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Intra-regional free trade agreements

Implications for regional trade integration in South Asia

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Free trade agreements (FTAs), particularly bilateral ones, whether signed for economic or political reasons, have been burgeoning globally since the early 1990s. This trend is likely to continue in the foreseeable future. Whatever may be the motives for entering into FTAs at the global level, a particularly disturbing trend of signing bilateral FTAs has been emerging in South Asia.

It is, however, necessary to distinguish between two types of FTAs being signed by South Asian countries—intra-regional and trans-regional. The first type includes the Indo-Bhutan Trade Agreement; the Indo-Nepal Trade Treaty; the Indo-Sri Lanka FTA, and the Pakistan-Sri Lanka FTA. The second category includes the Comprehensive Economic Partnership Agreement between India and Singapore, the India-Association of Southeast Asian Nations (ASEAN) FTA; the Pakistan-China FTA; and the Pakistan-Iran Preferential Trade Agreement. There are also other trans-regional agreements in the pipeline. For example, the early harvest programme involving Pakistan and Malaysia is going to be soon converted into a full-blown FTA, while India is negotiating an FTA with the European Union (EU). While such proliferation of FTAs in general can partly be ascribed to the slow movement in regional trade integration within South Asia, the aspiration of some countries in the region to expand market-access opportunities outside the region, combined with the sluggish pace of multilateral trade neogotiations under the World Trade Organization (WTO), seems to have contributed additionally to the second type of FTAs.

Although the second type of agreements could have severe implications for excluded countries within the region[1], the focus of this paper is to discuss the nature and contours of intra-regional FTAs signed by various South Asian countries and analyse the policy implications for regional trade integration within South Asia.

Intra-regional FTAs

The first intra-regional treaty in South Asia with some elements of trade cooperation and which predated the formation of the South Asian Association for Regional Cooperation (SAARC) was the treaty between Bhutan and India signed in 1949. This was followed by the Treaty of Peace and Friendship between India and Nepal in 1950. In 1960, India and Nepal entered into a Treaty of Trade and Transit, which was separated into two treaties in 1978. India and Nepal signed a fresh Treaty of Trade in 1996, which was last revised and renewed in 2009.

However, the recent spurt in FTAs emerged after India and Sri Lanka signed an agreement in 1998, followed by Sri Lanka signing a similar agreement with Pakistan in 2005. There are a few more agreements in the pipeline with Pakistan having proposed to sign an FTA with Nepal, and Bangladesh and Nepal having initiated discussions on the possibility of entering into an FTA. Bangladesh is the only major economy in South Asia which has not entered into any comprehensive FTA within the region, although it too is now planning to initiate FTA negotiations with India. [2]

What follows is a discussion on the contours of the major bilateral trade agreements within the region, their impact on trade flows, and their shortcomings.

Indo-Bhutan Trade Agreement

The Indo-Bhutan Treaty of 1949, which forms the bedrock of the two countries' relations, provides for, among others, "perpetual peace and friendship, free trade and commerce and equal justice to each other's citizens".[3] The trade element has been part and parcel of the treaty since its inception. Bilateral trade between these neighbours is dictated not only by the historical ties between the two countries but also by geographical reality.[4]

In the 20-year period from 1981, Bhutan's exports to India accounted for an average of 86.5 percent of its total exports, and imports from India accounted for an average of 79 percent of its total imports.[5] The share of exports to India in Bhutan's exports has remained more or less the same, averaging 88.7 percent between 2001 and 2007, the most recent period for which data are available (Table 1). However, imports are becoming slightly more diversified with imports from India accounting for, on an average, 74.2 percent in the same period (Table 1), and imports from other sources, in particular South-East Asian countries such as Indonesia, Malaysia and Singapore, rising more rapidly in the recent past.

Bhutan's trade profile has been radically altered in the past decade due to huge investments in hydro-electricity projects, mostly supported by India, which is the monopsony importer of power from Bhutan. The hydro-electricity sector accounts for some 12 percent of Bhutan's gross domestic product (GDP) and 45 percent of its government revenue.[6] According to the latest available data, Bhutan has been exporting a huge amount of electricity to India, with the export value having increased almost five-fold from Nu. 2.35 billion in 2002 to Nu. 10.03 billion in 2007. Electricity exports comprised 44.2 percent of Bhutanese exports to India. Growth of exports of base metals and metal articles, accounting for 27.7 percent of Bhutan's exports to India, has been even higher. Such exports increased by more than five times during 2002–2007 to Nu. 6.3 billion.

Two other factors that have contributed to Bhutan being the only country in the region to have succeeded in maintaining trade surplus with India in the past two years, which do not feature prominently in mainstream discussions, are worth highlighting here.

First, the Bhutanese currency, the Ngultrum, is pegged to and valued at par with the Indian currency[7], which makes it easier to trade without the fear of frequent and/or abrupt changes in prices resulting from exchange-rate fluctuations. Second, by virtue of Bhutan's "extraordinarily warm friendship" with India[8], the latter has accorded favourable treatment to the former in the areas of investment, infrastructure and building of human capital, which has helped Bhutan overcome its supply-side constraints.

Table 1 Direction of Bhutan's trade with India (Ngultrum million), 2001–2007

	2001	2002	2003	2004	2005	2006	2007
Imports from India	6,989	5,479	3,587	10,194	12,795	13,054	15,100
% of total imports of Bhutan	77.7	75.4	88.4	54.7	75.1	68.7	79.4
Exports to India	4,701	5,137	3,322	7,762	9,970	14,488	22,723
% of total exports of Bhutan	94.1	93.8	92.6	93.8	87.6	77.2	81.6

Source: Royal Monetary Authority of Bhutan.

Table 2 Direction of Nepal's trade with India (NPR million), 1991/92–2008/09

	1991/92	1995/96	2003/04	2004/05	2005/06	2006/07	2007/08R	2008/09P
Exports f.o.b	13,707	19,881	53,911	58,706	60,234	59,383	59,267	67,247
To India	1,450	3,682	30,777	38,917	40,715	41,729	38,556	40,964
% of exports	10.58	18.52	57.09	66.29	67.59	70.27	65.05	60.92
Imports c.i.f	31,940	74,455	136,277	149,474	173,780	194,695	221,938	284,571
From India	11,246	24,399	78,740	88,676	107,143	115,872	142,377	163,892
% of imports	35.21	32.77	57.78	59.33	61.65	59.51	64.15	57.59
Trade balance	-18,233	-54,573	-82,366	-90,767	-113,546	-135,312	-162,671	-217,324
With India	-9,796	-20,716	-47,962	-49,759	-66,428	-74143.5	-103,821	-122,928
% of balance	53.73	37.96	58.23	54.82	58.50	54.79	63.82	56.56

R = Revised; P= Projected.

Source: Ministry of Finance, Government of Nepal; and Nepal Rastra Bank.

Indo-Nepal Trade Treaty

The 1996 revision to the Indo-Nepal Trade Treaty, which came about amid special circumstances,[9] contained provisions that reflected the stage of development of Nepal, the weaker partner. The treaty allowed for duty-free access of almost all domestic primary products into each other's markets. For industrial products, the treaty provided for duty-free entry of all Nepali industrial products into the Indian market, except for those on a mutually agreed small negative list. In return, Nepal provided preferential access to Indian industrial products. These provisions led to a massive increase in trade between the two countries (Table 2). The treaty was to be reviewed every five years.

Pressure soon mounted from Indian industries that suffered a setback due to increased competition from Nepali exports. This led to the introduction of the following provisions in the treaty, when it was reviewed and renewed in 2002:

- Stringent rules of origin (ROO) requiring Nepali exports to fulfil the twin criteria of 30 percent value addition and change in tariff heading at the four-digit level of the Harmonized Commodities Description and Coding System (HS) to be eligible for preferential market access.
- Tariff-rate-quotas (TRQs) for four major products of export interest to Nepal, with zero-duty treatment provided to exports up to the quota, and most-favoured-nation (MFN) tariffs applied to exports exceeding the quota. The quotas were imposed as follows: vegetable ghee (1 million tons), acrylic yarn (10,000 kg), copper (7,500 tons) and zinc oxide (2,500 tons).
- Requirement for Nepal to submit the criteria applied for ROO on an annual basis.
- Clear specification of safeguard clauses, which define "injury" with a much more convenient trigger mechanism for the imposition of safeguard duty over and above normal tariff. The safeguard measure provided for in the original 1996 version of the treaty was with respect to an "export surge", which was set in general terms, thus making it difficult for the Indian authorities to prove that "injury" had actually taken place.

After these provisions, particularly the first three, were enforced, Nepal witnessed a significant slowdown in the value of its exports to India (Table 2). It must, however, be noted that the last point mentioned above has not played a detrimental role as the provision has not been invoked so far, although the risk of its invocation and the unpredictability associated with it remain.

While the imposition of quantitative restrictions hit Nepal's vegetable ghee exports hard, the industry's latest woes are of a different making. As a result of the Indian government's decision to reduce tariff on palm oil, the raw material for the production of vegetable ghee, Nepal's exports of this commodity to India nose-dived by 99.6 percent in 2008/09 over 2007/08—from NPR 2.13 billion to NPR 9.1 million.[10]

Besides, there have been complaints about several para- and non-tariff barriers imposed by India on Nepali exports. For example, India imposes a para-tariff of 4 percent under the heading Special Additional Duty (SAD) on imports from all sources. Although this requirement was waived for Nepali exports in keeping with the spirit, if not letter, of the treaty,[11] India has occasionally imposed such duties either for domestic political economy reasons or for purely political reasons, to extract concessions from Nepal on matters completely unrelated to trade.[12]

Although the latest revision to the treaty, made on 27 October 2009, extended the duration of the treaty to seven years, and included some provisions aimed at addressing Nepal's concerns over the imposition of para- and non-tariff barriers, it is doubtful that the changes will provide a major boost to Nepal's exports to India. Skepticism over the real intent of the revised treaty remains.[13]

However, the Nepali side is also not without fault. Although imposition of non-tariff barriers on Indian products is unheard of in Nepal, imposition of various para-tariffs is quite common.[14] Of the five para-tariffs applied by Nepal, the agricultural development fee (ADF) is particularly targeted at Indian products because it was not levied on imports subject to MFN tariff. However, due to Nepal's commitment to phasing out all the other duties and charges as part of its WTO accession commitments, Nepal has started reducing them and the ADF was accordingly reduced from 10 percent to 8 percent in 2007/08. Moreover, a budget announcement scrapped the local development fee with effect from 16 July 2009.

Indo-Sri Lanka Free Trade Agreement

Although the two treaties discussed above have historical roots, the signing of the Indo-Sri Lanka Free Trade Agreement (ISLFTA) is a manifestation of the sheer frustration with the regional trade integration process initiated with the launch of SAARC Preferential Trading Arrangement (SAPTA) in 1993.[15] It was also motivated by India's strategy of entering into bilateral trade agreements with its neighbours to isolate Pakistan, as well as by Sri Lanka's desire to gain a foothold in the largest market of the region. The agreement led to both the countries exchanging much deeper commitments than they did under SAPTA. Even the commitments under the Agreement on South Asian Free Trade Area (SAFTA), which came into force in mid-2006, pale in significance as far as trade-creating effects are concerned when compared to ISLFTA.[16]

The agreement takes into consideration the relatively lower level of development of Sri Lanka, and provides special and differential treatment to the country to help it gain not only additional market access, but also phase in its trade liberalization measures with a higher transition period.[17] This has had a significant, positive impact on not only bilateral trade between these coastal neighbours, but also cross-border flow of investment. While both the countries have achieved high export growth in each other's market, the gain for Sri Lanka is much more pronounced with total exports growing by almost 10 times between 2000 and 2005, although there has been a slight decline in exports since 2006 (Table 3), the reason for which is discussed later.

This agreement too has its own shares of problems. Some of the major contentious issues, mostly related to non-tariff barriers, which have often caused trade friction between India and Sri Lanka, are discussed below.

First, India imposes TRQs on products which account for 58 percent of Sri Lanka's global exports. While the TRQ for tea is 15,000 MT, the same for garments is 8 million pieces. While the TRQ for vegetable ghee was initially fixed at 250,000 MT, India unilaterally reduced it to 100,000 MT later. However, after persistent requests from Sri Lanka and a series of discussions, the original TRQ was restored.[18]

Second, India imposed port restrictions on tea and garment imports. Garments could be exported to India only through four ports, while tea could be exported to India only through two ports: Kochin and Kolkata ports. This partly explains the low quota utilization rate of less than 3 percent for tea.[19] Kelegama and Mukherji (2007) point to the political economy of port restrictions, arguing that: "These two ports are located in tea growing areas and the anti-tea import lobbies are strong and thus resist any foreign tea coming into the domestic market."[20] However, repeated Sri Lankan requests resulted in the relaxation of port requirements for both tea and garment exports in June 2007.[21]

Third, due to the imposition of stringent ROO on the import of CTC (crush, tear, curl) tea from Sri Lanka, the quota utilization rate is very low. There are two ROO criteria that must be satisfied by Sri Lankan tea exporters in order to get preferential market in India. They are:

Table 3 Direction of Sri Lanka's trade with India (US$ million), 2000–2007

	2000	2001	2002	2003	2004	2005	2006	2007
Total imports	600	601	834.70	1,076.17	1,357.88	1,440.27	1,822.07	2,784.99
% change	–	0	39	29	26	6	27	53
Total exports	58	72	168.86	241.14	385.46	559.21	494.06	516.40
% change	–	24	135	43	60	45	-12	5
Balance of trade	-542	-529	-665.84	-835.03	-972.42	-881.06	-1,328.01	-2,268.59
% change	–	-2	26	25	16	-9	51	71

Source: Weerakoon, Dushni and Jayanthi Thennakoon. 2008. India-Sri Lanka FTA: Lessons for SAFTA. Revised Draft Paper. Jaipur: CUTS International, for 2000–2001 and Department of Commerce, Sri Lanka for 2002 – 2007.

domestic value addition of at least 35 percent, and change in tariff heading. While it is not a serious problem for Sri Lankan tea exporters to meet the first criterion because there is hardly any imported input in tea, it impossible for them to meet the second one[22] because tea is such a unique commodity that it does not have any other HS code at the four-digit level other than 09.02.

Fourth, an extra tax of 20.5 percent is imposed in the southern Indian state of Tamil Nadu on imports from Sri Lanka.[23] Sri Lanka's understanding is that since this extra tax is not trade-neutral as it is not charged to the domestic producers based in Tamil Nadu, this violates the principle of national treatment, which is the cornerstone of the FTA. However, India's contention is that since Tamil Nadu charges similar taxes for goods brought into the state from any other state in India, this does not constitute a discrimination targeted specifically at Sri Lankan exports.

These problems are clearly reflected in the direction of Sri Lanka's trade with India (Table 3). Sri Lankan exports to India increased rapidly during the initial period of the implementation of the FTA and peaked in 2005, buoyed by the increase in exports of two commodities—vegetable ghee and copper—by 111 percent that year. However, after the unilateral reduction in the quotas on these products, Sri Lankan exports to India declined by 12 percent in 2006. In the same year, Sri Lankan exports of these two commodities declined by 29 percent.[24] Exports again picked up in 2007 after the original quotas were restored, although the peak exports of 2005 are yet to be realized again.

In order to further strengthen bilateral economic ties between the two countries, India and Sri Lanka decided to enter into a Comprehensive Economic Partnership Agreement (CEPA). Although the agreement should have been signed by August 2008, due to the problems highlighted above and lack of interest among Sri Lanka's private sector, the agreement has been shelved for the time being. This might be an indication that the initial enthusiasm for signing a CEPA has waned in Sri Lanka.

Pakistan-Sri Lanka Free Trade Agreement

Pakistan, which was closely watching these developments in the region, did not want to be left out. Therefore, albeit on a reactive mode, Pakistan too proposed to sign an FTA with Sri Lanka. The agreement signed in 2005 has already come into operation. It follows a format similar to ISLFTA as far as trade liberalization commitments, and special and differential provisions are concerned.[25] There are 697 items on Sri Lanka's negative list compared to 540 items on Pakistan's negative list. Similarly, Pakistan offered 206 items duty-free immediately after the FTA came into operation, compared to 102 items by Sri Lanka. Likewise, Sri Lanka has been given a five-year period for tariff phase-out compared to three years for Pakistan.[26]

Some argue that there are tremendous opportunities for enhancing trade between the two countries.[27] For example, Pakistan has provided duty-free access for up to 10,000 MT of tea exports. It has to be noted that Pakistan is a country that has limited domestic capacity in tea production, but has the highest per capita tea consumption in the world. While Pakistan could have easily imported tea from the two largest producers of tea in the region—India and Sri Lanka—the multinational tea-processing companies based in Pakistan chose to import from Kenya. Therefore, there has been a discernible change in the tastes of Pakistani consumers, a barrier that must be confronted by Sri Lankan exporters head-on through aggressive promotional campaign if they want to capture the Pakistani market.

There are other products of export interest to Sri Lanka which are included in the preferences provided by Pakistan. Sri Lanka can export 200,000 pieces of 21 readymade garment items under HS Code 61 and 62 duty-free, without having to fulfil the ROO requirement. For exports beyond this threshold and up to 3 million pieces, a 35 percent concession on MFN tariff is provided. Similarly, Sri Lanka can export up to 1,200 MT of betel leaves with 35 percent duty concession. Likewise, on ceramic products, Pakistan has offered a duty concession of 20 percent to Sri Lanka without any quota restriction whatsoever.[28]

Pakistan has also received significant concessions from Sri Lanka. For example, Sri Lanka has provided zero-tariff access to pharmaceutical and textiles products, and duty concession on PVC, carbon, machinery and transport items. Similarly, Pakistan can export up to 1,000 MT of potatoes and 6,000 MT of basmati rice at zero duty. Beyond these thresholds, MFN tariffs apply.[29]

However, the impact of the FTA has so far been limited if we compare it with the growth in bilateral trade between India and Sri Lanka after the signing of ISLFTA. Although the FTA became operational from 12 June 2005, the growth in exports from Sri Lanka to Pakistan over the last three years averages 14 percent and the growth in exports from Pakistan to Sri Lanka averages 7 percent in the same period (Table 4). The growth rates are lower than the average increases achieved over the three-year period prior to the FTA coming into operation, at 17

Table 4 Bilateral export trade between Pakistan and Sri Lanka (US$ million), 1999–2008

Exports from	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Sri Lanka	30.816	29.701	24.871	28.842	36.730	39.454	43.556	58.359	55.444	63.298
% change	14	-4	-16	16	27	7	10	34	-5	14
Pakistan	104.573	81.044	74.857	71.325	83.542	134.244	153.736	133.251	161.86	184.790
% change	10	-23	-8	-5	17	61	15	-13	21	14

Source: DOTS Online, www.imf.org.

percent and 24 percent, respectively. This in an indication that the agreement may have some political significance, but its economic benefit is either insignificant or yet to manifest.

Implications for regional trade

There are several economic and political implications of the competitive FTA frenzy that has gripped the region. Some of them are similar to the arguments advanced in the much discussed multilateralism vs. regionalism debate, which have been discussed extensively elsewhere,[30] but need some mention here as well, not least because these discussions need to be situated in a larger theoretical context. These discussions centre around: first, the issue of whether the two modes of liberalization (regional vs. bilateral) are competitive or complementary in nature; and second, the political factors influencing regional cooperation in South Asia and bilateral trade relations among the countries which have signed FTAs with each other.

Nature of trading arrangements

Quite akin to a largely unsettled debate on whether or not regional trade integration is a “building block” or a “stumbling block” to multilateral trade liberalization, a similar argument can be advanced in relation to the spate of FTA formations within the region. Most literature point towards the fact that bilateral FTAs within the region are acting as a “stumbling block” to regional trade integration within South Asia because of the following reasons.

Mini spaghetti bowl

The proliferation of bilateral FTAs in the region is likely to lead to the emergence of a “mini spaghetti bowl” with overlapping rules governing each bilateral FTA, as well as SAFTA and the WTO. This is quite akin to the famous “spaghetti bowl” phenomenon observed by Bhagwati (2002) in the context of regionalism in general.[31] Added to this is the fact that five countries in the region are also members of another trans-regional trading arrangement—the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) FTA. This will not only complicate the trading arrangements within the region, but will also dampen the prospects of using trade liberalization as a tool for enhancing the flow of cross-border investment.[32]

Hub and spoke pattern

There is a clear pattern of “hub and spoke” emerging within the region, a theory developed by Wonnacott (1990), in the context of North America.[33] Applied in the context of South Asia, India seems to be emerging as a hub, with other countries, such as Bhutan, Nepal and Sri Lanka (and probably Bangladesh in the near future) emerging as spokes. One of the major implications of this pattern is the hegemonic role of the hub, which has a power to alter the negotiating dynamics, much to the chagrin of the spokes. Weaker countries, in particular least-developed countries (LDCs), are placed at a disadvantage while negotiating with a much stronger trading partner, as opposed to what they could achieve if all the member countries negotiate on a regional basis. This resembles what is currently happening when developing countries (weaker partners) sign a bilateral FTA with powerful developed countries such as the United States or groupings such as the EU (or the European Free Trade Association, for that matter)—they, more often than not, fall into the trap of making commitments to implement such "WTO-plus" conditions that limit their policy space to address their development needs.[34]

Scarce negotiating capital

Given the scarce negotiating capital at their disposal, particularly in the case of LDCs, each country would be inclined to devote more resources to the agreement which it believes is more beneficial, on the balance, to it. This is bound to have a deleterious impact on SAFTA negotiations, which are becoming less and less attractive for countries which have signed FTAs with India, the largest market in the region.

Trade creation vs. trade diversion

On this issue, described by Jacob Viner (1950)[35], admittedly there has been some “trade creation” particularly between India on the one hand and Bhutan, Nepal and Sri Lanka on the other, although not so much between Pakistan and Sri Lanka, as indicated above.

However, it is equally important to note that there exists potential for "trade diversion", although no study has been conducted so far focusing on this issue. For example, if it is cheaper for India to import readymade garments from Nepal—a relatively high-cost source—due to zero-tariff access, India would not purchase the same from Bangladesh, although the latter is highly competitive in this sector, because it is required to pay MFN or SAFTA tariff to access the Indian market.

Political factors

The political factors behind FTAs can be broadly categorized into two sub-headings: Indo-Pakistan relations; and domestic political economy factors. This has led to fragmented trading arrangements in South Asia and has reduced incentives to strengthen SAFTA.

Indo-Pakistan relations

Rhetoric aside, political relations between these two nuclear rivals have remained sour ever since the creation of SAARC and little seems to be happening on both sides of the border to improve their ties. Even on the trade front, Pakistan having denied MFN treatment to India under SAFTA means that trade between these two countries still operates under a bilateral positive list approach. While the cost of non-cooperation is well documented[36], these countries are still bent on isolating each other from the rest of the region.

India is in a relatively advantageous position because of its market size and geography. Since it shares land or sea border with every country in the region except Afghanistan, it happens to be the largest trading partner in the region for all other countries. Therefore, it is attractive for those countries to enter into a bilateral FTA deal with India. However, Pakistan, which is the second largest market in South Asia, seems to be following a reactive strategy. A manifestation of this is its signing an FTA with Sri Lanka.[37] Although not helped much by geography, Pakistan has expressed its desire to enter into FTAs with other countries in the region, notably Bangladesh and Nepal.

Another example of exclusion is the signing of BIMSTEC FTA, which excludes Pakistan and the Maldives—two original members of SAARC—and Afghanistan, a latecomer. However, this situation is not likely to change dramatically unless and until normalcy is restored in Indo-Pakistan political relations.

Domestic political economy factors

Strong domestic political economy factors hinder the prospects of increased trade despite the signing of bilateral FTAs. The fact that a vocal exporters' lobby has an interest in exploiting the opportunities offered by an (potential) FTA with India is reflected in the way Nepal's FTA with India was crafted in the first place. While "fly–by-night" investors producing goods with little value addition such as zinc oxide, synthetic yarn, copper wire and vegetable ghee benefitted in the initial period after the signing of the treaty, small farmers, who are least organized, had to face the brunt of increased imports of subsidized agricultural products from India.[38]

Another example of the political economy factor at play is India's resorting to various types of non-tariff barriers to prevent imports from countries such as Sri Lanka and Nepal, thus jeopardizing the predictability in trade relations, whenever India is under pressure from its domestic lobby to restrict imports.

The way forward

A fundamental problem with the bilateral FTAs signed by India with Nepal and Sri Lanka is that they are built on a very weak foundation, providing a handful of "fly–by-night" exporters, who have established factories in Nepal and Sri Lanka, with the opportunity to make quick money without contributing to local value addition and generating substantial employment. Frequent and unilateral imposition of non-tariff barriers, besides the short duration of trade agreements (particularly, in the context of Nepal), has made such agreements with India unpredictable. Therefore, even if bilateral FTAs are to be maintained for the time being alongside SAFTA, they should be built on sound economic logic and made more predictable.

Whether dictated by political, economic or geographical realities, the proliferation of bilateral FTAs among South Asian countries does not bode well for the future of regional integration. The "competitive FTAs" and "politics of exclusion" could lead to a situation wherein SAFTA is rendered redundant. One way to break the current impasse is to leave the political issues aside and pursue regional economic cooperation aggressively such that economic imperatives eventually dominate Indo-Pakistan relations, paving the way for an amicable settlement of contentious political issues. Since there is no dearth of literature discussing ways to revive SAFTA, this paper has not focused on this issue. However, it is necessary to note that a gradual pruning of sensitive lists; removal of non-tariff barriers; relaxed ROO for the LDCs of the region and support for strengthening their supply-capacity; and inclusion of services, investment and energy within the framework of regional economic cooperation are necessary to provide a solid foundation for enhanced economic ties among South Asian countries. ■

Notes

[1] See, for example, in the context of the proposed EU-India FTA, Winters, Alan, Peter Holmes, Javier López González, Jim Rollo, Maximiliano Méndez Parra, Michael Gasiorek and Anirudh Shingal. 2009. *Innocent Bystanders: An EU-India Free Trade Agreement and Potential Implications for the Excluded Countries*. London: Commonwealth Secretariat.

[2] Although Bangladesh has signed an FTA with Bhutan, it covers only a limited number of products and hence does not have any major implications for overall intra-regional trade in South Asia. See World Bank. 2008. Bhutan Trade Brief. http://info.worldbank.org/etools/wti2008/docs/brief23.pdf (accessed 12.10.09).

[3] Choden, Tashi. 2004. Indo-Bhutan Relations: Recent Trends. *Journal of Bhutan Studies*, Vol. 11, Winter 2004: 112–128: 114.

[4] The historic trade route from India to Tibet Autonomous Region of China, has been closed since 1959, which, together with the absence of a road link, means that Bhutan's trade with China is almost non-existent (World Bank. 2008. Note 2). [5] Choden. 2004: 117. Note 3.

[6] ADB and UNCTAD. 2008. *Quantification of Benefits from Economic Cooperation in South Asia*. New Delhi: Asian Development Bank, p 12.

[7] ADB and UNCTAD. 2008. Note 6. [8] See Choden. 2004: 121. Note 3.

[9] This was when Indian Prime Minister I.K. Gujral, who had a soft corner for India's neighbours and who propounded the "Gujral Doctrine" which entailed developing friendly relations with neighbouring countries by not following a strict "reciprocity" principle, the hallmark of India's foreign policy prior to, and after, Gujral's premiership. During this time, Nepal also had a democratically elected non-communist government, which had extremely good relations with India.

[10] NRB. Recent Macroeconomic Situation: Based on Annual Data of 2008/09. www.nrb.org.np (accessed 12.11.09).

[11] According to the letter of the treaty, India is only required to provide waiver of basic customs duty.

[12] For this see Faye, Michael L., John W. Mcarthur, Jeffrey D. Sachs and Thomas Snow. 2004. The Challenges Facing Landlocked Developing Countries. *Journal of Human Development 5 (1)*, March: 31–68.

[13] See, for example, Kharel, Paras. 2009. The Devil in Trade Detail. *Republica*. 2 November.

[14] Nepal used to impose para-tariff barriers in the form of: a) agriculture development fee; b) local development fee; c) special duty; d) cigarette and alcohol fee; and e) cigarette and alcohol control fee. See Adhikari, Ratnakar. 2003. Impact of Withdrawing Local Development Fees on Decentralisation Process in Nepal. Report prepared for United Nations Development Programme (UNDP) – Asia Trade Initiatives, Hanoi.

[15] See, for example, Weerakoon, Dushni. 2007. Regional Economic Cooperation under SAARC: Possibilities and Constraints. In Anjum Siddiqui (ed.). *India and South Asia: Economic Developments in the Age of Globalization*. M.E Sharp: Armonk, pp. 234–251.

[16] Weerakoon, Dushni and Jayanthi Thennakoon. 2008. India-Sri Lanka FTA: Lessons for SAFTA. Revised Draft Paper. Jaipur: CUTS International.

[17] Kelegama and Adhikari. 2007. Repositioning SAFTA in the Regionalism Debate. In Anjum Siddiqui (ed.). India and South Asia: Economic Developments in the Age of Globalization. M.E Sharpe: Armonk: 252–266.

[18] See de Mel, Deshal. 2008. Indo-Sri Lanka Free Trade Agreement: Sri Lankan Perspectives. Trade Insight 4(2):11–13; Weerakoon and Thennakoon. 2008. Note 19; Kelegama, Saman and Indra Nath Mukherji. 2007. India-Sri Lanka Bilateral Free Trade Agreement: Six Years Performance and Beyond. Discussion Paper (RIS-DP# 119). New Delhi: Research and Information System for Developing Countries.

[19] Kelegama and Mukherji. 2007. Note 18.

[20] Kelegama and Mukherji. 2007: 27. Note 18.

[21] Weerakoon and Thennakoon. 2008. Note 16.

[22] ibid. [23] ibid. [24] ibid.

[25] Kelegama, Saman. 2006. Sri Lanka's Free Trade Agreement with Pakistan. Daily News. 23 January. http://www.dailynews.lk/2006/01/23/fea01.htm (accessed 09.10.09).

[26] ibid. [27] ibid.

[28] Ministry of Commerce, Government of Pakistan. http://www.commerce.gov.pk/PSFTA (accessed 09. 10.09). [29] ibid.

[30] See, for example, Kelegama and Adhikari. 2007. Note 17.

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[34] See, for example, Montes, Manuel and Ratnakar Adhikari. 2005. Dangerous Liaison. South China Morning Post, Hong Kong, 14 December.

[35] Viner, Jacob. 1950. The Customs Union Issue. New York: Carnegie Endowment for International Peace.

[36] See, for example, CUTS. 1996. Cost of Non-cooperation to Consumers in South Asian Countries: An Illustrative Study. Jaipur: Consumer Unity & Trust Society.

[37] This does not, however, mean that other factors were less important. To be sure, Pakistan and Sri Lanka share an excellent relation at the political and military levels.

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