **P**akistan's textile industry under **SAFTA** could benefit from trade rationalization and flow of raw materials. Our Textile industry feels that **SAFTA** could be an opportunity as well as a possible threat. The most fearing factor would be that in case cotton crop fails in one part of the region, it could have a snowball effect on prices of other **SAARC** member states. The most encouraging aspect of situation is that the tariff structure of **P**akistan had already been rationalized and is presently lower than the competitive countries of the region. Therefore, it would not be difficult for our business and industry to compete with products of other **SAARC** member states.

Despite the fact that **P**akistan will be having an advantage of local raw material i.e. cotton, but it will have to do a lot to improve its quality, which will have direct implication on final product. From the seven members of **SAARC**, only **P**akistan and **I**ndia are cotton producers and will be enjoying an edge of local raw material over other countries of the region. However, it is equally encouraging that cotton yield per acre in **P**akistan is double than **I**ndia and with little more efforts on the part of growers and the government control over supply of spurious fertilizer and pesticides could mean a lot for much higher production per acre. Furthermore, raw cotton trade is free in **P**akistan and all sort of subsidies are no more on this major crop. There is no restriction on import or export of cotton. Against this, **I**ndia has yet to move on this direction and state involvement is still there. Above all **I**ndia has yet to lift subsidies on agriculture products.

The basic textile industry; spinning and weaving in **P**akistan is most competitive in the region and has an edge over the industry of other **SAARC** member states. But **P**akistan needs to do a lot in value-added textile sector. **B**angladesh is not a cotton growing country but presently earns over US$ 3.5 billion on export of value-added textile goods, particularly garments. Now, if a country having no indigenous raw material could excel in this field then why **P**akistan could not achieve this goal whose total export in textiles is around US$ 7 billion.

In textiles industry, **P**akistan is more competitive in low value added products such as cotton yarn, grey cloth and bleached woven cotton, whereas **I**ndia has a comparative advantage in high value added products. If this trend continues, **P**akistan will remain confined to low skill, low value added sectors while **I**ndia will move into more diversified and high-value added segments. This issue needs to be addressed not just in relation to **SAFTA** but also in the context of global trade.

Generally assessing the impact on textile producers in the region, we see that since **P**akistan has successfully competed with **I**ndia in international markets, there is no reason to believe that we will not be able to do so in domestic market. In terms of textile costs and productivity, the industry in the two countries is more or less equally efficient.

4.1.3 Engineering Sector

Examining the impact on engineering sector, we see that the **I**ndian engineering sector is comparatively healthier. It is unlikely that **P**akistan-**I**ndia trade will result in major market penetration by **I**ndian goods. This is due to considerable market presence enjoyed by **K**orean and **T**aiwanese products. In the segment of mechanical equipment and machinery, since domestic production is severely limited, there is no threat from **I**ndian imports. The transport sector, however, poses a serious challenge for

Pakistani producers. The prices of scooters, motorcycles and cars under 1000 cc are 50 per cent higher in **P**akistan than in **I**ndia. In a liberalized trade regime, **I**ndia will easily be able to penetrate in domestic market.

Analyzing the **I**ndian exports, we find that it consists of a larger percentage of high value added and skill intensive products. On other hand, **P**akistan has failed to create a diversified, modern and competitive industrial sector. The engineering sector in **P**akistan has faced negative protection due to lower duties on finished products than on raw materials. Hence, **I**ndian auto industry would certainly get benefit from **SAFTA**. One example in this regard is that our *Suzuki Mehran* is the equivalent of Indian *Maruti 800*. Price comparison of these two shows that our car is currently available at almost double the Indian price for same car.

Analyzing electrical and electronic equipment segments, **P**akistani manufactures have maintained their competitiveness in a climate of low tariffs and high level of smuggling goods. It is thus unlikely that **I**ndian products will affect them. In more quality conscious markets, **P**akistani consumers are unlikely to switch demand from superior products imported from better international suppliers.

4.1.4 Energy Sector

The greatest economic benefit from trade relations between **I**ndia and **P**akistan would occur in the sphere of energy co-operation. **I**ndia is one of the most rapidly growing energy markets in the world, and **P**akistan can fulfill this need as a potential transit route for energy from **I**ran and **C**entral **A**sia. This would require construction of a pipeline from **I**ran, the **P**ersian **G**ulf, and **C**entral **A**sia through **P**akistan to **I**ndia. It is estimated that a joint pipeline, as a shared project between **I**ndia, **P**akistan and the country of origin would get **P**akistan around US$ 600 million in transit fees. It would also make it easier to attract foreign investment by multinational countries and better financing terms from international capital markets.

4.1.5 Small and Medium Enterprises

The most ponder able issue after **SAFTA** would be the future of **SME**s in **P**akistan. As in **P**akistan more than two million **SME**s are contributing 30 per cent to **GDP** and generating around 25 per cent of manufacturing sector's export earnings. Their contribution to value-added sectors of manufacturing industry rose to 35 percent in 1998 from 27 percent in 1981.

SMEs in **P**akistan constitute 90 per cent of business and are responsible for 80 per cent of non-farm based employment. In spite of being a major non-farm employment generator and contributor to the country's **GDP**, the competitiveness of **SME**s is marred by their structural weaknesses and lack of institutional support from the government.

SMEDA officials candidly admit that no study has so far been conducted to analyze the possible implications of free trade on regional **SME**s. However, it is generally believed by most **SME**s that implementation of

SAFTA would lead to plant closures and unemployment because our **SME**s do not have the kind of strength they need to compete in a free-trade environment.

Once the hullabaloo over signing of **SAFTA** subsides, most of us would be in a better position to see that our small and medium-sized industries, already grappling with numerous structural and institutional weaknesses, remain the most vulnerable sector. Though smaller in number, we can find many people who genuinely view development as a window of opportunity to improve quality and efficiency through greater exposure to a regional competition, especially with **I**ndia, despite the challenges of free trade.

SME's have survived cheap imports and smuggling from China and would survive **I**ndia. Certain industries like sugar, home appliances, automobile, Pakistan Steel etc, which should never have been there because of being inefficient, would be wiped out. Some believe that only those industries would be able to hold out against **I**ndian products, which are already into export. The exporting industries of readymade garments, knitwear and hosiery have already achieved a minimum level of efficiency and become competitive enough. Mainly those who market their products only within the country and do not or cannot export, will face problem.

India is one of the most protected economies and it would not be an easy task for our **SME**s to compete with its neighbor under existing conditions. In addition to high protective tariffs, **I**ndians have also built certain **NTB**s to protect their indigenous industry. Our businessmen and their representative associations would have to remain vigilant to head off any intentional or unintentional effort on the part of the **I**ndian government to support its industry to wipe out ours. Safeguards are available under WTO regime to avert such efforts through anti-dumping proceeding.

A major contributor to fears of getting swamped by **I**ndian goods is the incompetitiveness and inefficiency of our **SME**s due to various factors. Our **SME**s are fraught with problems ranging from their smaller size to higher production cost, lack of access, easy and cheap finance, modern technology and capital goods, non- availability of local raw material and lower productivity. Expensive labor, skill gaps and flawed tax structure in **P**akistan have also impeded growth of small and medium units. Almost all of them are outside the documented, formal economy. This means that these units can neither have access to finance to support their production nor capacity to upgrade their technology to improve efficiency and productivity. This results in higher input and production costs as well as lack of efficiency and competition.

SMEs need a lot of financial and technological support from the government, to sustain and compete in a free trade era. **SMEDA** officials contend that country has ample time to develop **SME**s on modern lines before they have to face a competition in the region.

4.1.6 Information Technology

The initiative to boost trade among **SAARC** member countries through preferential and free trade pacts would definitely help to improve the performance of various economic sectors. However, its impact on **IT** industry has divergent views. Presently, our **IT** and software industry is in the process of consolidation and organizational overhauling. It is hoped that collaboration with the member states especially with India - the fastest **IT** growing industry in **SAARC** region - would bring more opportunities for us to explore markets of smaller members like **N**epal, **B**hutan, etc. This initiative would help **IT** industry to prepare for the tough competition with regional rivals, besides it would give opportunities to make its presence in other markets in the form of collaboration, exchange of expertise and know-how.

Dispelling a general impression that **I**ndian **IT** industry is a threat to local **IT** industry, **P**akistan should go for collaboration. But still it is too early to identify areas of cooperation and joint ventures. In this regard, cooperation of both the governments at equal level is crucial. **I**ndia's **IT** industry is older than **P**akistan and had advantage of being a big country having investment and active marketing by **I**ndians in different parts of the world. The major dilemma with our industry is that we never try to excel in **IT** field and the result is that we are still at zero.

Indian **IT** sector is far ahead and this could be judged from the fact that its software exports are near US$13 billion whereas ours are hardly US$ 20 million. The reason for this big difference is that we are not producing quality **IT** professionals. Private **IT** universities and institutions are not producing quality human resources because the curriculum are not up to international standards and did not meet the requirements of producing quality **IT** professionals.

4.2 Impact on Economy

According to a study conducted by the **M**inistry of **C**ommerce, there are numerous advantages to free trade with **I**ndia. These include lower prices for consumers, more revenue for the government from legalizing the existing illegal trade, lower production costs, increased competitiveness and greater market access. The **K**arachi **C**hamber of **C**ommerce agrees with this view and asserts that cheaper steel and iron ore imports from **I**ndia will have a positive impact on the engineering sector. Numerous small industries in **P**akistan are likely to benefit from cheaper raw materials from **I**ndia, which will have an employment enhancing effect. Hence local industry, faced with increased competition, will have to become more efficient in order to compete with **I**ndian products. According to South Asia Development and Cooperation Report 2001/2002[6], it would make more sense for **P**akistan to import wheat from India instead of buying it from **C**anada and the

[6] South Asia Development and Cooperation Report 2001/2002

United **S**tates. The report estimates that this would entail a financial saving of US$ 25 in freight charges alone on every tonne of imported wheat.

Moreover, **I**ndia can provide us cheap textile machinery, dyes, chemicals, and steel. It is also commonly argued that **P**akistan will benefit enormously by importing tea, which it currently buys from **K**enya at a much higher cost. Proponents of trade with **I**ndia feel that although short-term impact of free trade with **I**ndia may be negative because of its more developed industrial base, **P**akistan will benefit in the long run due to increase in competition and access to a larger market. There are some apprehensions regarding imports and exports as well. Let's see what are those: -

4.2.1 Sentiments about Imports. The negative sentiment on **SAFTA** especially on free trade with **I**ndia is driven by fears of **I**ndia's strong industrial base and its cutting edge in industries like capital goods and engineering. **I**ndia has definite advantage in engineering industry due to availability of raw materials at substantially lower cost. However, under arrangements of **SAFTA**, our engineering units can acquire steel from **I**ndia at cheaper rates and also enable Pakistan Steel to produce steel at lower cost by importing its basic raw material. Besides, shipping distance being made shorter, raw material import from **I**ndia will result in reduction of high inventory carrying cost of engineering industry.

Moreover, there is no hi-tech textile machinery industry in **P**akistan. Almost all requirements for **BMR** expansion are met through import. Some of textile machinery, we import from **S**witzerland and **G**ermany is made under licence in **I**ndia at much lower cost. For putting of machinery, especially hi-tech textiles machinery industry in **P**akistan, it will be advisable to enter into joint ventures with leading machinery manufacturers possibility under buy back arrangements.

Current production capacity of the chemical industry in **P**akistan can meet only 10 per cent of its requirements. Import of chemicals has grown consistently and reached the level of US$ 2.2 billion during 2002-03. Pakistan can greatly benefit from import of dyestuffs and chemicals, plastics raw material form **I**ndia at lower prices. Import of cheaper chemicals and dyes can particularly help to enhance competitiveness of our leading export sectors like textile and leather.

There are definitely certain industrial sectors, which will be adversely affected such as auto parts, pharmaceuticals, etc. But under *Article 6(3*) there is provision of ***Sensitive Lists***; which should be negotiated. The items included in the Sensitive list shall be subjected to maximum ceiling to be agreed among the contracting states. The products where preferential imports could cause serious injury to domestic industry may fall in this list. Besides, legal framework is available in the shape of anti-dumping, countervailing and safeguard measures under WTO regime, which would be applied under **SAFTA** for protecting local industry.

4.2.2 Export Potential. **P**akistan is well positioned to exploit big export market of **SAARC** region. **P**akistan can export with advantage to vast **SAFTA** market, products such as cotton yarn, textile fabrics, leather products, surgical instruments, vegetables and fruits and other agricultural products to meet regional shortfalls.

The textile sector, which contributes 67 per cent to our exports, is expected to do well under **SAFTA**, withstand competition from **I**ndia and make inroads in the regional markets. During last four years, textile sector has invested US$ 3 billion to bring their production at par with world quality. It is heartening to note that three more value added items namely bed wear, knitwear and readymade garments have joined fabrics in the elite club of billion dollar in export of textile goods during 2002-03. Our bed wear products have outclassed the **I**ndian all over the world. Similar situation prevails in knitwear and certain cotton fabrics. **I**ndians have an edge in georgette and some other silk products, but as far as cotton textiles are concerned, **P**akistan is much more developed. But in case of blended textile products, made from a combination of manmade and natural fabrics, which are preferred in clothing the world over, **I**ndia has an advantage. Presently, **P**akistan's blended clothing has ratio of 27-73 against international ratio of 52 per cent synthetic yarn in blended textiles, while in **I**ndia and **C**hina the standard man made fiber content is 35 per cent in blended textiles.

Sri **L**ankan apparel manufacturers can source **P**akistani fabrics. **P**akistan is a top-notch producer of denim and we can expect more orders from **S**ri **L**ankan garments manufacturers. Similarly, **B**angladesh had a great potential to absorb **P**akistan's fabrics and yarn, which they prefer due to prices. It may be noted that **B**angladesh has increased its spinning capacity, but still 30 per cent of its requirements can be met by **P**akistan. At times due to problems of direct shipment, they purchase **I**ndian goods from warehouses set up by **I**ndians.

The apprehensions regarding **P**akistan's exports to **I**ndian market and fear of capturing our markets by India also need to be analyzed. But before doing so some facts should be considered. Our consumer and light engineering goods are uncompetitive due to under-capitalization, high costs of electricity, poor quality, bad management practices, and unscientific market research. An examination of sector wise impact of trade with **I**ndia reveals that transport equipment, cement and pharmaceutical industries in **P**akistan would be negatively affected by free trade with India. The prices of cars, scooters, motorcycles and cycles are significantly lower in **I**ndia as compared to **P**akistan. With implementation of **SAFTA**, **I**ndian manufacturers will find no difficulty in capturing these markets. Their pharmaceutical sector consists mainly of generic products compared to **P**akistan's pharmaceutical industry, which is dominated by high priced products produced by **MNE**s. Similarly the cement sector in **I**ndia is more competitive due to economies of scale and lower costs.

According to trade statistics for the region, it is an established fact that **I**ndia has benefited from trade in the region more than any other country. **I**ndia's share of exports in intra-SAARC trade has shown strong growth during post-SAARC period, despite low levels of overall regional trade and weak regional integration. During pre-SAARC period of 1975-85, **I**ndia's exports increased from US$160 million in 1975 to US$ 315 million in 1984, at a compound growth rate of 7.8 percent. For **B**angladesh, India's exports rose from US$180 million in 1991 to US$1 billion in 2001-2002, while imports increased from US$31 million to US$50 million in the same period. On the other hand countries like **N**epal, have suffered a lot in recent years and its exports to **I**ndia has declined rapidly in post-SAARC period. These facts compel us to take necessary measures to effectively meet future challenges and compete with **I**ndia in the regional trade.

4.2.3 Cross-Border Investment & Joint Ventures. All the countries in **SAARC** region attach great importance to inflow of **FDI**, but due to lack of political and economic stability and consequent negative perception of the region, it could not attract investment commensurate with its potential. The **SAFTA** accord will help to create conducive environment for investing in each other's country and other countries and multinationals will follow suit.

The accord has no provision for collaboration in the service sector, but movement of people, frequent exchange of delegations and interactions will lend impetus to cross border collaboration in this sector. There are bright prospects for collaboration in **IT** with India. In 2003, **I**ndian exports of Software, **IT** Services and **B**usiness **P**rocess **O**utsourcing (**BPO**) were US$ 12 billion. **P**akistan has considerable competence in **IT** sector but software exports are merely US$ 50 million, which can be boosted through collaboration.

Recently, a 14-member delegation of **P**akistan **S**oftware **H**ouses **A**ssociation (**PASHA**) has visited India, on a special invitation to attend the annual premier event of **I**ndia's **N**ational **A**ssociation of **S**oftware **S**ervices **C**ompanies. As a result, they have agreed to collaborate with each other to help in boosting outsourcing revenue from developed nations. It will help grow the sector in the sub-continent. Potential areas of collaboration are Call Centers, BPO, joint ventures and training in R & D.

4.2.4 Other Benefits. **SAFTA** would immensely benefit **P**akistan, as it would enable it to import tea, auto parts, consumer durables, pharmaceuticals and films from **I**ndia at cheaper prices. At present, **P**akistan, which has one of the highest per capita consumption of tea, imports 150 million kg of tea, mainly from **K**enya. On the other hand, Indian tea industry is facing troubled times due to surplus production, falling exports and declining global prices. If a Free Trade Area comes into being, a substantial part of **P**akistani market will divert to India because of price competitiveness, easy transportation and popularity of **I**ndian tea. Presently, **I**ndia accounts for less than 4 million kg of **P**akistani tea imports. That too through indirect route shipped to **K**arachi via **C**olombo, **S**ingapore and **D**ubai, making **I**ndian tea costly. Illegal trade between **I**ndia and **P**akistan was estimated at nothing less than US$1.5-2 billion while official trade stood at US$ 262 million in 2002-03, which would also be curbed after implementation of **SAFTA**.

Analysis of **SAFTA** agreement reveals some achievements for **P**akistan as well. C*lause g of Article 8* allows transit facilities for intra-SAARC trade, especially for the landlocked contracting states. This clause would enable Pakistan to export its goods through **I**ndia to **B**angladesh, **N**epal and **B**hutan. However, there is no legal obligation to offer similar concessions to **I**ndia for its exports to **A**fghanistan, which is not a **SAARC** member state. **SAFTA** also requires simplification and harmonization of customs and banking procedures, which would help facilitate **P**akistan's exports to **I**ndia, hovering around just US$ 45-50 million through official channels.

Pakistan has a comparative advantage in manpower. We should concentrate on producing manpower possessing qualifications, experience and skills laid down by importing countries. As the shift is towards skilled and qualified persons, we have to improve standards of our educational and training institutions to avail expanding opportunities for providing human services.

4.3 Problem Areas

Analysis of limiting factors of trade between **SAARC** countries indicates that availability of transport is a big issue in the region. We have no direct shipments to **I**ndia and **B**angladesh through sea, which is the cheapest medium of transportation. Only **S**ri **L**anka is accessible directly through shipping lines. **N**epal and **B**hutan are landlocked. These limiting factors serve as barriers. Hence, Intra-regional trade enhancement is not possible without a fast medium of transportation between **SAARC** countries. Some other problematic areas, serving as limiting factors are as under: -

4.3.1 Political Issues.

SAARC region in general and **I**ndo-**P**ak in particular have suffered because of political miscalculations and misadventures of their leaders. **I**ndia under the Congress rule remained addicted to state controlled economy that could give it at best 4 per cent growth rate till it opted to liberalize its economy in early 90s. **P**akistan underwent traumatic political experiences but despite them made enviable economic progress in 60s. It could not maintain the same momentum during 70s and 80s. The decade of 90s proved to be a *'decade lost'*. Bangladesh showed signs of improvement but task of uplifting the country economically within three decades was hard dedicated efforts. The regional economic stagnation towards economic integration persisted for more than 10 years after coming of **SAARC** into being in 1985. Specific reasons for this were that none of the **SAARC** member states then opted for bold economic reforms. **I**ndia held onto the policy of protecting her market and **I**ndo-**P**ak political conflict made the region dead as far as economic cooperation and integration was concerned.

The consequences of living with political conflicts severally limited the prospects of making economic gains for **SAARC** countries. The benefits would have, otherwise, accrued because of enhancement of regional trade, increased foreign investment, human resource development and innovation to improve industrial and agricultural sectors. Some of economic indicators (*shown in Table 5*) give credence to this stark reality.

SAARC region's share in global trade is around two per cent, intra-regional trade is 4-5 per cent of member states' exports and **SAARC**'s total **GDP** is 1.5 per cent of global **GDP**. Intra-region per capita income varies steeply between US $ 600 (for **S**ri **L**anka, *the highest*) and US $ 180 (for **B**hutan, *the lowest*). In direct contrast to low **SAARC** intra-regional trade, world's leading integrated regions, the **EU** and **ASEAN** have 60 per cent and 25 per cent intra-regional trade respectively. The most important question is that will **SAFTA** provide an opportunity to enhance intra-regional trade to any reasonable percentage? The answer to this question should be positive, but it is difficult to quantify at this stage.

In addition to poor economic indicators of **SAARC** region, the region suffers because of illiteracy, gender biases, high maternal and infant mortality, poverty, poor governance, religious extremism and other socio-economic ills, which indirectly affect economic growth and regional cooperation.

4.3.2 Indo-Pak Trade Relations: A Historical Perspective

India and **P**akistan have a long history of bilateral trade relations. Soon after independence, **I**ndia was **P**akistan's biggest and most important trading partner. In 1948-49, **P**akistan's exports to **I**ndia were 56 per cent of her total exports (mostly from former **E**ast **P**akistan) and her imports were 32 per cent of total imports. But, **P**akistan's quest for industrialization and non-resolution of political conflicts, made trading between the two countries gradually prohibitive. Just recently **I**ndia had moved its forces to **P**akistani border and closed all means of transportation. This greatly hampered trade between two countries. This sort of situation cannot lead to the establishment of good and long-lasting trade relations and can jeopardize **SAFTA,** as the two countries are biggest economies of the region. *Table 6* presents a brief history of Pakistan's Trade with India from 1992-2002.

Pakistan's industrialists have fears that an open trade with reduce tariff rate would give **I**ndia a big advantage to overwhelm **P**akistani market and thus put them in the corner. **I**ndia remained interested in boosting trade relations with **P**akistan and gave trading preference over conflict resolution. That is why **I**ndia in principle granted **M**ost **F**avored **N**ation (**MFN**) status to **P**akistan in 1995. But she made trading less attractive by imposing high tariff. **P**akistan did not reciprocate but maintains a positive list of 600 trading items that can be imported from **I**ndia. *Table 7* shows product categories currently being traded between India and Pakistan and *Table 8* indicates products categories likely to be exchanged in near future.

4.3.3 India's Trade Relations with other SAARC Member States

Other examples of Indian trade relations with **SAARC** member states include closure of transit trade by **I**ndia of **N**epal in late 80's. In addition, **I**ndia has running dispute with **B**angladesh over the use of river water and certain territorial areas recently resulting in an armed clash between border guards of the two countries. India had also sent its army to **S**ri **L**anka under the guise of Peace Keeping Force. Before that it was actively supporting Tamil Elam separatist in war against **S**ri **L**anka government. In addition, **I**ndia maintains a naval base in **M**aldives and **B**hutan is treaty bound to **I**ndia on security issues.

4.3.4 Size of Indian Economy

Indian Economy is the largest regional economy and one of the largest upcoming emerging economies of the world. It has a major role to play in regional economic integration as it has a stronger, finer and broad industrial base. Another important factor is large size of the **I**ndian market and its central location. Eighty per cent of **SAARC**'s intra-regional trade is to and from **I**ndia. Some of its products like steel, autos, electronic goods, garment and medicines and software are comparatively of better quality and cost effective. **I**ndia is now home to more then a billion people and its large industry backed by government erected barriers can easily swamp entire South Asian market. In early 90's when the Congress government decided to shift economy to liberalization and free market regime, it had three major economic problems to address:

a. A large public sector incapable of delivering according to its potential. Since then the problem has not been fully addressed. The **I**ndian economy is still plagued with an unmanageable public sector like the **C**hinese economy.

b. A tacit resistance to allow private capital, particularly foreign private capital flow in the country.

c. Despite liberalization, the **I**ndian economy has not succeeded in attracting **F**oreign **D**irect **I**nvestment (**FDI**) substantially.

4.3.5 Economic Liberalization

It is not yet clear that how far the SAFTA will take into account the effect of domestic subsidies on prices of its products when it comes into effect. For example, there are large power subsidies available to **I**ndian farmers, while **P**akistani farmers are crushed by excessive energy tariffs. These tariffs obviously make a difference in setting of their prices. Going by the experience of the **E**uropean **U**nion, agricultural issues are likely to be the most contentious. However, the contention is something for future. **P**akistan, **I**ndia and **S**ri **L**anka are committed to reducing their tariffs to 0-5 per cent levels by 2013, rest by 2016. The significance of 1 January 2006, when the agreement will come into effect, is that it is cutoff date for all governments to file their list of '*sensitive items*,' to which tariff reductions will not apply. This sets the scene for prolonged negotiations and many trade-offs.

It has yet to be seen after trade liberalization under both regional and global pacts that whether Indian agriculture sector is really thriving on research or the huge subsidies has also a role in it. **I**ndia subsidizes its farm sector to the tune of around Rs 400 billions on fertilizers, electricity, imputed irrigation and other inputs, which according to an **EU** estimate make these subsidies 2.5 per cent of **I**ndia's **GNP**.

4.3.6 High Cost of Inputs in Pakistan

Pakistan has done away with subsidies under auspices of donor agencies like **IMF**, **W**orld **B**ank and **A**sian **D**evelopment **B**ank and sectors like fertilizers have been brought under **GST**. The controversial dealing with the **I**ndependent **P**ower **P**roducers (**IPP**s) coupled with inefficiency of **WAPDA** has led to electricity tariff highest in the region. This has all lead to an increase in the cost of inputs making Pakistani products expensive and uncompetitive in international markets.

4.3.7 Inter Regional Trades

Though **I**ndia remains the largest trading partner of nearly all the member states of SAFTA. However its trade with **P**akistan, which is the second largest economy in SAFTA, is negligible. Most of trade is carried out via third country like **D**ubai, **M**alaysia or by cross-border smuggling estimated to be more then US$ 2 Billion. Inter-regional trade remains the most important prerequisite for the regional economic integration. *Table 3* shows intra **SAARC** trade and *Table 6* shows Trade with **I**ndia from 1992 to 2003.

Chapter 5

Conclusion and Recommendations

5.1 Conclusion

SAARC region has remained hostage to **I**ndo-**P**ak political antagonism during past 18 years. Bilateral trade between **I**ndia and **P**akistan is very low. There are both political and economic obstacles to expanding trade between the two countries. Hence greater economic co-operation could provide mutual economic benefits. Economic integration will get going if political conflicts are insight for resolution. Perhaps most importantly, it could generate new linkages between two business communities. The groundwork done so far should help in resolving political conflicts not only between **I**ndia and **P**akistan but set momentum to resolve conflicts between **I**ndia-**S**ri Lanka and **I**ndia-**B**angladesh as well.

In light of above, it is clear that **SAFTA** presents both potential benefits and challenges for **P**akistan. Potential benefits of **SAFTA** can be summarized as expansion of trade with member countries; technology exchange; access to a much larger market, decrease in cost of production; increase in industrial competitiveness; and increase in disposable incomes due to lower consumer prices. However, due to long time frame of **SAFTA**, member states should go first for Preferential Trade. It would prepare the markets for eventual free trade and give the governments of member states enough time to resolve political disputes. This will boost inter regional trade, an important requirement for regional trade block.

It is envisaged that **SAFTA** will help in evolving a horizontal specialization across South Asia to enable the most optimal utilization of resources in the region. The motivation for **SAFTA** also lies in the hope that inter-regional economic co-operation will eventually lead to better relations with India, and consequently cutting on our defense expenditures. Hence we would be able to divert our scarce resources to more productive sectors.

Pakistan's domestic industry may also face some serious challenges from intra-**SAARC** imports, especially in the short-run. **P**akistan may not be able to increase its exports to **I**ndia, since she produces similar goods that compete for the same price in International markets. **P**akistan needs to concentrate on developing policies to diversify and upgrade its export base, and creating a favourable climate for private investment. Trade liberalization with **SAARC** countries will also encourage policy makers as well as private sector to increase their efforts to strengthen **P**akistan's international competitiveness. However, this depends on how well **P**akistan responds to the pressures of liberalization. Trade theories and studies reviewed in thesis, argue that regional trade liberalization will lead to restructuring of **P**akistan's economy from less to more competitive sectors, and industries that can achieve international competitiveness will grow due to greater access to a larger market. It is thus imperative for private sector as well as policy makers to understand how **SAFTA** will impact them and devises a constructive and practical strategy for investments in trade infrastructure.

Formation of **SAFTA** will impart a fresh dynamism to intra-SAARC trade, which can give our industry larger power and opportunities to increase business with **SAARC** countries and a unique regional identity. The question that will execution of **SAFTA** help increasing trade among the member states, particularly between **I**ndia and **P**akistan has an affirmative reply. The positive answer is keeping in view of illegal and informal trade via third country, and across border between the two countries.

5.2 Recommendations

Due to long time frame of **SAFTA**, the member states should go first for Preferential Trade. It would prepare the markets for eventual free trade and to give the member states enough time to resolve their political disputes. The member states should work towards reducing subsidies given by the **I**ndian government to its agriculture and especially industrial sector. Only then can a level playing field could be created for **SAFTA** to transform into reality.

For the success of **SAFTA**, all member countries must come together and evolve common export strategy for agricultural commodities, which are the mainstay of their economies. They should cooperate and share agricultural technologies for quantum jump in agricultural yield, production as well as agro-based processing.

In the context of regional cooperation, three key elements are very important. They also need special attention and focus at appropriate levels. These elements are political ideology including political security, economic and civic security and national interests. Our regional integration arrangements must seek to facilitate these elements before implementation of **SAFTA**.

It is also recommended that **P**akistan should modernize her value-added textile sector. With implementation of **WTO** regime from January 2005 and **SAFTA** from January 2006, the **I**ndian cotton can reach anywhere in **P**akistan in 48 hours by road with almost the same transportation expenses within Pakistan from ginneries to the mills. **P**akistan has to be on guards but nothing to fear if it becomes competitive in more value added products.

Transport facilities for intra-regional movement of goods should be enhanced. Currently, shipment to **I**ndia and **B**angladesh is via **D**ubai whereas **N**epal and **B**hutan being landlocked countries cannot be accessed through sea. The number of trains available for transportation of goods to **I**ndia is very limited. We should utilize heavy-duty trucks as a quickest and most convenient mode of transportation. These trucks can go to **N**epal, **B**hutan as well as to **B**angladesh. Besides, we should also look for the feasibility of developing **P**ort **Q**asim as **SAARC**'s last port of call.

If we compare the performance of intra-SAARC trade with other regional blocs we find that there have clearly been missed opportunities. Our regional trade is very low and weakest area right now is the regional trade. For the prosperity of region, all the member countries should boost their efforts to enhance trade with the implementation of **SAFTA**.

For the establishment of **SAFTA**, it is imperative that the political disputes between member countries should be resolved. **SAARC** region has remained hostage to

Indo-Pak political antagonism during past 18 years. The groundwork done so far and the desire of both countries' leaders to improve relations should help in resolving political conflicts not only between **I**ndia and **P**akistan but set momentum to resolve conflicts between **I**ndia-**S**ri Lanka and **I**ndia-**B**angladesh as well. Only then we can achieve the goals of **SAFTA**. The biggest example of this is the complete halt in the trade between **I**ndia and **P**akistan due to closing of all roads, railways and air links. Fears of terrorism have further compounded the problems. For the enhancement of mutual cooperation, all the member states of **SAFTA** should do wholehearted and sincere efforts to remove such hurdles in their relations. Moreover, the bordering countries should sincerely come forward to resolve their disputes and political irritants to promote regional cooperation.

Geographic, political and economic differences among member countries create some problems, as small countries are reluctant to have a free trading arrangement with neighbors. It is recommended that **C**onfidence **B**uilding **M**easures (**CBM**s) must be initiated before implementing **SAFTA** for more cooperation and mutual trust. For example, if the two big economies of **SAARC**; **I**ndia and **P**akistan shun their bilateral differences, their regional trade volumes would definitely grow from the current low levels.

India is the major exporter and minor importer in intra-SAARC trade. This issue should be addressed before a real free trade regime can take place. The fear of LDCs should also be removed through **CBM**s and they be provided with the equal growth opportunities with implementing **SAFTA**.

Pakistan is reluctant to offer **I**ndia the **MFN** status due to political apprehensions and fears of major losses to local industries. On the other hand, India had granted **MFN** status to Pakistan in 1995, but maintained quota restrictions; licensing requirements; currency issues; registration process, tardy customs clearance procedures and other restrictions to suppress imports from **P**akistan. **P**akistan should also grant the **MFN** status to **I**ndia. It is important because **WTO** regime would be in place from next year and after signing **SAFTA**, we would have to normalize our trade relations otherwise with **I**ndia. Therefore, the progress towards uniform tariff regimes would open up all barriers. Under **MFN** terms, **P**akistan would be obliged to grant **I**ndian goods with treatment similar to that offered to other countries under WTO rules.

Can **SAFTA** lead to an Economic Union? The answer is wide open. By all counts and indications, such a union is still a distant dream. However, we can say that by the signing of **SAFTA**, we have taken the first step towards it and we should keep on moving the track. **SAFTA** is shooting for intra-SAARC trade, which is at present very low. The trade between **SAARC**'s Big Two, **I**ndia and **P**akistan, through official channels, is US$ 200 million a year. But, the overall trade via third countries likes **S**ingapore and **D**ubai is estimated at US$ 1.5 billion a year. It clearly shows the potential for **SAFTA**.

SAARC member countries must move forward expeditiously towards the establishment of a **S**outh **A**sian **D**evelopment **B**ank which can underwrite important, region-oriented mega-projects of mutual benefit to **SAARC** members.

For the effectiveness of this accord, member countries must also look for the speedy action on poverty alleviation, South Asian Development Fund, cooperation in the field of energy, trans-regional oil and gas pipelines, Information Technology, Research & Development and the means of transportation.

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Abbreviations and Acronyms

ADB	**A**sian **D**evelopment **B**ank
AFTA	**ASEAN F**ree **T**rade **A**rea
APEC	**A**sia-**P**acific **E**conomic **C**ooperation
ARF	ASEAN **R**egional **F**orum
ASEAN	**A**ssociation of **S**outh **E**ast **A**sian **N**ations
ASEM	**A**sia **E**urope **M**eeting
BMR	**B**alancing**, M**odernizing and **R**ehabilitation
BPO	**B**usiness **P**rocess **O**utsourcing
CARs	**C**entral **A**sian **R**epublics
CBMs	**C**onfidence **B**uilding **M**easures
CER	**C**loser **E**conomic **R**elations
COEs	**C**ommittee **O**f **E**xperts
EALAF	**E**ast **A**sia-**L**atin **A**merica **F**orum
ECO	**O**rganization for **E**conomic **C**ooperation
ECSC	**E**uropean **C**oal and **S**teel **C**ommunity
EEC	**E**uropean **E**conomic **C**ommunity
EMU	**E**conomic and **M**onitory **U**nion
EU	**E**uropean **U**nion
EURATOM	**E**uropean **A**tomic **E**nergy **C**ommunity
FDI	**F**oreign **D**irect **I**nvestment
GATT	**G**eneral **A**greement on **T**ariffs and **T**rade
GCC	**G**ulf **C**ooperative **C**ouncil
GNP	**G**ross **N**ational **P**roduct
GSP	**G**eneralized **S**ystem of **P**references
GST	**G**eneral **S**ales **T**ax
ID	**I**slamabad **D**eclaration
IMF	**I**nternational **M**onetary **F**und
IPA	**I**ntegrated **P**rogramme of **A**ction

KCCI	**K**arachi **C**hamber of **C**ommerce and **I**ndustries
LDCs	**L**east **D**eveloped **C**ountries
MFN	**M**ost **F**avoured **N**ation
MNE	**M**ulti **N**ational **E**nterprises
NAFTA	**N**orth **A**merican **F**ree **T**rade **A**rea
NLDCs	**N**on-**L**east **D**eveloped **C**ountries
NTBs	**N**on **T**ariff **B**arriers
OIC	**O**rganization of **I**slamic **C**ountries
PASHA	**P**akistan **S**oftware **H**ouses **A**ssociation
PIPRO	**P**akistan **I**ntellectual **P**roperty **R**ights **O**rganization
PPP	**P**urchaser **P**ower **P**arity
PTA	**P**referential **T**rade **A**greement
R & D	**R**esearch and **D**evelopment
RTA	**R**egional **T**rading **A**reas
SAARC	**S**outh **A**sian **A**ssociation for **R**egional **C**ooperation
SAED	**S**outh **A**sian **E**conomic **U**nion
SAFTA	**S**outh **A**sian **F**ree **T**rade **A**rea
SAP	**S**tructural **A**djustment **P**rogramme
SAPTA	**SAARC** **P**referential **T**rading **A**greement
SMC	**SAFTA** **M**inisterial **C**ouncil
SME	**S**mall and **M**edium **E**nterprise
SMEDA	**S**mall and **M**edium **E**nterprise **D**evelopment **A**uthority
SPF	**S**outh **P**acific **F**orum
TAC	**T**reaty of **A**mity and **C**ooperation
TLP	**T**rade **L**iberalization **P**rogramme
UNDP	**U**nited **N**ations' **D**evelopmental **P**rogramme
WB	**W**orld **B**ank
WTO	**W**orld **T**rade **O**rganization

Tables
Charts & Graphs

South Asian Free Trade Area (SAFTA) Accord

Agreement on South Asian Free Trade Area (SAFTA) has been signed at 12th SAARC Summit in Islamabad in 2004. The governments of the SAARC (South Asian Association for Regional Cooperation) member states comprising the People's Republic of Bangladesh, the Kingdom of Bhutan, the Republic of India, the Republic of Maldives, the Kingdom of Nepal, the Islamic Republic of Pakistan and the Democratic Socialist Republic of Sri Lanka hereinafter referred to as "Contracting States".

Previously, Agreement on SAARC Preferential Trading Arrangement (SAPTA) was signed in Dhaka on 11th April 1993. That agreement provides for the adoption of various instruments of trade liberalization on a preferential basis. It was hoped that preferential trading arrangements among SAARC member states will act as a stimulus to strengthening of national and SAARC economic resilience, and development of national economies of the Contracting States by expanding investment and production opportunities, trade, and foreign exchange earnings as well as development of economic and technological cooperation[1]. The inclination towards this agreement shows the concern of member states realizing the fact that a number of regions are entering into such arrangements to enhance trade through free movement of goods.

Recognizing that **L**east **D**eveloped **C**ountries (**LDC**s) in the region need to be accorded special and differential treatment commensurate with their development needs; and Recognizing that it is necessary to progress beyond a Preferential Trading Arrangement to move towards higher levels of trade and economic cooperation in the region by removing barriers to cross-border flow of goods. Various articles agreed upon by the member states are appended below:-

[1] Daily Dawn dated 07 January 2004

Article - 1

Definitions: For the purposes of this Agreement

1. ***Concessions*** mean tariff, Para-tariff and non-tariff concessions agreed under Trade Liberalization Programme.

2. ***Direct Trade Measures*** mean measures conducive to promoting mutual trade of Contracting States such as long and medium-term contracts containing import and supply commitments in respect of specific products, buy-back arrangements, state trading operations, and government and public procurement.

3. ***Least Developed Contracting State*** refers to a Contracting State, which is designated as a "Least Developed Country" by the United Nations.

4. ***Margin of Preference*** means percentage of tariff by which tariffs are reduced on products imported from one Contracting State to another as a result of preferential treatment.

5. ***Non-Tariff Measures*** include any measure, regulation or practice, other than "tariffs" and "Para-tariffs".

6. ***Para-Tariffs*** mean border charges and fees, other than "tariffs", on foreign trade transactions of a tariff-like effect, which are levied solely on imports, but not those indirect taxes and charges, which are levied in the same manner on like domestic products. Import charges corresponding to specific services rendered are not considered as Para-tariff measures.

7. ***Products*** mean all products including manufactures and commodities in their raw, semi-processed and processed forms.

8. ***SAPTA*** means Agreement on SAARC Preferential Trading Arrangement signed in Dhaka on 11th April 1993.

9. ***Serious Injury*** means a significant impairment of domestic industry of like or directly competitive products due to a surge in preferential imports causing substantial losses in terms of earnings, production or employment unsustainable in the short term.

10. ***Tariffs*** mean customs duties included in the national tariff schedules of the Contracting States.

11. ***Threat of Serious Injury*** means a situation in which a substantial increase of preferential imports is of a nature to cause "serious injury" to domestic producers, and

that such injury, although not yet existing, is clearly imminent. A determination of threat of serious injury shall be based on facts and not on mere allegation, conjecture or remote or hypothetical possibility.

Article - 2

Establishment:

The Contracting States hereby establish the South Asian Free Trade Area (SAFTA) to promote and enhance mutual trade and economic cooperation among the Contracting States, through exchanging concessions in accordance with this Agreement.

Article - 3

Objectives and Principles

The Objectives of this Agreement are to promote and enhance mutual trade and economic cooperation among Contracting States by, inter-alia:

a. Eliminating barriers to trade in, and facilitating cross-border movement of goods between territories of the Contracting States.

b. Promoting conditions of fair competition in the free trade area, and ensuring equitable benefits to all Contracting States, taking into account their respective levels and pattern of economic development.

c. Creating effective mechanism for implementation and application of this Agreement, for its joint administration and for resolution of disputes.

d. Establishing a framework for further regional cooperation to expand and enhance mutual benefits of this Agreement.

Moreover, **SAFTA** shall be governed in accordance with the following principles:

a. The provisions of this Agreement and will govern SAFTA also by rules, regulations, decisions, understandings and protocols to be agreed upon within its framework by the Contracting States.

b. The Contracting States affirm their existing rights and obligations with respect to each other under Marrakesh Agreement Establishing the World Trade

Organization and other Treaties/Agreements to which such Contracting States are signatories.

c. SAFTA shall be based and applied on the principles of overall reciprocity and mutuality of advantages in such a way as to benefit equitably all Contracting States, taking into account their respective levels of economic and industrial development, pattern of their external trade and tariff policies and systems.

d. SAFTA shall involve free movement of goods, between countries through, inter-alia, elimination of tariffs, para-tariffs and non-tariff restrictions on movement of goods, and any other equivalent measures.

e. SAFTA shall entail adoption of trade facilitation and other measures, and progressive harmonization of legislations by the Contracting States in relevant areas.

f. The special needs of the Least Developed Contracting States shall be clearly recognized by adopting concrete preferential measures in their favour on a non-reciprocal basis.

Article - 4
Instruments

The SAFTA Agreement will be implemented through the following instruments:

1. Trade Liberalization Programme
2. Rules of Origin
3. Institutional Arrangements
4. Consultations and Dispute Settlement Procedures
5. Safeguard Measures
6. Any other instrument that may be agreed upon.

Article - 5

National Treatment

Each Contracting State shall accord national treatment to the products of other Contracting States in accordance with the provisions of Article III of GATT, 1994.

Article - 6

Components

SAFTA may, inter-alia, consist of arrangements relating to tariffs, para-tariffs, non-tariff measures and direct trade measures.

Article - 7

Trade Liberalization Programme

Contracting States agree to the following schedule of tariff reductions:

a. The tariff reduction by the Non-Least Developed Contracting States from existing tariff rates to 20% shall be done within a time frame of 2 years, from the date of coming into force of the Agreement. Contracting States are encouraged to adopt reductions in equal annual installments. If actual tariff rates after coming into force of the Agreement are below 20 per cent, there shall be an annual reduction on a Margin of Preference basis of 10 per cent on actual tariff rates for each of the two years.

b. The tariff reduction by the Least Developed Contracting States from existing tariff rates will be to 30 per cent within time frame of 2 years from the date of coming into force of the Agreement. If actual tariff rates on the date of coming into force of the Agreement are below 30 per cent, there will be an annual reduction on a Margin of Preference basis of 5 per cent on actual tariff rates for each of the two years.

c. The subsequent tariff reduction by Non-Least Developed Contracting States from 20 per cent or below to 0-5 per cent shall be done within a second time frame of 5 years, beginning from third year from the date of coming into force of the Agreement. However, the period of subsequent tariff reduction by Sri Lanka shall be six years. Contracting States are encouraged to adopt reductions in equal annual installments, but not less than 15 per cent annually.

d. The subsequent tariff reduction by the Least Developed Contracting States from 30 per cent or below to 0-5 per cent shall be done within a second time frame of 8 years beginning from third year from the date of coming into force of the Agreement. The Least Developed Contracting States are encouraged to adopt reductions in equal annual installments, not less than 10 per cent annually.

2. The above schedules of tariff reductions will not prevent Contracting States from immediately reducing their tariffs to 0-5 percent or from following an accelerated schedule of tariff reduction.

3. Contracting States may not apply Trade Liberalization to tariff lines included in the Sensitive Lists, which shall be negotiated by the Contracting States (for LDCs and Non-LDCs) and incorporated in this Agreement as an integral part. The number of products in the Sensitive Lists shall be subject to maximum ceiling to be mutually agreed among the Contracting States with flexibility to Least Developed Contracting States to seek derogation in respect of the products of their export interest.

4. The Sensitive List shall be reviewed after every four years or earlier as may be decided by SAFTA Ministerial Council (SMC), established under Article 10, with a view to reducing number of items in the Sensitive List.

5. The Contracting States shall notify the SAARC secretariat all non-tariff and para-tariff measures to their trade on an annual basis. The Committee of Experts (COEs), established under Article 10, in its regular meetings to examine their compatibility with relevant WTO provisions, shall review notified measures. COEs shall recommend elimination or implementation of measure in the least trade restrictive manner in order to facilitate intra-SAARC trade.

6. Contracting Parties shall eliminate all quantitative restrictions, except otherwise permitted under GATT, 1994, in respect of products included in the Trade Liberalization Programme.

7. Notwithstanding the provisions contained in paragraph 1 of this Article, the Non-Least Developed Contracting States shall reduce their tariff to 0-5 per cent for products of Least Developed Contracting States within a timeframe of three years beginning from the date of coming into force of the Agreement.

Article - 8

Additional Measures

Contracting States agree to consider, in addition to the measures set out in ***Article 7***, adoption of trade facilitation and other measures to support and complement SAFTA for mutual benefit. These may include, among others:

a. Harmonization of standards, reciprocal recognition of tests and accreditation of testing laboratories of Contracting States and certification of products.

b. Simplification and harmonization of customs clearance procedure.

c. Harmonization of national customs classification based on HS coding.

d. Customs cooperation to resolve dispute at customs entry points.

e. Simplification and harmonization of import licensing and registration procedures.

f. Simplification of banking procedures for import financing.

g. Transit facilities for efficient intra-SAARC trade, especially for the land-locked Contracting States.

h. Removal of barriers to intra-SAARC investments.

i. Macroeconomic consultations.

j. Rules for fair competition and promotion of venture capital.

k. Development of communication systems and transport infrastructure.

l. Making exceptions to their foreign exchange restrictions, if any, relating to payments for products under the SAFTA scheme, as well as repatriation of such payments without prejudice to their rights under Article XVIII of the General Agreement on Tariffs and Trade (GATT) and relevant provisions of Articles of Treaty of IMF.

m. Simplification of procedures for business visas.

Article - 9

Extension of Negotiated Concessions

Concessions agreed to, other than those made exclusively to the Least Developed Contracting States, shall be extended unconditionally to all Contracting States. The initial notification shall be made within three months from the date of coming into force of the Agreement and COE shall review the notification in its first meeting and take appropriate decisions.

Article - 10

Institutional Arrangements

1. The Contracting States hereby establish the SAFTA Ministerial Council (SMC).

2. The SMC shall be the highest decision-making body of SAFTA and shall be responsible for administration and implementation of this Agreement and all decisions and arrangements made within its legal framework.

3. The SMC shall consist of the Ministers of Commerce and Trade of the Contracting States.

4. The SMC shall meet at least once every year or more often as and when considered necessary by the Contracting States. Each Contracting State shall chair the SMC for a period of one year on rotational basis in alphabetical order.

5. The SMC shall be supported by a COE with one nominee from each Contracting State at the level of a senior economic official, with expertise in trade matters.

6. The COE shall monitor, review and facilitate implementation of the provisions of this Agreement and undertake any task assigned to it by the SMC. The COE shall submit its report to SMC every six months.

7. The COE will also act as Dispute Settlement Body under this Agreement.

8. The COE shall meet at least once every six months or more often as and when considered necessary by the Contracting States. Each Contracting State shall chair the COE for a period of one year on rotational basis in alphabetical order.

9. The SAARC secretariat shall provide secretarial support to the SMC and COE in discharge of their functions.

10. The SMC and COE will adopt their own rules of procedure.

Article - 11
Special and Differential Treatment for LDC States

In addition to other provisions of this Agreement, all Contracting States shall provide special and more favourable treatment exclusively to the Least Developed Contracting States as set out in the following sub-paragraphs: -

a. The Contracting States shall give special regard to situation of the Least Developed Contracting States when considering application of anti-dumping and/or countervailing measures. In this regard, the Contracting States shall provide an opportunity to Least Developed Contracting States for consultations. The Contracting States shall, to the extent practical, favourably consider accepting price undertakings offered by exporters from Least Developed Contracting States. These constructive remedies shall be available until all Contracting States have completed trade liberalization programme.

b. Greater flexibility in continuation of quantitative or other restrictions provisionally and without discrimination in critical circumstances by the Least Developed Contracting States on imports from other Contracting States.

c. Contracting States shall also consider, where practical, taking direct trade measures with a view to enhancing sustainable exports from the Least Developed Contracting States, such as long and medium-term contracts containing import and supply commitments in respect of specific products, buy-back arrangements, state trading operations, and government and public procurement.

d. Special consideration shall be given by Contracting States to requests from Least Developed Contracting States for technical assistance and cooperation arrangements designed to assist them in expanding their trade with other Contracting States and in taking advantage of potential benefits of SAFTA. A list of possible areas for such technical assistance shall be negotiated by the Contracting States and incorporated in this Agreement as an integral part.

e. The Contracting States recognize that the Least Developed Contracting States may face loss of customs revenue due to implementation of the Trade Liberalization Programme under this Agreement. Until alternative domestic arrangements are formulated to address this situation, the Contracting States agree to establish an appropriate mechanism to compensate the Least Developed Contracting States for their loss of customs revenue. This mechanism and its rules and regulations shall be established prior to commencement of the Trade Liberalization Programme (TLP).

Article - 12

Special Provision for Maldives

Notwithstanding the potential or actual graduation of Maldives from the status of a Least Developed Country, it shall be accorded in this Agreement and in any subsequent contractual undertakings thereof treatment no less favourable than that provided for the Least Developed Contracting States.

Article - 13

Non-application. Notwithstanding the measures as set out in this Agreement its provisions shall not apply in relation to preferences already granted or to be granted by any Contracting State to other Contracting States outside the framework of this Agreement, and to third countries through bilateral, Plurilateral and multilateral trade agreements and similar arrangements.

Article - 14

General Exceptions

a. Nothing in this Agreement shall be construed to prevent any Contracting State from taking action and adopting measures, which it considers necessary for protection of its national security.

b. Subject to requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where similar conditions prevail, or a disguised restriction on intra-regional trade, nothing in this Agreement shall be construed to prevent any Contracting State from taking action and adopting measures which it considers necessary for the protection of:

i. Public morals.

ii. Human, animal or plant life and health.

iii. Articles of artistic, historic and archaeological value.

Article - 15

Balance of Payments Measures

1. Notwithstanding the provisions of this Agreement, any Contracting State facing serious balance of payments difficulties may suspend provisionally concessions extended under this Agreement.

2. Any such measure taken pursuant to paragraph 1 of this Article shall be immediately notified to the COEs.

3. The COEs shall periodically review measures taken pursuant to paragraph I of this Article

4. Any Contracting State, which takes action pursuant to paragraph 1 of this Article, shall afford, upon request from any other Contracting State, adequate opportunities for consultations with a view to preserving stability of concessions under SAFTA.

5. If no satisfactory adjustment is effected between the Contracting States concerned within 30 days of beginning of such consultations, to be extended by another 30 days through mutual consent, the matter may be referred to the COEs.

6. Any such measures taken pursuant to paragraph 1 of this Article shall be phased

out soon after the COE comes to conclusion that balance of payments situation of the Contracting State concerned has improved.

Article - 16

Safeguard Measures

1. If any product, which is the subject of a concession under this Agreement, is imported into the territory of a Contracting State in such a manner or in such quantities as to cause, or threaten to cause, serious injury to producers of like or directly competitive products in importing Contracting State, the importing Contracting State may, pursuant to an investigation by the competent authorities of that Contracting State conducted in accordance with the provisions set out in this Article, suspend temporarily the concessions granted under the provisions of this Agreement. The examination of impact on domestic industry concerned shall include an evaluation of all other relevant economic factors and indices having a bearing on state of the domestic industry of product and a causal relationship must be clearly established between "serious injury" and imports from within the SAARC region, to the exclusion of all such other factors.

2. Such suspension shall only be for such time and to the extent as may be necessary to prevent or remedy such injury and in no case, will such suspension be for duration of more than 3 years.

3. No safeguard measure shall be applied again by a Contracting State to the import of a product which has been subject to such a measure during the period of implementation of Trade Liberalization Programme by the Contracting States, for a period of time equal to that during which such measure had been previously applied, provided that period of non-application is at least two years.

4. All investigation procedures for resorting to safeguard measures under this Article shall be consistent with Article XIX of GATT, 1994, and WTO Agreement on Safeguards.

5. Safeguard action under this Article shall be non-discriminatory and applicable to the product imported from all other Contracting States subject to the provisions of paragraph 8 of this Article.

6. When safeguard provisions are used in accordance with this Article, the Contracting State invoking such measures shall immediately notify the exporting Contracting State(s) and the COEs.

7. In critical circumstances where delay would cause damage which it would be difficult to repair, a Contracting State may take a provisional safeguard measure pursuant to a preliminary determination that there is clear evidence that increased imports have caused or are threatening to cause serious injury. The duration of provisional measure shall not exceed 200 days; during this period pertinent requirements of this Article shall be met.

8. Notwithstanding any of the provisions of this Article, safeguard measures under this article shall not be applied against a product originating in a Least Developed Contracting State as long as its share of imports of the product concerned in the importing Contracting State does not exceed 5 per cent, provided Least Developed Contracting States with less than 5 per cent import share collectively account for not more than 15 per cent of total imports of the product concerned.

Article - 17

Maintenance of the Value of Concessions

Any of the concessions agreed upon under this Agreement shall not be diminished or nullified, by the application of any measures restricting trade by the Contracting States, except under provisions of other articles of this Agreement.

Article - 18

Rules of Origin

Rules of Origin shall be negotiated by the Contracting States and incorporated in this Agreement as an integral part.

Article - 19

Consultations

1. Each Contracting State shall accord sympathetic consideration to and will afford adequate opportunity for consultations regarding representations made by another Contracting State with respect to any matter affecting the operation of this Agreement.

2. The COEs may, at the request of a Contracting State, consult with any Contracting State in respect of any matter for which it has not been possible to find a satisfactory solution through consultations under paragraph 1.

Article - 20

Dispute Settlement Mechanism

1. Any dispute that may arise among the Contracting States regarding the interpretation and application of the provisions of this Agreement or any instrument adopted within its framework concerning rights and obligations of the Contracting States will be amicably settled among the parties concerned through a process initiated by a request for bilateral consultations.

2. Any Contracting State may request consultations in accordance with paragraph 1 of this Article with other Contracting State in writing stating reasons for the request including identification of measures at issue. All such requests should be notified to the COEs, through the SAARC secretariat with an indication of legal basis for the complaint.

3. If a request for consultations is made pursuant to this Article, the Contracting State to which the request is made shall, unless otherwise mutually agreed, reply to the request within 15 days after the date of its receipt and shall enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution.

4. If the Contracting State does not respond within 15 days after the date of receipt of request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of request, then the Contracting State that requested holding of consultations may proceed to request committee of experts to settle the dispute in accordance with working procedures to be drawn up by the committee.

5. Consultations shall be confidential, and without prejudice to the rights of any Contracting State in any further proceedings.

6. If the consultations fail to settle a dispute within 30 days after the date of receipt of request for consultations, to be extended by a further period of 30 days through mutual consent, the complaining Contracting State may request the COEs to settle the dispute. The complaining Contracting State may request the COEs to settle the dispute during 60-day period if the consulting Contracting States jointly consider that consultations have failed to settle the dispute.

7. The COEs shall promptly investigate the matter referred to it and make recommendations on the matter within a period of 60 days from the date of referral.

8. The COEs may request a specialist from a Contracting State not party to the dispute selected from a panel of specialists to be established by the committee within one year from the date of entry into force of the Agreement for peer review of the matter referred to it. Such review shall be submitted to the committee within a period of 30 days from the date of referral of matter to the specialist.

9. Any Contracting State, which is a party to the dispute, may appeal the recommendations of the committee of experts to the SMC. The SMC shall review the matter within the period of 60 days from date of submission of request for appeal. The SMC may uphold, modify or reverse the recommendations of the COEs.

10. Where the COE or SMC concludes that the measure subject to dispute is inconsistent with any of the provisions of this Agreement, it shall recommend that the Contracting State concerned bring the measure into conformity with this Agreement. In addition to its recommendations, the Committee of experts or the SMC may suggest ways in which the Contracting State concerned could implement the recommendations.

11. The Contracting State to which committee's or SMC's recommendations are addressed shall within 30 days from the date of adoption of the recommendations by the committee or the SMC, inform the committee of experts of its intentions regarding implementation of the recommendations. Should the said Contracting State fail to implement the recommendations within 90 days from the date of adoption of the recommendations by the committee, the committee of experts may authorize other interested Contracting States to withdraw concessions having trade effects equivalent to those of the measure in dispute.

Article - 21

Withdrawal

1. Any Contracting State may withdraw from this Agreement at any time after its entry into force. Such withdrawal shall be effective on expiry of six months from the date on which a written notice thereof is received by the secretary-general of the SAARC, the depositary of this Agreement. That Contracting State shall simultaneously inform the committee of experts of the action it has taken.

2. The rights and obligations of a Contracting State, which has withdrawn from this Agreement, shall cease to apply as of that effective date.

3. Following the withdrawal by any Contracting State, the committee shall meet within 30 days to consider action subsequent to withdrawal.

Article - 22

Entry into Force

1. This Agreement shall enter into force on **1st January 2006** upon completion of formalities, including ratification by all Contracting States and issuance of a notification thereof by the SAARC secretariat. This Agreement shall supersede the Agreement on SAARC Preferential Trading Arrangement (SAPTA).

2. Notwithstanding the supercession of SAPTA by this Agreement, the concessions granted under the SAPTA Framework shall remain available to the Contracting States until completion of the TLP.

Article - 23

Reservations

This Agreement shall not be signed with reservations, nor will reservations be admitted at the time of notification to the SAARC secretariat of completion of formalities.

Article - 24

Amendments

This Agreement may be amended by consensus in the SMC. Any such amendment will become effective upon the deposit of instruments of acceptance with the Secretary General of SAARC by all Contracting States.

Article - 25

Depository

This Agreement will be deposited with the secretary-general of the SAARC, who will promptly furnish a certified copy thereof to each Contracting State. In witness where of the undersigned being duly authorized thereto by their respective governments have signed this Agreement.

Evolution of Economic Integration in South Asia

First South Asian Foreign Secretaries' Meeting, 1981
Technical Co-operation in five selected areas (agricultural, telecommunication, rural development, meteorology, and health and population)

Second South Asian Foreign Ministers' Meeting, 1983
Launched the **I**ntegrated **P**rograms of **A**ctions (**IPA**) through **S**outh **A**sian **R**egional **C**ooperation foreign ministers began to meet on a regular basis

Establishment of SAARC, 1985
Objectives are defined on a wide range of issues, including: promoting welfare, accelerating economic growth, strengthening collective self-reliance, etc

- A Secretariat was set up in **N**epal
- A set of **IPA**s is discussed under **SAARC**

South Asian Preferential Trading Arrangement (SAPTA), 1995
Signed in 1993 by the Council of Ministers Operational in December 1995; notified the **WTO** as a **PTA**

Three Rounds of Tariff Cut under SAPTA
SAPTA-1 (226 6-digit HS items) concluded in 1995

SAPTA-2 (1800 6-digit HS items) concluded in 1997

SAPTA-3 (2700 6-digit HS items) concluded in 1998

SAPTA-4 initiated in 1999 but postponed

Working Toward a Free Trade Area (SAFTA) by 2001
Agreed in a summit in 1997 but seems to be difficult to implement by the deadline