

Regional Integration, Trade and Conflict in South Asia

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Contents

Acronyms.....	4
Abstract	6
1. Introduction.....	7
2. Mapping Regional Trade Agreements and Conflicts.....	9
2.1 Conflict in South Asia	9
2.2 Chronology of conflict in South Asia since 1980.....	10
2.3 Bilateral conflicts and tensions	11
2.3.1 India and Pakistan.....	11
2.3.2 India and Sri Lanka	12
2.3.3 India and Bangladesh	13
2.3.4 India and Nepal.....	13
2.3.5 Relations between other SAARC members	14
2.4 Intra-state strife in South Asia	14
2.5 Mapping South Asian regional trade agreements	15
2.5.1 Cooperation despite conflict	15
2.5.2 SAARC	17
2.5.3 SAPTA.....	17
2.5.4 SAFTA.....	18
3. RTAs, Trade and Conflict	23
3.1 Theoretical underpinnings of the trade-conflict linkage.....	23
3.2 Existence of trade complementarities in South Asia: The basis for trade	24
3.2.1 Potential investment collaboration	25
3.3 RTAs and trade growth: Evidence from South Asia.....	25
3.3.1 Formal and informal trade trends in South Asia	25
3.3.2 RTAs and trade promotion	27
3.3.3 Global and multilateral institutions: Trade leakages outside the region	29
3.4 Exploring the causality between trade and conflict.....	30
3.4.1 From conflict to trade	30
3.4.2 Bilateral agreements: From trade to conflict mitigation.....	31
4. Regional Integration Processes.....	32
4.1 Internal/regional processes	32
4.2 External processes.....	33
4.2.1 Impact on intra-state conflict	34
5. Looking to the Future	36
Bibliography.....	39
Annex 1: Intra-regional Export Shares: A Comparison Across Southern RTAs.....	45
Annex 2: Map of South Asia	46

Acronyms

ADB	Asian Development Bank
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
ASEM	Asia-Europe Meeting
BIMSTEC	Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation
BoP	Balance of Payments
CEC	Commission on Economic Cooperation
CECA	Comprehensive Economic Cooperation Agreements
CHT	Chittagong Hills Tract
COE	Committee of Experts
COP	Committee of Participants
DC	Developing country
EC	European Commission
ECO	Economic Cooperation Organization
ESAS	East South Asia Sub region
ESCAP	Economic and Social Commission for Asia and the Pacific
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTA	Free Trade Agreement
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
GEMS	Global Environment Measurement System
GNP	Gross National Product
GSP	Generalized System of Preferences
IGG	Inter-Governmental Group
IOR	Indian Ocean Rim Association for Regional Cooperation
IPA	Integrated Program of Action
IPCS	Institute of Peace and Conflict Studies, Sri Lanka
IPKF	Indian Peace-keeping Force
IR	International relations
IT	Information Technology
LDCs	Least Developed Countries
LTTE	Liberation Tigers of Tamil Eelam
MFN	Most Favored Nation
NAFTA	North America Free Trade Agreement
NTB	Non-tariff barrier
PTA	Preferential Trade Agreement
RTA	Regional Trade Agreement
SAARC	South Asian Association for Regional Cooperation
SADC	South African Development Cooperation
SAFTA	South Asian Free Trade Agreement
SAGQ	South Asia Growth Quadrangle
SAPTA	South Asian Preferential Trade Arrangement

SARC	South Asian Regional Cooperation
SARI	South Asia Regional Initiative for Energy Cooperation and Development
SCCI	SAARC Chamber of Commerce and Industry
SL	Sri Lanka
SMC	SAFTA Ministerial Council
TIFA	Trade and Investment Framework Agreement
TNCs	Trans-national Corporations
ULFA	United Liberation Front of Assam
UNDP	United Nations Development Program
US	United States
USD	United States Dollars (\$)
WB	World Bank
WTO	World Trade Organization

Abstract

The world has witnessed a proliferation of regional trading arrangements (RTA) over the past two decades. Since 1990, close to 250 RTAs have been officially notified. The last year has been the most prolific period in RTA history, with 43 RTAs being notified to the WTO. The drivers of RTAs are heterogeneous, reflecting economic, political, social and cultural forces. These drivers can be new markets and trade opportunities, growing frustration with multilateral trade negotiations (e.g., WTO), an attempt to establish countervailing negotiating power, or an attempt to reduce illegal trade and smuggling. They could even reflect attempts to export models of regional cooperation such as the EU to other regional blocks. The heterogeneity of these drivers illustrates clearly that RTAs promote far more than just trade or, for that matter, economic integration. They ought to be seen in an inclusive manner, as a means to achieve socio-economic prosperity and political stability within the region.

The reality in South Asia is that RTAs have failed to promote peace. Despite tariff reducing agreements via a preferential trade agreement (SAPTA) and, most recently, a free trade agreement (SAFTA), regional tensions continue to stall economic integration and interdependence. Political instability within smaller nations as well as animosity towards a surging India is largely responsible for stalled talks – which appear to create an environment where little progress is visible. Economic globalization also complicates regional integration as national agendas take second billing to extra regional arrangements, eroding confidence-building measures that would contribute towards regional cooperation. In short, “conflict” is a driver of trade rather than its consequence. The recourse is a series of bilateral relations, promoted largely by private sector actors, where the larger South Asian nations leverage their size to ensure one-sided benefits. Further, a noticeable rise in intra-state tension has imparted a negative dimension to South Asia’s experience with economic globalization.

The study findings suggest reverting to SAARC’s mandate. An approach that takes into account shared commitments to institutional, cultural, religious – spiritual, social and environmental development, is more likely to yield measurable steps that build peace between all nations, promote equitable development and in turn, address the concerns of groups responsible for intra-state instability. Joint efforts through a SAARC parliament, management of environmental resources and celebrating a common heritage would encourage stability through real people to people contact. The international community could best contribute by ensuring that policies formulated at the global level take into account the needs for the equitable distribution of wealth to marginalized segments of society, particularly in rural areas throughout the region. An overarching, integrated effort could also catalyze sector-country comparative advantage and by promoting regional trade would generate secondary peace dividends – both inter and intra-state.

1. Introduction

The world has witnessed a proliferation of regional trading agreements (RTAs) over the past two decades. Since 1990, close to 250 RTAs have been officially notified. The last year has been the most prolific period in RTA history, with 43 RTAs being notified to the WTO. The drivers of RTAs are heterogeneous, reflecting economic, political, social and cultural forces. These drivers can be new markets and trade opportunities, growing frustration with multilateral trade negotiations (e.g., WTO), an attempt to establish countervailing negotiating power or an attempt to reduce illegal trade and smuggling. They could even reflect attempts to export models of regional cooperation such as the EU to other regional blocks. The heterogeneity of these drivers illustrates clearly that RTAs promote far more than just trade or, for that matter, economic integration. They ought to be seen in an inclusive manner, as a means to achieve socio-economic prosperity and political stability within the region.

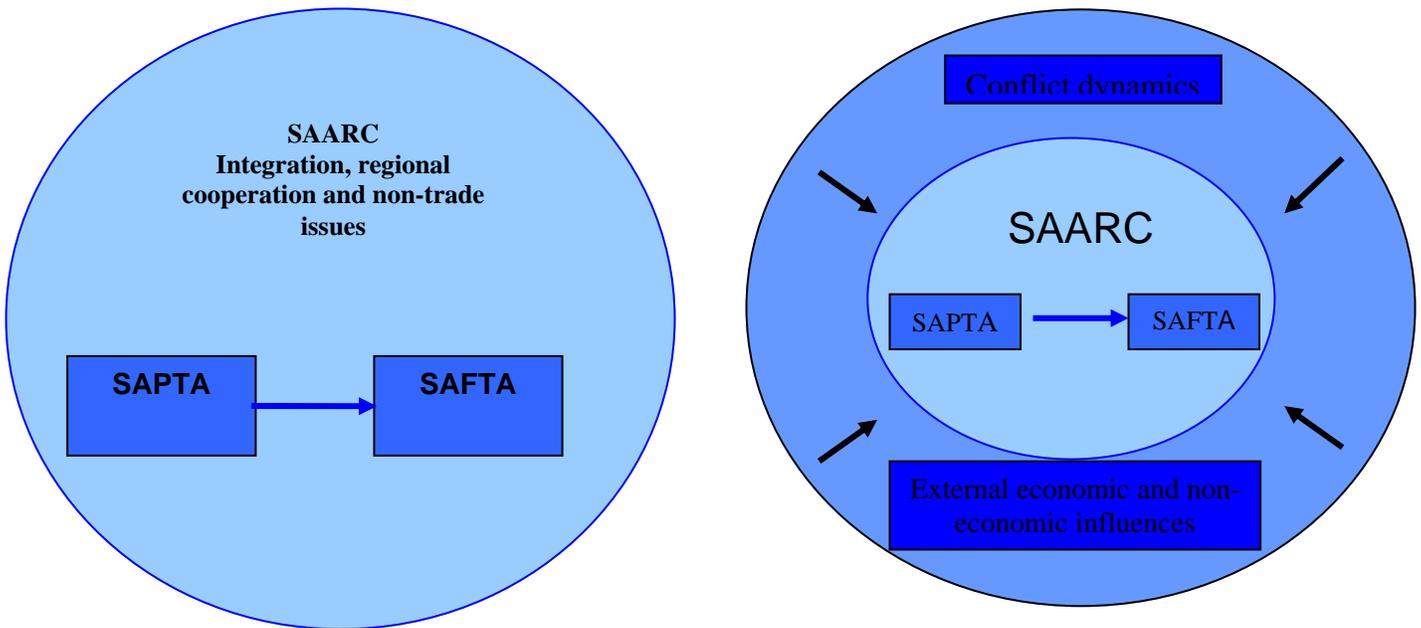
As the number of operational RTAs has grown, so has the interest in the multi-faceted impact RTAs tend to have within and outside the region. Perhaps the most significant and yet somewhat ignored aspect is the link between RTAs and political stability, the latter being one of the key determinants of inter and intra-state conflict within a region. Our study focuses on the South Asian region and examines the economic, political and strategic context in which RTAs are embedded. This is a strategically important region where the states have a history of integration as well as conflict. In the colonial era, most of South Asia was under British rule. India, the largest country of the region was a well-integrated single economy at the time. With the break up of colonial India into modern day Pakistan and India, and later a further split of Pakistan into Bangladesh, regional economic integration weakened considerably. At the same time, states within the region experienced long spells of intra and inter-state tensions.

The region therefore presents itself as a suitable case to examine the trade-conflict linkage. For this study, we look at all three existing RTAs in the region. The institution of the South Asian Association for Regional Cooperation (SAARC) is the overarching RTA with an economic and political mandate. Members include Pakistan, India, Sri Lanka, Maldives, Nepal, Bangladesh, and Bhutan. Within the SAARC mandate, two South Asian agreements aiming at economic integration have been constituted, namely the South Asian Preferential Trade Agreement (SAPTA) and the South Asian Free Trade Agreement (SAFTA). Both agreements are primarily trade related and were formulated during the course of SAARC negotiations. While other sub-regional and bilateral groupings exist, these are the only truly regional initiatives that can be analyzed to shed light on the RTA-conflict linkage in South Asia.

In particular, we look at RTAs as part of a larger regional integration process. We deconstruct the some what binary question, “Does trade promote or mitigate conflict?” In doing so we attempt to determine whether conflict can be seen as a cause or a consequence of trade. If the former, then can we view conflict mitigation as an outcome of a broader integration process. The analysis addresses two simple questions and is represented by the following schematic:

- Do RTAs promote trade?

- Does trade mitigate conflict?



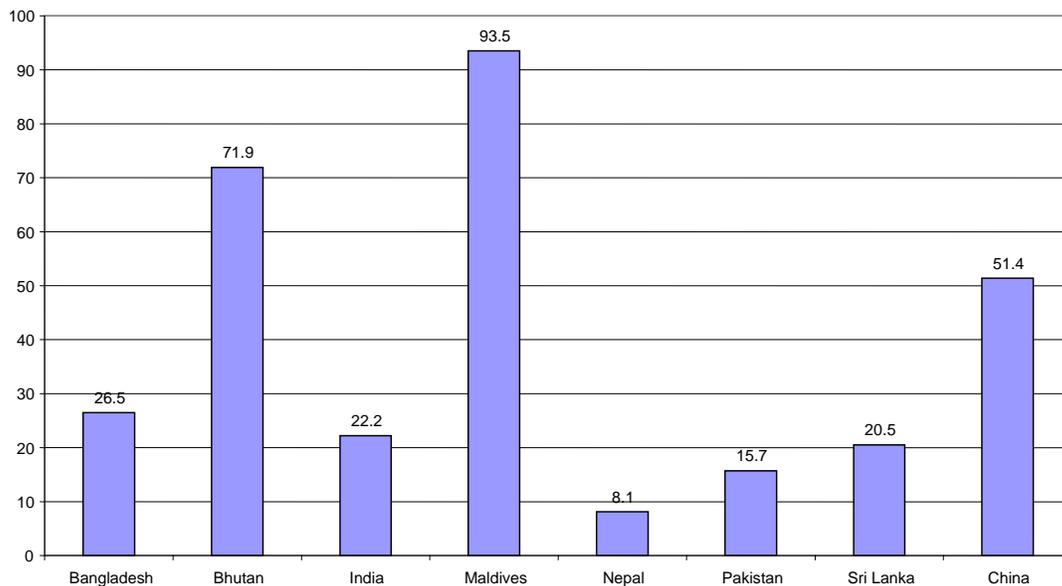
The paper has five sections. Section 2 reviews the history of conflict in South Asia and maps the RTAs. Section 3 examines the causal links between trade and conflict. Section 4 analyzes conflict mitigation within a broader regional integration process. Section 5 concludes with a look to the future.

2. Mapping Regional Trade Agreements and Conflicts

2.1 Conflict in South Asia

South Asia is a conflict prone region subject to continuous political tensions. India, by far the largest country, and geographically centrally located, has developed differences with most of its smaller neighbours. Tensions have tended to recur periodically and have not allowed an atmosphere of mutual trust to prevail. Reflecting these tensions, a recent EU report rates political risk in the context of trade investment in South Asia as high. The report only shows the two smallest SAARC members, Maldives and Bhutan, as highly stable. All other states are considered fragile, with the average stability values falling well below the global average (European Commission 2005)

Figure 1: Political Stability



Note: Higher values imply better ratings

Source: *Governance Matters: Governance Indicators for 1996-2002*, World Bank, 2003.

2.2 Chronology of conflict in South Asia since 1980

A timeline of the history of conflict in the region since 1980 indicates a high incidence of inter and intra-state conflict.

Table 1: Chronology of major conflict in South Asia

Inter-state conflict				
Year	India-Bangladesh	India-Sri Lanka	India-Nepal	India-Pakistan
1985	Muhurichar Island conflict			
1987		Indian Peace Keeping Force (IKPF) sent to Tamil Nadu to disarm the Tamils		
1988			Tensions over disagreement on transit treaty	
1989		Withdrawal of IPKF demanded by Sri Lankan government		
1991		India boycotts SAARC Colombo summit		
1998				Both countries test nuclear weapons
1999				Kargil conflict in Indian-held Kashmir
2001	Pyrdivah village border conflict			Terrorist attack on Indian parliament blamed on Pakistan, leading to both countries amassing troops along the border
Intra-state conflict				
	Sri Lanka	India	Maldives	Pakistan
1983	Widespread anti-Tamil rioting following the deaths of soldiers in an LTTE ambush.			
1984		Prime Minister Indira Gandhi killed by Sikh body guards after ordering troops to flush out Sikh militants from Amritsar.		
1988			Attempted coup thwarted with the help of Indian commandos	
1990		Kashmiri separatist		

		movement gains momentum		
1992		Hindu-Muslim riots in Ayodhya following the demolition of Babri Mosque		
1993	President Premadasa killed in LTTE bomb attack.			
1999				Prime Minister Nawaz Sharif ousted in military coup led by General Pervez Musharraf.
2004				On-going Waziristan and Balochistan conflict

Source: SDPI in-house compilation, August 2006

An aspect of note is how internal instability and external tensions and conflicts feed off each other to create a cycle of political and economic instability. In the case of India and Pakistan the process is volatile, interspersed by short periods of peace. This was historically true in Sri Lanka and India's case, although the violence appears to have developed an internal momentum and has become more sustained. Intrinsicly, the nexus of intra and inter-state conflicts has delayed internal economic and political reforms, and stalled regional economic integration and trade. We present an overview of conflict in the region, focusing on the post-SAARC period when South Asian countries were making efforts to enhance regional trading arrangements. It is important to note that all bilateral conflicts during this period have been Indo-centric, reflecting to a large extent India's hegemonic aspirations, backed by its military supremacy in the region.

2.3 Bilateral conflicts and tensions

2.3.1 India and Pakistan

Relations between India and Pakistan, the two largest states in the region, embody the permanent regional instability, and to which these countries have contributed in large measure. The two states have been locked in perpetual conflict – either overt or covert, since they gained independence in 1947, constituting the single largest constraint to regional economic integration. The early part of the 1980s was marked by dormant rather than active conflict. Having lost a decisive war to India in 1971 that resulted in the separation of Bangladesh from Pakistan, Pakistan took a more muted, possibly realistic stance on Kashmir, allowing the two countries to address economic and trade issues. Discussions, eventually, led to the creation of SAARC in 1985. However, the underlying intransigence, reflecting the historical, religious and military dynamics, led to a significant deterioration in relations by the late 1980s. The Kashmiri separatist movement gained momentum in Indian Kashmir in the late-1980s. Soon after, Pakistan started providing political and military support to the insurgents. Such support kept the two sides at loggerheads throughout the 1990s. India

continuously blamed Pakistan for the unrest in Kashmir, accusing it of training and sending cadres to join the insurgency (Bose 2004).¹

The security concerns between Pakistan and India peaked in 1998, when both sides tested nuclear weapons, introducing a highly unstable dimension to the security paradigm.² In 1999, Pakistan and India were embroiled in an armed confrontation in the Kargil region of Kashmir. Although the conflict ended in a stalemate, Kargil marked the first conflict between two nuclear-armed neighbours and brought many to realize the potential for a nuclear catastrophe. Tensions reached a new high in 2002 when India blamed Pakistan for having engineered a terrorist attack on the Indian parliament. The two sides found themselves in the midst of a ten-month long stand-off, with a million troops amassed on the Indo-Pakistan border, making this the largest military mobilization in the region's history. Given intense international pressure, a *détente* was finally reached before the conflict escalated (Synnott 1999; Khan 2003).

Amidst continuing tensions, Pakistan and India have made several attempts to initiate a peace process geared towards settling their disputes. Major initiatives were undertaken preceding the Kargil War in 1999, when the two sides signed the "Lahore Declaration", and in 2001 when the Pakistani President Parvez Musharraf made an unsuccessful attempt at initiating a peace bid (Bose 2001). The peace process is the latest attempt by the two sides to seek rapprochement. While the current effort has lasted longer than preceding initiatives, by and large, Indo-Pakistan tensions still remain high. The deep-rooted suspicion between the two sides is unaltered and major outstanding issues remain unresolved. Even if the current peace bid were to stay on track, it would take decades before Pakistan and India begin to trust each other.

2.3.2 India and Sri Lanka

In the 1980s Sri Lanka slowly came under the grip of ethnic conflict between the majority Sinhalese and minority Tamil separatists seeking independence of Northern Sri Lanka. India had a natural interest in the issue, given the sizable Tamil population in Southern India. As early as 1983 India attempted, albeit unsuccessfully, to mediate Sri Lanka's conflict.

Ethnic violence in Sri Lanka led to serious Indo-Sri Lankan tensions as the Indian government openly began to sympathize with the Sri Lankan Tamils. The Liberation Tigers of Tamil Elam (LTTE), a militant outfit, was reportedly funded by the Indian state of Tamil Nadu, a fact tolerated by the central government in New Delhi (India 1995). Moreover, in 1987, when the Sri Lankan government attempted to regain control of its northern territory through an economic blockade, India came to the rescue of the Tamils. In July 1987, India decided to send the Indian Peace-keeping Force (IPKF) to Sri Lanka under an agreement that sought to disarm the Tamils and achieve peace. The agreement caused further resentment among Sri Lankan Sinhalese who saw this as an Indian attempt to establish its hegemony over Sri Lanka. Relations between India and Sri Lanka reached their nadir in 1989

¹ Bose provides a detailed account of the problem in Kashmir.

² Some—albeit pro-establishment—analysts argue differently, claiming that nuclear capability creates a deterrent.

when the Sri Lankan government demanded the withdrawal of the IPKF (Bhasin 2000; Kumar 2001).

Given that the Indo-Sri Lankan tensions climaxed at a time when SAARC was in its infancy, the impact on the regional arrangement was clear. India boycotted the 1991 SAARC summit in Colombo, causing its postponement. When the summit eventually took place, it was an abrupt one-day affair, punctuated by the tensions between the hosts and India (Uyangoda 2003).

Since the early 1990s, whilst maintaining its interest in the Tamil movement, India has refrained from intervening directly. It has also started to officially support the Sri Lankan government's position. Moreover, the two sides have looked to enhance cooperation in other sectors, leading to a significant improvement in their relationship. While the Tamil separatist movement does create minor irritants from time to time, India seems genuinely interested in a peaceful internal solution to the problem. On the whole, Sri Lankan suspicions of India's hegemonic designs have reduced substantially, allowing relations between the two countries to become more cordial.

2.3.3 India and Bangladesh

Despite the fact that India supported East Pakistani separatists, who eventually gained independence for what is now Bangladesh, relations between the two countries have seen-sawed. Although the two sides penned economic agreements and an annually renewable treaty on the contentious issue of water sharing, a number of concerns remain unsettled. A general concern, which Bangladesh shares with other SAARC members, is its suspicion of India's quest for direct influence on its neighbours.

Specifically, in the early 1990s, India-Bangladesh relations deteriorated over a dispute concerning the Farakka Barrage, where India has built a feeder canal to divert water to its side of the river (McGregor 2000). Tensions surface intermittently as no permanent solution to major outstanding issues has been found. In 2001, India and Bangladesh found themselves in the midst of a minor border confrontation. The conflict centered around the disputed border territory near Pyrdiwah village but remained contained to the border forces on both sides (Truce 2001). The river island of Muhurichar is also claimed by the two countries. However, this issue has remained dormant since 1985. In the late 1980s, India sought to build a fence on the Indo-Bangladesh international border to stop illegal immigrants from pouring into West Bengal. This issue has assumed serious proportions in the recent past as the west-bound influx has increased (Bowring 2003). Lately, India has also accused Bangladesh of being sympathetic towards Pakistan and acting as a conduit for anti-India terrorist operations. Bangladesh, on the other hand, blames India for supporting anti-Dhaka, Chakma insurgents.

2.3.4 India and Nepal

The Indo-Nepal relationship has also been fraught with tension although the two sides have not allowed their overall relationship to be held hostage to their differences. The Indo-Nepal equation is a classic example of big power-small power political maneuvering with the smaller power, Nepal, trying its utmost to retain an independent posture, despite being

economically dependent on India. The bulk of the problems between the two sides are grounded in economic concerns.

Indo-Nepal relations were quite strained when SAARC was formed. India had denied Nepal's bid to be declared an international security zone (Murthy 1999). Nepal's acquisition of Chinese weaponry met with a strong official protest from the Indian government, worried about losing its influence in Katmandu. In 1988, Nepal refused to accommodate Indian demands on the long-standing transit treaty between the two countries. Nepal took a hard-line approach, and after the expiration of the treaty in 1989, faced an economic blockade from India, a development that led to further escalation in Indo-Nepal tensions (India 1995).

More recently, a conciliatory strain in bilateral relations has emerged. Although India and Nepal also have an outstanding territorial dispute on a 75 square kilometer area, the issue has not impacted Indo-Nepal relations to any significant degree (International Boundary 1998). Since the early 1990s, Nepal's worsening economic and political situation has forced it to seek rapprochement with India. In 1990, the special security relationship between the two countries was restored and in the mid-1990s, fresh trade and transit treaties were signed along with other economic agreements (Murthy 1999). India has also supported the Nepalese government in its fight against the ongoing Maoist rebellion in the country, a fact that has further improved relations between the two countries.

2.3.5 Relations between other SAARC members

Apart from tensions between India and its neighbours, other SAARC members have, by and large, maintained conflict-free relations. Since SAARC was initiated, there have been no noticeable conflicts between any member states except India. In fact, India has often been wary of designs of smaller states to 'gang up' in order to neutralize its influence. This has added to mutual suspicions between smaller members and India. Indeed, countries like Sri Lanka have turned to Pakistan to offset setbacks in relations with India. In 1999, Sri Lanka acquired military assistance from Pakistan to defend against possible aggression from the Tamil rebels at a time when New Delhi refused to come forward with such assistance (Uyangoda 2003). India has also blamed Bangladesh for allowing Pakistani intelligence to function on its territory and for acting as a base for terrorist attacks inside India, an allegation it levies against Pakistan as well. Nepal-Bangladesh relations have also been cordial, as Katmandu has attempted to neutralize some of New Delhi's influence by entering into various agreements with Dhaka.

2.4 Intra-state strife in South Asia

In addition to the inter-state tensions that have plagued South Asia, countries in the region have also experienced extended intra-state strife. Further, as mentioned the two should not be viewed in isolation, as they feed off each other in dampening or expanding cycles. With the exception of the Maldives and Bhutan, intra-state conflict has been almost endemic to other SAARC member states. India has long battled the insurgency in Kashmir that was initiated by Kashmiri Muslims opposing New Delhi's rule. In addition, during the 1980s, India experienced a strong separatist movement, "Khalistan", in the state of Punjab. Resistance to Delhi's rule also exists in pockets based in Nagaland in the country's North

East (Sahadevan 1999). Of these, the Kashmiri struggle is by far the most threatening, seriously affecting Indo-Pakistan relations.

Pakistan has had its share of internal conflicts. Since SAARC came into existence, the principal problems have been sectarian in nature. Sunni-Shia violence peaked in the aftermath of the Afghan jihad in the early 1990s.³ Although conditions have improved, sectarian violence continues to erupt periodically. Recently, the inflexible centrist policies of an army-dominated government have reignited the dormant nationalist movement in Balochistan (Hussaini 2005). The “Talibanization” of the Federally Administered Tribal Areas (FATA), a large swathe of the NWFP, also reflects converging resentment against central government neglect and its pro-US stance.

The Sri Lankan ethnic conflict between the Sinhalese and Tamil separatists has already been discussed. The conflict continues and despite numerous attempts at peace talks, including third party mediation, most notably by Norwegian government, no breakthrough has been achieved. While violence is intermittent, it escalates periodically, keeping the state unstable.

Since 1996, Nepal has been threatened by a well-organized Maoist rebellion that is challenging the country’s monarchy (Thapa and Sijapati 2003). The rebellion is one of the major factors responsible for the deterioration of the Nepalese economy. While initiatives to accommodate the Maoist demands have been undertaken, none have satisfied the rebels. Consequently, the rebellion remains active and continues to threaten the center through constant targeting of state functionaries.

Bangladesh has had to mobilize counter-insurgency operations against the Chakma insurgents in the Chittagong Hill Tracts. The area has been quite turbulent in the past, with the insurgents demanding regional autonomy from the center. With the exception of intermittent periods of high tensions, the government has managed to contain the aspirations of the insurgents. In 1999, a peace accord was signed between the Awami League government and the insurgents under which increased autonomy was to be provided. However, resentment on the lack of implementation of the accord still exists. Consequently the goal of finding a permanent solution remains elusive (Chowdhury 2002).

Maldives and Bhutan have by and large remained free of internal strife. Maldives did however foil a coup attempt in 1988 with assistance from Indian paratroopers and naval forces (India 1995). It has also recently been confronting constitutional differences among political actors (European Commission 2005). However, none are significant enough to destabilize the state.

2.5 Mapping South Asian regional trade agreements

2.5.1 Cooperation despite conflict

Regional integration in the form of economic cooperation and political harmony are mutually reinforcing. ASEAN + 3, APEC and ASEM in Asia have led to improved relations between East Asian countries. Without regionalism and inter-regionalism, Japan’s relations

³ In the province of Punjab, official figures indicate 776 deaths from 1990-2001. *The News*, May 18, 2002.

with its neighbours would have been even more problematic, and regional as well as interregional forums have provided the framework for personal meetings between Japanese ministers and their Chinese and South Korean counterparts, which would not have been possible on the bilateral level.⁴ The success of the EU has demonstrated that regionalism, even on such a wide scale, can be instrumental in overcoming historical animosities, embedding democracy and the rule of law, thus guaranteeing regional security and leading to overall stability. Economic integration has come to be regarded as an important tool for diplomacy and conflict mitigation.

The idea of regional cooperation in South Asia had come under discussion at three conferences: the Asian Relations Conference in New Delhi in April 1947, the Baguio Conference in the Philippines in May 1950, and the Colombo Powers Conference in April 1954. However, the idea did not take root with the leadership of the region until President Zia ur-Rehman of Bangladesh shared his 'Working paper on Regional Cooperation in South Asia' with the heads of states of South Asia in November 1980. A variety of reasons contributed to the success of President Zia ur-Rehman's initiative.

The new regimes in the region displayed more accommodative diplomacy than their predecessors. However, a renewed, more open stance towards foreign relations was not the only impetus for cooperation. External pressures were being felt by the leaders of South Asia. The North-South dialogue seemed to be failing, resulting in more protectionist attitudes being adopted by the North. The 1979 oil crisis put pressure on South Asian economies which were already suffering from balance of payments difficulties. The 1979 Soviet invasion of Afghanistan put the security of South Asia at risk and provided the leaders with another reason to have closer ties in order to foster understanding of common problems and conflicts before they spun out of control. At this critical juncture, a report by the Committee on Studies for Cooperation in Development in South Asia (CSCD) identified many feasible areas of cooperation between the countries of South Asia (Dash 1996).

Despite these commonalities, the inter-state relations of India and Pakistan, the fear of India as a hegemonic power felt by its neighbouring countries, and India's fear of a hostile small-country coalition had to be accounted for in all steps towards integration. In view of this lack of trust, the first proposal showed remarkable foresight in ensuring its acceptability and avoided all political and controversial matters, and rather identified areas of cooperation that were truly regional in nature. Moreover, it adopted an incremental approach to integration. As a result, between 1980 and 1983, four meetings at the foreign secretary levels took place to establish the principles of organization and narrow down areas for cooperation. Three years of preparatory discussions at the official level culminated in the first South Asian foreign ministers' conference, held in New Delhi in August 1983. At this meeting the Integrated Program of Action (IPA) on the mutually agreed areas of cooperation of agriculture, rural development, telecommunications, meteorology, health and population control, transport, sports, arts and culture, postal services and scientific and technical cooperation was launched, which was the first step towards establishing SAARC.

⁴ Interregionalism: A New Diplomatic Tool, The European Experience with East – Asia by Dr. Michael Reiterer

2.5.2 SAARC

The establishment of SAARC in South Asia aimed to bring stability to South Asia by enhancing regional cooperation. SAARC was the first formal initiative that sought to bring the countries of South Asia to the same platform with the aim of promoting the welfare and quality of life of its people through accelerated economic growth, social progress and cultural development in the region. In addition, SAARC aims to strengthen cooperation of member countries with other developing countries, to strengthen cooperation among the member countries in international forums on matters of common interests and to cooperate with international and regional organizations with similar aims and purposes.⁵

While the charter of SAARC promotes active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields, the main thrust of regional efforts has been directed towards economic integration. South Asian leaders recognized that opening their economies to trade and investment, especially with neighbouring countries, could lay the groundwork for bringing peace to the conflict-ridden region of South Asia.

All activities that are undertaken within this framework are governed by the overarching principles of *sovereign equality, territorial integrity, political independence and non-interference in the internal affairs of other States*. On the one hand, mutual benefit is a primary consideration; the sovereign equality condition weighs in against powerful countries leveraging their power against weaker countries. On the other hand, member states can not involve themselves in bilateral conflicts within the region. The clauses on territorial integrity and non-interference in member countries' internal affairs rules out SAARC's role as a peacekeeper. Its charter states explicitly that *bilateral and contentious issues shall be excluded from the deliberations of SAARC*. This clause effectively keeps inter-state conflict off the table in all member-to-member interactions.

2.5.3 SAPTA

The South Asia Preferential Trading Agreement was signed in 1993 and expired on 31st December 2003. This agreement dealt exclusively with trade in goods and was the first step in the establishment of an economic union. Under SAPTA, member countries extended concessions on tariff, para-tariff and non-tariff measures in successive stages. They were free to liberalize trade at their own pace and select the items they offered to liberalize. The agreement made provisions for establishing a Committee of Participants, consisting of representatives of all contracting states as the monitoring body of SAPTA, to review the progress made by SAPTA, and ensured that the gains from trade were shared by all contracting states. The Committee of Participants (COP) also acted as the dispute resolution body for SAPTA.

The agreement included several provisions giving special treatment to Least Developed Countries (LDCs). For instance, support to LDCs involved the identification, preparation and establishment of industrial and agricultural projects in their territories, which could

⁵ SAARC secretariat

provide the production base for exports to other contracting states. The combination of special treatment with the monitoring role played by the COP ensured, in theory, equitable gains from trade. SAPTA also contained anti-dumping clauses which suspended concessions to the perpetrators of such dumping. The intent behind such measures was to ensure fair trade for all member states, and eliminate potential conflicts/tensions between member states based on skewed economic power relations. SAPTA also allowed countries to withdraw from the agreement in case they faced balance of payments difficulties. This provision aimed to minimize intra-state economic disruptions. Also, SAPTA deferred to other bilateral, multilateral and plurilateral agreements that contracting countries were signatory to. In doing so it sought to harmonize itself with other agreements.

Despite the inclusion of these measures SAPTA proved to be structurally weak in addressing trade-related disputes. This was most likely in recognition of the fact that the more powerful member states would not agree to embedded rules-based institutional and legal mechanisms for dispute settlement. The documented cases where such settlements were attempted involved bilateral dialogues. When the matter could not be resolved this was deferred to the COP, which issued decisions which were neither time-bound nor legally binding. Essentially, the COP developed its own procedures for dealing with contentious issues on a case-by-case basis.

2.5.4 SAFTA

SAFTA came into force on 1st January 2006 and is the most comprehensive mechanism that strives towards intra-SAARC economic cooperation. In contrast to SAPTA, SAFTA has a well-defined approach to trade liberalization. It specifies time-staggered tariff reductions for each member country. Thus, India and Pakistan are mandated to reduce tariffs from existing levels to 20 percent within two years effective January 2006. Subsequently, they are to come down to 0-5 percent from 2008 to 2013. For LDC members, the tariff reduction schedule is more flexible. They are to reduce their tariffs to 30 percent in the first two years of the agreement. The time period for the second stage of reductions, at the end of which tariff levels are to be reduced to 0-5 percent, is eight years, i.e., achieved by 2016. In the same vein, regarding trade-related dispute resolution, SAFTA goes a step further than SAPTA in stipulating that the anti-dumping and safeguard provision of SAFTA cannot be invoked against a product originating in a LDC, provided its share in exports to the contracting country does not exceed 5 of its total imports.⁶

A more comprehensive agreement than SAPTA, SAFTA addresses a broader range of trade-related issues, such as the harmonization of standards and certification, customs clearance procedures and classification, transit and transport facilitation, rules for fair competition and foreign exchange liberalization. Both with respect to its fair trade provisions and the broadening of its economic agenda, SAFTA offers better prospects than SAPTA for improving relations between the member countries, albeit through a similarly indirect route. In the intrastate context, countries are allowed to maintain higher tariffs for sensitive lists of commodities (industry protection) and pull back from the agreement due to balance of payments difficulties. While this flies in the face of liberalization, it does underscore the fact

⁶ <http://www.saarc-sec.org/main.php?id=12&t=2.1>

that SAPTA is sensitive to national economic concerns and aware that these can affect a country's political stability.

SAFTA's dispute settlement mechanism is substantively similar to SAPTA – if anything there are more tiers of consultations, involving a Committee of Experts (COE) and the SAFTA Ministerial Council (SMC). However, much as in the case of SAPTA, no institutional or legal mechanisms for dispute settlement exist and both the COE and the SMC will continue to devise procedures on a case-by-case basis.

In a relatively explicit intrastate security context, the agreement includes a clause on *national security* where states are not to be forced to take any measures that compromise their national interests. This effort to allay domestic political sensitivities can also assure buy-in to the agreement. In addition, the General Exceptions clause deals with animal and plant life and health, and articles of artistic, historic and archaeological value. Attention to these areas helps in building peoples' confidence that SAFTA does not threaten but safeguards their quality of life.

The matrices below indicate the presence and importance of trade, conflict and conflict-related (governance) language in the RTAs, bilateral, sub-regional and extra-regional agreements.

Trade and conflict language							
Regional Trade Agreements	Trade	Dispute settlement			Conflict mitigation/resolution within member states	Security clauses	
		Consultation	Arbitration	Decision by established body		General security exception ⁷	Cooperation on specific security concern
<i>SAARC</i>	○		-			-	
<i>SAPTA</i>	●	●	-	●	-	-	-
<i>SAFTA</i>	●	●	-	●	-	●	-
Bilateral agreements							
<i>India-Sri Lanka</i>	●	●	-	○	-	●	-
<i>India-Nepal</i>	○	●	-	-	-	○	-
<i>India-Maldives</i>	○	○	-	-	-	○	-
<i>India-Bhutan</i>	●	●	-	-	-	○	-
<i>Pakistan-Nepal</i>	○	○	-	-	-	●	-
<i>Sri Lanka-Nepal</i>	○	-	-	○	-	-	-
<i>Nepal-Bangladesh</i>	●	○	-	-	-	●	-
Sub/extra-regional agreements							
<i>BIMSTEC</i>	●	●	-	●	○	●	-
<i>SAGQ</i>							

- Mentioned in sufficient detail to be implemented under the agreement
- Mentioned in agreement but with minor detail; No implementation procedure provided
- Not mentioned in agreement

⁷ A General Exception Security clause allows the Contracting Parties to violate the Agreement in case of threat to national security

Conflict-related (governance) language					
Regional Trade Agreements	Rule of law	Transparency	Property rights	Democracy	Human rights and gender issues
<i>SAARC</i>	-	-	-	-	o
<i>SAPTA</i>	-	-	-	-	-
<i>SAFTA</i>	-	-	-	-	-
Bilateral agreements					
<i>India-Sri Lanka</i>	o	-	-	-	-
<i>India-Nepal</i>	o	-	-	-	-
<i>India-Maldives</i>	-	-			
<i>India-Bhutan</i>	-	-	-	-	-
<i>Pakistan-Nepal</i>	-	-	-	-	-
<i>Sri Lanka-Nepal</i>	-	-	-	-	-
<i>Nepal-Bangladesh</i>	o				
Sub/extra-regional agreements					
<i>BIMSTEC</i>	-	-	-	-	-
<i>SAGQ</i>					

Recent economically-focused agreements do not contain text which addresses conflict resolution measures in parallel with trade, let alone dispute resolution mechanisms. While bilateral agreements have improved relations and are in theory capable of containing tensions, normalizing relations and addressing common security interests (border and peace treaties), their effectiveness in addressing all of these issues within one agreement, based upon economic development and trade aspirations, is questionable. A review of the text of recent bilateral agreements (see section 1, matrix 1) reveals that the majority of the language of bilateral trade arrangements does not mention dispute resolution, let alone conflict mechanisms. While bilateral agreements of all categories are capable of addressing inter state conflict, their ability to address intra state conflict – which plagues South Asia as a result of class, ethnic (Vanhanen 2004), political (Sahadevan 1999), religious and social divisions, remains questionable.

During SAARC's inception, South Asian leaders realized that political relations on regional integration could stall regional economic cooperation. Consequently, as indicated earlier, bilateral issues were kept out of SAARC's purview to prevent political tensions between members from stalling the initiative. Today, the absence of recourse to deliberate upon bilateral political relations has become a major concern for member states. Realizing the negative impact of political tensions on trade arrangements in the region, some analysts have called for a regional institutional mechanism to contain conflict among members. Others have even suggested the need to amend the SAARC charter to allow it to deliberate upon bilateral issues. As early as 1990, Ariyasinghe had proposed a 'strategic regional security framework' designed to ensure regional security in South Asia. No progress has been made on this front, and realistically such a development is not on the cards any time soon. Member states, particularly Pakistan and India, must find means outside of the SAARC arrangement to resolve their differences.

Two key points emerge. First, the incidence of inter-state and intra-state conflict in South Asia is high and shows no signs of abating. Second, RTAs have not been designed explicitly to mitigate inter and intra-state conflicts and tensions. As the mapping shows, these RTAs focus primarily on economic cooperation. Having said that the progressively extended economic mandate of the agreements, the concessions built into the agreements for LDCs, sensitive lists and national security clauses which are at odds with the liberalization mandate and dispute settlement mechanisms have both inter and intra-state security implications, even though these are not formally articulated.

In the following section, we explore causal links between the RTAs, trade and conflict looking for answers to the following questions. Have RTAs an economic/trade rationale? Have RTAs fulfilled their mandate in generating intra-regional trade? Conversely, are RTAs a mirror image of regional political developments, and RTA negotiations hostage to what happens on the political front? What has been the role of RTAs in conflict mitigation?

3. RTAs, Trade and Conflict

3.1 Theoretical underpinnings of the trade-conflict linkage

Literature on the issue of RTAs and peace principally draws on two theories, the classical theory of trade and international relations theory. Trade theory is premised on the fact that trade is inherently beneficial for countries as it brings efficiency gains for producers, consumers, and governments. More recent literature carries this argument forward with regard to preferential and regional trade agreements.⁸ Proponents argue that regional trading blocks (through PTAs or RTAs) bring about political stability by increasing interdependence.⁹ By increasing the economic incentive for peace and by providing channels for the non-military resolution of disputes, interdependence may bring amelioration of international or regional conflict, as a welcomed political externality. With respect to intra-state conflicts, trade theorists contend that increased trade spurs domestic economic activity, thus generating employment and reducing unrest within domestic populations.

International relations (IR) theory presents the opposite thesis. It suggests that trade by itself is not sufficient to ensure the absence of conflict. In fact, in certain cases, it can exacerbate conflict. According to IR specialists, the decision to trade or go to war depends on the potential returns from trade and the future expectations of the level of trade. Moreover, a state's choice between conflict or trade is said to be based on relative trade benefits, and not absolute gains as trade theory suggests. If a country perceives the other to gain much more from trading, it would deem it in its interest not to liberalize trade. On the issue of intra-state conflict, IR theory is extended to suggest that the gains from trade are likely to be asymmetrical within the trading countries, given distortions in domestic distribution mechanisms. This increases the likelihood of intra-state strife reflecting the privileged elite's control over the entire resource pie.

The empirical evidence, provided in case studies, supports both views. The liberal approach is substantiated by the cases of Europe and – to a lesser extent – Latin America, where economic inter-linkages have led to a significant decline in conflict between states. On the other hand, in South Asia, less developed regions in Latin America and Africa where regional trading arrangements like the South Asian Preferential Trade Agreement (SAPTA) and South African Development Cooperation (SADC) have been in place for some time, there has been little evidence of political stability. Barbieri (2002) finds a consistent, positive relationship between trade ties and conflict, specifically participation in militarized interstate disputes. Hevre (2002), on the other hand, demonstrates a clear negative relationship between trade and conflict. Reuveny (2000) and Mansfield (not dated) document empirical evidence which points in both directions. Rodrik (2000) demonstrates that the yardstick that matters with respect to internal conflict mitigation is the construction of a high quality institutional environment, rather than trade-openness or consistency with WTO rules. The

⁸ For a discussion of trade theory, see Peter Robson, *The Economics of International Integration* (London: Routledge, 1998). Quoted in S. Akbar Zaidi, *Issues in Pakistan's Economy* (Karachi: Oxford University Press, 2004).

⁹ For a discussion on PTAs, see Rosson, C-Parr, et al., "Preferential Trading Arrangements: Gainers and Losers from Regional Trading Blocs," <<http://www.ces.ncsu.edu/depts/agecon/trade/eight.html>>. Quoted in Zaidi, *Issues*.

divergence of views and empirical results illustrate clearly that the scope for innovative research in the trade-conflict linkage remains considerable.

3.2 Existence of trade complementarities in South Asia: The basis for trade

Recent literature (Wickramasinghe 2001; CUTS 2005; Burki 2004) on South Asian trade indicates significant trade complementarities across the region, highlighting, in particular, the presence of such complementarities in the services sector. Additionally, the literature suggests that increased trade flows are likely to engender technical efficiency, improve resource allocation and allow countries to create niches by specializing in different products within a given industry.

A number of studies have predicted gains from regional trade. Kumar et al (2002) estimate that a complete elimination of trade barriers may increase intra-SAARC trade volumes by a factor of almost two. Another estimate projects the long-term trade increase ensuing from SAFTA at USD 14 billion (FPCCI 2003). A 1993 World Bank study suggested that a free trade arrangement between Pakistan and India could have increased their trade flows nine-fold within a ten-year period (Burki 2004).

Mukherjee (1992) identified as many as 113 potentially tradable items within the SAARC region. These include tea and coffee, cotton and textiles, garments, rubber, light engineering goods, iron and steel, cement, edibles (dry fruits, spices, vegetables), medical equipment, pharmaceuticals and agro-chemicals, among others. Due to existing trade barriers a number of these items are currently imported into the region.

Specifically, in the Pakistan-India context, Pakistan could import pharmaceuticals, textile machinery, light engineering industry items (refrigerators, irons, air-conditioners, washing machines, televisions), sugar, cement, organic and inorganic chemicals, and paper and pulp, which it currently does from elsewhere at much higher cost. Reciprocally, Pakistan could export to India cotton, surgical and sporting goods, leather products, and dry and fresh fruits (see Annex 1 for a comprehensive list of tradable items).

Zones of comparative advantage embrace countries, making trade feasible across these zones. Thus, Sri Lanka, Bangladesh and India all export tea, while Pakistan imports it. India and Bangladesh export jute and jute products to the rest of the SAARC member countries. Pakistan and India produce cotton, which its neighbours require. Similarly, India and, to a lesser degree, Pakistan export manufactured goods within the region.

Informal trade (smuggling) in South Asia is also a good index of trade complementarity. Under free trade, a substantial proportion of informal trade is likely to switch to formal channels. The major items currently being traded informally in the region include cloth of different varieties, cosmetics, jewelry, bicycles, medicines, cattle, sugar, spices, raw cotton, garments, machinery, cement, aluminum, petroleum products, automobiles, tyres and tubes, electrical goods, unprocessed food, rice, and flour.¹⁰

¹⁰ This list has been compiled from Taneja (1999), Khan (*forthcoming*), and Chaudhary (1995).

Bilateral FTAs in South Asia are proof that trade is capturing complementarities between countries. The Indo-Sri Lanka FTA – fears of industry contraction in both countries notwithstanding – has led to a three-fold increase in bilateral trade flows (Thakurta 2006).

3.2.1 Potential investment collaboration

The services sector is potentially a major driver of economic integration. India's dominance in information technology (IT) can be a trigger for profitable affiliations with reputed institutions in India. These can be joint ventures or strategic alliances where skilled professionals from neighbouring countries, especially Pakistan, can be utilized productively (FPCCI 2003; Taneja 2005). Joint ventures between India and Pakistan in the agro sector could be mutually beneficial, especially in processing and packaging, and with the potential to generate 400,000 jobs in both countries (FPCCI 2003).

Energy is another area of possible collaboration. India, the most energy deficient country in the region, stands to gain from investment partnerships with countries with hydro power surpluses, such as Pakistan, Nepal and Bhutan. Pakistan, abstracting from political hurdles, is on line as a conduit for Iranian natural gas to India. Bangladesh's considerable gas reserves have yet to be tapped. Ultimately, over a long-term planning horizon, one could envisage connectivity through a network of energy, gas and oil grids to help lower energy costs (CUTS 2005; Burki 2004).

India's comparative advantage in technical education, the new cornerstone of economic development, can be deployed to the advantage of its South Asian neighbours. Pakistan can mobilize its potential in the areas of irrigation, food preparation and textiles, for a similar purpose (Burki 2004). Other service sectors with promise for regional cooperation are water, tourism and health. In the tourism sector, a joint marketing and management strategy could bring collective gains to the region.

3.3 RTAs and trade growth: Evidence from South Asia

3.3.1 Formal and informal trade trends in South Asia

Despite the indicated complementarities, trade between SAARC countries has remained low. Intra-regional trade in South Asia accounts for a mere 4-5 percent of the SAARC countries' total exports (FPCCI 2003). In contrast to the global trend, intra-regional trade in South Asia has declined dramatically over the past five decades, and has remained stagnant at approximately 2 percent during 1980-2002, a figure lower than most other regional trading blocks (see Annex 1).

Table 2: SAARC intra-regional trade (USD million)

Year	Intra-SAARC trade	SAARC world trade	Percentage
Pre-SAPTA period			
1986	1055	44042	2.4
1987	1146	49480	2.3
1988	1732	52669	3.3
1989	1723	58595	2.9
1990	1590	65490	2.4
1991	1914	63435	3.0
1992	2488	71149	3.5
1993	2458	72211	3.4
Post-SAPTA period			
1994	2937	82839	3.5
1995	4263	103878	4.1
1996	4928	110962	4.4
1997	4447	115370	3.9
1998	6001	123144	4.9
1999	5511	131152	4.2
2000	5884	146924	4.0
2001	6537	143443	4.6

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

Formal trade statistics in South Asia, however, do not reflect the true magnitude of intra-regional trade. A substantial volume of trade flows through illegal channels, either smuggled across borders or transiting through third countries. The total value of informal trade in South Asia is estimated at USD 1.5 billion.

Table 3: India's informal trade with South Asian countries (USD million)

	Exports	Imports	Total Trade
Bangladesh	299.0	14.0	313.0
Sri Lanka	185.5	21.8	207.3
Pakistan	10.3	534.5	544.8
Nepal	180.0	228.0	408.0
Bhutan	31.3	1.2	32.6
		Total	1,505.7

Sources: Chaudhary (1995) for Bangladesh; Taneja et. al. (2002) for Sri Lanka and Nepal; Khan et. al. (*forthcoming*) for Pakistan; Rao et. al. (1997) for Bhutan.

While informal trade volumes are substantial, even the addition of these to formal trade flows does not accurately reflect the true trade potential of the region. This reflects the persistence of tariff and non-tariff barriers which have both suppressed intra-regional trade and diverted it into illegal channels.

3.3.2 RTAs and trade promotion

The explicit linkages between RTAs and trade promotion are to be found in SAPTA and SAFTA which were, as noted, established under SAARC, but whose primary mandate is trade promotion. The combined value of trade (exports and imports) increased from USD 1.24 billion in 1980 to USD 6.5 billion in 2001 (see Table 1). The bulk of this increase occurred during the SAPTA period. As a percentage of total SAARC trade, intra-regional trade increased from 2 to 4.6 percent over the same period. However, this increase should be seen against the back-drop of extremely low absolutes.

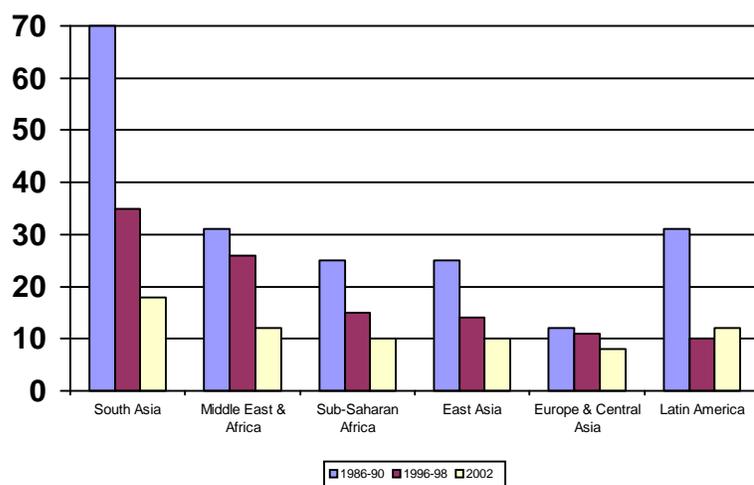
3.3.2.1 Tariff and non-tariff barriers

South Asian economists argue that for significant trade to ensue, all quantitative restrictions and non-tariff barriers should be removed (Mukherjee 2002; Upreti 2000). Second, they point out while many items have been brought under preferential trade, only a handful are actively traded items (Mukherjee 2001). Third, the fears of economic dominance by more powerful partners should be allayed.

While SAPTA has engineered a lowering of these barriers, the low trade response suggests that the measures have to be more drastic. In a dynamic context, trade liberalization needs to be undertaken in conjunction with investment liberalization, as it will foster structural changes in industry. For example, allowing regional competitive advantages and specialization to flourish will build the horizontal and vertical capacities of rising firms, enabling them to compete globally (FICCI 2003). This will then sustain the thrust towards diversification. Also, joint ventures between firms within the region will present a viable way of circumventing trade barriers. It is hoped that SAFTA, with its broader trade facilitation mandate will be able to achieve much of this. Thus far, however, South Asian RTAs have failed to make a lasting impact on intra-regional trade.

Measures that have hindered trade growth in South Asia include both tariff and non-tariff barriers. In fact, South Asia is credited with the highest inter-state barriers to trade in the world. In the early 1990s, Bangladesh's unweighted average tariff was as high as 79 percent, followed by Pakistan at 59 percent and India at 51 percent (Taneja 2004). While the averages have come down significantly and currently stand at around 20 percent, they are still higher than the average in other regional trading blocks.

Figure 1: Comparison of South Asian tariffs with other regional trading blocks



Source: World Bank, WTO, IMF (statistics from various years)

Pursell and Sattar (2004) found India and Bangladesh to be in the top 10 percent of the 139 sampled countries on the basis of unweighted tariffs. In another study that researched all types of border barriers, Kee et. al. (2004) found India to be the most protected economy in the world and Bangladesh the fifth most protected. Moreover, Bangladesh uses “supplementary duties” that often end up doubling the effective tariff. Bangladesh and Pakistan also maintain a substantial negative list specific to India, thus restricting or banning the import of certain potentially tradable items.

Non-tariff barriers are equally high among South Asian countries, and continue to pose major hurdles to intra-regional trade. In the early 1990s India and Bangladesh had the highest non-tariff barrier coverage ratio for primary and manufactured goods. For primary products, India’s ratio stood at 72 percent and Bangladesh’s at 59 percent (Taneja 1999). Moreover, India has employed the anti-dumping measure most frequently in recent times, even surpassing the U.S.(World Bank 2004). Pakistan accuses Indian customs authorities of biased treatment towards Pakistani consignments, as a way of neutralizing the formal MFN status India has granted to Pakistan.¹¹

Table 4: Non tariff measures-coverage ratio of South Asian countries

Country	Non tariff measures-coverage (%)	
	Primary	Manufactured
India	72	59
Pakistan	7	17
Bangladesh	55	47
Sri Lanka	3	4
Nepal	1	1

Source: World Bank (1997).

¹¹ We found this during primary research for Khan (*forthcoming*). Also see, Business Forum (2005).

Further, all South Asian countries are lax in implementing trade facilitation measures. A key aspect of trade facilitation is improving the efficiency of customs authorities. Customs clearance procedures are time consuming. For example, as many as 38 signatures are required to clear a consignment imported into Pakistan (Khan *forthcoming*). In India, an export consignment needs 258 signatures and key punching can take up to 22 hours (Roy 2003). The average time required to clear Indian and Bangladeshi customs is about 3 times that in the developed world (World Bank 2004). In short, the high tariff and non-tariff barriers in South Asia have stunted trade growth significantly and have led to trade leakages to extra-regional sources.

A related concern specific to RTAs is whether they actually contribute to the creation of new trade or simply divert extra-regional to relatively high cost intra-regional trade. In the latter case, the potential productivity gains from RTAs would be lost, the cost for the importing country would increase and it would end up foregoing tariff revenues (World Bank 2004). High existing tariffs pre-SAFTA have implications for trade diversion. An initial reduction from these high levels would probably lead to trade diversion. South Asia has efficient low cost producers in the region who have been rendered uncompetitive due to the existence of trade barriers, both open and hidden. In fact, presently a large percentage of South Asian imports are from outside the region and at much higher cost. For example, Sri Lanka currently imports railway coaches from Romania forgoing the much cheaper alternative available in Southern India. In cement and ship building Sri Lanka trades with South Korea instead of tapping the cheaper options in Pakistan and India (Dash 1996). Pakistan imports iron ore and textile machinery at a higher cost than are available from India. Existing tariff barriers also drive up local input costs, thus making South Asian exports more expensive in relation to sources outside the region. The removal of these tariffs would lower input prices and give an additional competitive boost to manufactured goods produced within the region. However over the long run, when tariffs fall to zero, trade creation is likely to kick in. The caveat to this is that a free trade regime is not a realistic possibility and that SAFTA contains sensitive lists which will continue to ensure industry protection.

3.3.3 Global and multilateral institutions: Trade leakages outside the region

The SAARC member countries have continued reforms within World Bank and IMF conditionalities. They have, in various degrees, introduced trade, industrial and investment policy reforms. The reforms include reductions in tariff slabs, tariff rates, quantitative restrictions, establishing export processing zones for FDI, joint venture arrangements, fiscal and financial incentives to industry and currency convertibility. These reforms have contributed in large measure to the growth of trade with the North.

Although trade has increased between some member states (growth increases have been most dramatic between Bangladesh–India and Sri Lanka-India.), trade within the region has been increasingly dwarfed by trade with outside nations. The largest trading partners are North America and the European Union followed by East Asia and Australasia (in the case of Bangladesh). Only 4-5% of the region's total trade is within the SAARC region.

In order to counter these leakages and restore parity in intra-regional trade, RISNODEC (2004) proposes equivalent measures within the region, such as pushing regional economic integration more holistically via the creation of a customs union, as envisaged under SAFTA.

It also proposes to diversify extra-regional trade to countries such as China in order to obtain better terms of trade for South Asian products.

On balance, while trade volumes have increased in the region, they are low in absolute terms – the lowered trade barriers associated with the global push towards liberalization diverting a substantial portion of the trade outside the region and towards the north. This trend is exacerbated by the persistence of intra-regional trade barriers.

3.4 Exploring the causality between trade and conflict

3.4.1 From conflict to trade

Existing literature is reticent in exploring the direction of causality between trade and conflict. Interestingly, the South Asian case inverts our hypothesis that trade promotes peace. The paradigm here seems to be that conflict hinders trade and economic integration. As with other developing nations in Latin America, Africa and the Middle East, South Asia illustrates that economic liberalization cannot serve as the sole driver of peace within the region (Ades and Chua 1997). In fact, political stability is a pre-requisite for instituting and locking in economic liberalization measures, an environment that South Asia has not been able to develop.

Trade growth has been negatively affected by inter-state conflicts in the region. While it is more difficult to establish a direct link between intra-state strife and stunted trade growth, there is little disagreement that almost all major intra-state tensions in South Asia have had spill over effects on inter-state relations. Ethnic violence in Sri Lanka caused disruption of the Indo-Sri Lankan relationship, the Kashmir struggle has put Pakistan and India at odds, and the Bangladesh insurgency has strained relations between Bangladesh and India. Intra-state strife has punctuated (in the Sri Lankan case it was the principal factor) inter-state tensions, and thus played a significant role in curtailing growth of trade flows within the region.

An analysis along a time-line explains the link between inter-state conflicts and trade relations within South Asia. SAPTA's below par performance can be attributed to the fact that in the early 1990s, tensions between most conflict prone members had escalated, thus slowing down the process of economic integration. SAPTA only attained modest improvements as a number of potentially tradable items that were perceived to favor the other party were intentionally left out during negotiations. Political tensions between member states also delayed the finalization of the SAFTA agreement. The Agreement, initially planned to be finalized in 2001, was signed after a three-year lag in 2004 (Bhandara 2001). Just as SAARC came about at a time when the Pakistan-India conflict was dormant and no other major conflict was active in the region, SAFTA has also been finalized utilizing the rare window when no SAARC member state is embroiled in conflict.

Further, political tensions and mutual suspicions between SAARC members have not allowed SAARC's negotiation procedures to be decentralized. Given the mistrust between member states, regional cooperation is mainly dealt with by the ministries of foreign affairs where perceptions of national security normally dominate political decision-making. No

country has allowed the institutional framework to be widened to line ministries, such as finance, labor and transport, which would make SAARC processes more relevant to domestic agendas. It would also help to consolidate, through provincial and district committees, better sub regional understandings at the village and district level in adjacent/cross border communities. However, it remains clear that political stability and mutual trust are needed before such decentralization could come about and offer hope of real progress on regional economic integration.

3.4.2 Bilateral agreements: From trade to conflict mitigation

Formal trade agreements have materialized between countries in an effort to bypass the political logjam stalling movement on the RTAs. Part of this momentum has been generated by India's desire to leverage its economic size and influence over its neighbours. While smaller countries, such as Bangladesh, Nepal and Sri Lanka, have complied in an effort to circumvent the Indo-Pak induced SAARC stalemate, increased trade with their larger neighbour has also created fears of Indian economic and cultural domination. The outcomes are ambiguous; in some cases, there is evidence that the ensuing trade has improved bilateral relations, while in others, political obstacles continue to hinder both bilateral agreements and bilateral trade once these agreements are in force.

Thus, India signed an FTA with Sri Lanka in 1998 (European Commission 2005) and a new trade and transit treaty with Nepal in the mid-1990s. India also entered into a free trade agreement with Bhutan, one of the only two SAARC members which have not had any substantial disputes with India (European Commission 2005). The only two major SAARC members which have not concluded any trade pact with India are Pakistan and Bangladesh. Pakistan is yet to grant India MFN status. While the ongoing peace process has engendered improved trade ties between the two countries, Pakistan is still reluctant to grant India MFN status. Pakistan continues to view trade relations as secondary to settlement of outstanding disputes, specifically Kashmir.¹² The Indo-Pakistan case is a clear illustration of bilateral trade being held hostage to conflict. Also, despite India and Bangladesh having signed an MFN trade arrangement as early as 1980, political tensions have only allowed for modest trade flows. Bangladesh continues to maintain a restrictive trade regime vis-à-vis India and has refused to trade even in commodities in which it possesses a comparative advantage and in defiance of trade logic. (Bowring 2003). Even in the Indo-Sri Lankan and Indo-Nepalese cases the enhanced trade ties have not led to a permanent settlement of historical political disputes. In fact, trade has hardly impacted political relations. Even today, the long-standing points of contention cause temporary disruption in relations from time to time (see section 2.3).

¹² Trade between the two countries went up six-fold in the current fiscal year, compared to the previous year.

4. Regional Integration Processes

As RTAs have been unable to develop momentum due to persisting regional tensions, their ability to proactively mitigate conflict has been limited. However, concurrent processes are in evidence which aim to promote political stability. These processes reflect intra-regional non-trade, non-economic arrangements and/or pressure by external powers with political stakes in the region. In particular, informal political dialogue and processes from beyond the region are increasingly playing a role in measuring and facilitating peace and conflict mitigation. Both processes can impact intra-state conditions and, in turn, can be impacted by them.

4.1 Internal/regional processes

A series of agreements have been signed over the years between India and its neighbours, with which it shares a history of conflict and tension (See Table 4). One characteristic of the more successful bilateral agreements is that they cover a range of issues that are independent of one another. In the case of Bangladesh and Sri Lanka, addressing ‘foundational’ issues of peace building and border issues early on has been key to relationship building. While earlier agreements cover border treaty, water sharing, religious harmony and peace building issues, more recent agreements involve credit, and economic development (commitments to research and infrastructure cooperation followed by credit agreements and tariff reductions). The Indus Water Treaty between Pakistan and India is an example of one of the region’s water sharing agreements (Iyer 1999) that while threatened by tensions, unresolved issues and possible abrogation, has become a successful instance of conflict resolution (Iyer 2002).

Table 5: Chronology of key bilateral agreements

Nations	Nature of Agreement and Date
India Pakistan	Peace (Place of Worship) – 1953, 1955 Border – 1948, 1952, 1955, 1958, 1959, 1960, Indus Water Treaty (1960), 1965, 1965, 1966, 1972, 1974, 1991, 1999 Conflict – 1965, 1966, 1971, 1972, 1973, 1974(2), 1975, 1988 Trade – 1947, 1957, 1960, 1961, 1963, 1974, India Extending MFN, Pakistan declines
India Bangladesh	Border – 1972(2), 1974, 1976, Resource – Farakka 1977, 1982, 1983, 1984, Ganga Water Sharing (1996) Trade – 1972, 1973, 1974, 1980, 1981, 1982, 1988 FTA India Interested, Bangladesh wary of protectionism
India Bhutan	Peace – 1949 Trade – Trade and Commerce (1995)
India Maldives	Border – 1976(2) Trade – 1975, 1981
India Nepal	Peace – 1950, 1953, 1954 Resource – 1958, 1987, Mahakali Treaty (1996) Trade – 1950, 1954, 1958, 1959, 1960, 1964, 1966, 1971, 1973, 1976, 1978(3), 1985, 1987, 1990, 1991(3), 1996, 1999, 2001
India Sri Lanka	Peace – 1954, 1986, 1987, 1989 Border – 1964, 1974, 1986 Trade – FTA (1998), Credit Agreement (2001)

Source: South Asia Foundation <http://www.southasiafoundation.org>, Bilaterals.org <http://www.bilaterals.org>

Formal trade agreements have materialized between countries in an effort to sideline conflict and political tensions. As mentioned, India signed an FTA with Sri Lanka in 1998 (European Commission 2005) and a new trade and transit treaty with Nepal in the mid-1990s. India also entered into a free trade agreement with Bhutan, one of the only two SAARC members which have not had any substantial disputes with India (European Commission 2005).

4.2 External processes

Interestingly, most of the political processes aiming at conflict mitigation in South Asia are externally driven. While intra-regional dialogues are part of the normal diplomatic routine, there have been few internally generated movements geared towards sustained mitigation efforts. In fact, bilateral political issues have been kept out of SAARC's purview to accommodate the sensitivities of member countries. However, in view of the negative impact of political tensions on trade arrangements in the region, some analysts have called for a regional institutional mechanism to address conflict among members. Others have even suggested amending the SAARC charter to allow it to deliberate upon bilateral issues. As early as 1990, Ariyasinghe had proposed a 'strategic regional security framework' designed to ensure regional security in South Asia (see section 2.5).

SAARC's failure has allowed extra-regional forces to step into the political vacuum in South Asia. The peace-process between the Tamil and the Sinhalese factions in Sri Lanka was initiated by Norway and backed by the World Bank and the Asian Development Bank among other financial institutions (Uyangoda 2003). Scandinavian countries have played a significant role in moving the Sri Lankan-LTTE peace process forward through, for instance, the 2002 Memorandum of Understanding. Also international pressure from the US, consequent upon the LTTE being listed as a terrorist organization, has led to a clamp down on financial flows from the Tamil diaspora. In the case of India and Pakistan the peace process began and moves ahead against a backdrop of immense US pressure to settle and resolve bilateral disputes between the two countries. With two nuclear states and a conflict-prone geo-political situation, the international community has every interest in ensuring absence of violent conflict in South Asia. At the same time, however, western involvement can create paradoxes. Thus, the recent US-India rapprochement has alienated Pakistan and threatened a fragile peace, which the US wished to engineer in the first place. Similarly, the Iran-Pakistan-India gas pipeline is a classic example of a promising regional initiative having to be shelved due to external influence. While all regional parties were interested in the project, which analysts believed could provide the much-needed framework for energy cooperation in South Asia, the US influence on India forced it to remain non-committal on the issue. That said, third party mediation by Western countries has, for the most part, prevented violent inter-state conflict in the region.

China, along with ASEAN nations, is likely to be a key player in future South Asian geopolitics. Beijing maintains a military interest in the region due to Sino-Indian territorial disputes and has hosted regular visits by leaders from Nepal, Bangladesh and Sri Lanka to ensure that increased Sino-India relations would not be to their detriment. Beijing remains critical of India's coercive diplomacy and remains cordial with Pakistan through military cooperation. As a result of its relations with SAARC countries, in the capacity of a SAARC

observer, China may become a more formal player in terms of maintaining peace in the region (Malik 2001).

4.2.1 Impact on intra-state conflict

Unfortunately, the impact of externally influenced political processes on intra-state conflict in South Asia has been negative. Such influences, particularly in the case of Pakistan, illustrate how increased outside involvement can result in divergent positions within a nation. On the one hand, the secular elite welcomed US intervention, while those within the lower classes swayed towards more conservative rhetoric from religious quarters. Furthermore, an already weakened state is further undermined due to an increase in intra-state extremist activities. Similarly, increased UN involvement in the Nepalese crisis, facing resistance from the Nepalese government, has further increased the distance between the government of Nepal and the mainstream political parties, as well as the citizens of Nepal (Pradhan 2005).

Interestingly, there have been internal movements from governments across South Asia to negotiate with local extremist outfits in attempts to mitigate intra-state conflict. While at one time, state actors were the only prominent figures in inter and-intra state politics, recent trends show several non-state actors as impacting the political landscape (See Table 5). Recent dialogues between regional and extra regional actors in South Asia have involved militant groups, multi-lateral organizations (ADB – SAGQ) and other political and economic actors that are not central to the operation of the state but are important to the political equilibrium and internal security of the countries. Even though the processes attempt to encompass the needs of all stakeholders, the mere presence of these groups have mitigated and undermined the impact that already weakened states can have on the socio-political environment within which they function. While some South Asian nations have successfully negotiated agreements and arrangements with militant groups (India with the Khalistan movement and Bangladesh with its tribal leaders), the sporadic recurrence of violence throughout the region has raised questions about the effectiveness of the state in mitigating conflict. Various actors have abandoned the state (Such as tribal leaders in Afghanistan and Balochistan) and have opted to pursue their own agenda, irrespective of the conflict and tension that may arise, and despite of the benefits of cooperative arrangements.

Table 6: Key South Asian militant groups

Cause	Contesting Group/Party	Demands
Fear of Loss of Identity (as a result of arbitrary national territorial formation)	Nagas, Mizos, Meiteis, Assamese, Kashmiris, Baluchis	Secession
Fear of Assimilation (out of arbitrary ethnic boundary maintenance)	Bodos, Meiteis, Sikhs, Lhotshampas	Secession or Autonomy
Fear of Marginalization (as a result of out group domination)	Tripuris, Meiteis, Assamese, Gorkhas, Sindhis, Sri Lankan Tamils, the CHT tribals	Secession or Autonomy
Sense of relative deprivation (as result of denial of equality)	East Pakistanis, Sri Lankan Tamils, Mizos, Baluchis, Mohajirs, Sindhis, Assamese, Meiteis, Tripuris, Gorkhas	Secession or Autonomy
Sense of Powerlessness (out of hegemonic majoritarianism)	East Pakistanis, Sri Lankan Tamils, Baluchis, Pakhtuns, the CHT tribals, Sikhs, Assamese, Kashmiris, Dravidians	Secession or Autonomy

Source: Sahadevan, P., 1999, Ethnic Conflict and Militarism in South Asia,

One explanation for the failure of the state's initiatives for mitigating internal conflict is the fact that state spending on the social sector has been limited in favor of deficit reductions and military spending. This creates a double indemnity as high military spending creates regional tensions while, intra-state, social problems remain unresolved because of inadequate financial outlays. Inter-state, too, while external influences in South Asian politics may have ensured absence of violent conflict in the recent past, such influences have not been able to generate permanent solutions to outstanding issues, an inherently unstable situation which allows these conflicts to recur. Electing for arbitration from a third party rather than looking inwards for a solution further prevents the region from evolving into a politically mature and self-sufficient political entity. In this manner, SAARC countries settle for short-term conflict mitigation rather than developing a lasting internal solution that eliminates the cause of the conflict. The efficacy of external processes has its limits, as dispute resolution through mediation or under third party pressure can only *prevent* conflict, not resolve it. For conflict to be resolved permanently, and for long-term peace to be achieved, dispute resolution measures have to be built and institutionalized by the SAARC countries themselves.

5. Looking to the Future

In looking towards the future, it is difficult to compile a series of proven remedies that will solve the increasingly sophisticated web of challenges that constrains peace, stability and development in South Asia. Furthermore, identifying a productive economic role for external actors is daunting, in spite of the evidence presented.

Peace within SAARC remains an elusive goal despite its emergence as a regional entity in the international political system. However, the fact that formal cooperation has survived recurrent setbacks is testimony of the resilience of the organization. The antagonistic nature of relations with large sets of outstanding issues, low levels of intra-SAARC trade and joint economic ventures, inadequate information and infrastructure facilities; independent and largely uncoordinated economic polities pursued by each country in the subcontinent characterize a bleak economic future. Militarization and fundamentalism as competing forms of governance present an equally worrisome regional political paradigm.

International players can increase and contribute to peaceful relations within the region by mitigating the impacts that economic globalization will have on the region's marginalized communities that reside within conflict prone areas. The international community can remedy market failures; it would be naïve to recommend a succinct list of initiatives that would have, with some certitude, a positive impact on mitigating conflict within South Asia. Rather, the international community should continue to engage with all stakeholders in South Asia in a manner that elevates development to include not just economic needs but also social, cultural and religious values intrinsic to the region.

While lessons from the EU and ASEAN prove the benefits of regional integration, there is still a need to shape institutions that, as commentators indicate, are asked to compete and yet cooperate in the neo-liberal political economy (Mukherjee Reed 1997). Durable peace must therefore include the resolution of domestic and long-standing differences. Growth of economic integration will depend on how individual nations deal with contentious issues and remain committed to regional cooperation. Peace also needs to include resolution of the Kashmir issue, border problems, distribution of natural resources and of the corrosive politics that divides Hindu, Muslim, Sikh and Buddhist along with the other religious minorities.

Political analysts have proposed the creation of a SAARC Parliament to offer new types of political interaction that would be an important condition for increasing transactions, linkages and coalitions. This might go beyond the bureaucratic-technical parameters of SAARC and introduce political, moral, cultural and civilizations dimensions of regionalism. Such a parliament could address conflict in the region, take advantage of civil society, incorporate the principal of 'unity in diversity' and incorporate a two-stage development process – where government has high influence – to a level where popular participation is relied upon. Conflict could be managed through three stages: from input (source, latent and manifestation of identified conflict) to management (understanding, containing and negotiating problems) and finally to output (consequences defined and outputs generated and drafted) (Paranjpe 2002).

Shared management of renewable resources such as water can be leveraged within the region (India/Pakistan and India/Nepal/Bhutan) as a focal point for peace building efforts. The evidence points to linkages between environmental factors and security, namely trans-boundary water issues in conflict settings. The environment in the context of conflict can be most effectively defined as resources at risk of depletion, as well as damage that can result from human impact. Such was the case between India and Pakistan during partition with the separation of the Indus river tributaries which Pakistan relied upon heavily. The World Bank mediated agreement can inform a sub-regional grouping to address the water and energy dependency between Nepal, Bhutan and India, and between India and Bangladesh. SAARC could and should serve as a regional vehicle for extending resource management across the region to include Pakistan. Other threats to South Asia's environmental security include acid precipitation, deforestation, degradation of agricultural land, over use and pollution of water supplies and depletion of fish stocks (Homer-Dixon 2001). As international cooperation within Asia is required to address such issues, relevant negotiation must extend beyond South Asia. Cross-boundary conservation efforts to jointly manage resources and conserve natural tracts of ecosystems that benefit the South Asian biome are feasible. For example, the South Asian Seas Action Plan has been developed and, following adoption in March 1995, has been agreed to by the governments of Bangladesh, Maldives, Sri Lanka, Pakistan and India. Data collection between India and Pakistan also exists through the Global Environment Measurement System (GEMS) and the Global Resource Information database (Rajen 2003). While such agreements do enhance people to people contact, they have not been capable in and of themselves of mitigating conflict and easing tensions.

Beneath the political colorations of South Asia, reside the socio economic aspirations of its middle class. Some argue that in order for the region to prosper, a new idea of South Asia will have to emerge and the primary driver will have to be the aspirations of the middle class for something more than private affluence in the midst of public squalor. Hence, social capital building that challenges all of the region's societies and effective collective action within and then across will be the test of whether or not this society emerges (Singh 2005). Other informal political dialogues need to include citizen to citizen contact, which addresses displaced persons following partition (East Bangladesh and West Bengal, the Two Punjabs) and the social and religious values of being able to visit ones homeland, place of birth and ancestral grave sites. Education and cultural exchange should include students, writers, intellectuals and artists to be able to mix and exchange ideas on a new South Asia (Ahmed 2003).

Summing up, SAARC security discourses must be expanded to include political, social and environmental perspectives in order to achieve sustainability (Thakur and Newman 2004). Joint law enforcement, intelligence and linkages with international organizations could suppress violence if linked with broader development objectives that take into account the root causes of violence and the injustices that fan the flames of conflict. The issue then becomes, does socio economic justice (as in, do economic injustices) come close enough to be treated as social injustices such as terrorism? For example, terrorism that results from the building of a dam may result in stemming the tide of development, stalling progress that would lead to additional development and thereby a further displacement of peoples.

The international community can take measures through bilateral agreements and trade by encouraging equitable development within agreements, fair trade and better understanding

of the socio economic and political reality of poorer segments of society. While their current understanding is framed within an economic paradigm that seeks to modernize South Asia at the expense of sustainable development that impacts the poor, a shift towards more all-encompassing development would address concerns and issues within the marginalized classes which is where intra-state conflict manifests itself.

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Annex 1: Intra-regional Export Shares: A Comparison Across Southern RTAs

	1990	2001	Year in force
Latin America			
Andean Group	4.2	11.2	1988
Mercosur	8.9	20.8	1991
Africa			
COMESA	6.3	5.2	1994
SADC	3.1	10.9	1992
UEMOA	12.1	13.5	2000
Asia			
ASEAN/AFTA	19.0	22.4	1992
SAARC	2.4	4.6	1985

Source: UNCTAD, Handbook of Statistics 2002; WTO, International Trade Statistics 2002

Annex 2: Map of South Asia

