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DISCUSSION PAPER

REGIONAL INTEGRATION IN THE WTO ERA: SOUTH ASIA AT CROSSROADS

South Asia Watch on Trade, Economics and Environment (SAWTEE)
&
CUTS Centre for International Trade, Economics & Environment (CUTS-CITEE)

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CONTENTS

LIST OF ACRONYMS

AB	Appellate Body
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
APEC	Asia Pacific Economic Commission
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
BBIN	Bangladesh, Bhutan, India and Nepal
BIMST-EC	Bangladesh, India, Myanmar, Sri Lanka and Thailand – Economic Cooperation
CARICOM	Caribbean Community and Common Market
CASAC	Coalition for Action on South Asian Cooperation
CBMs	Confidence Building Measures
CEC	Committee on Economic Cooperation
CIS	Commonwealth of Independent States
COP	Committee of Participants
CRTA	Committee on Regional Trade Agreements
CSCE	Commission for Security and Cooperation in Europe
CSGR	Centre for Study on Globalisation and Regionalisation
CUs	Customs Union
CUTS	Consumer Unity and Trust Society
DSB	Dispute Settlement Body
EC	European Commission
ECOWAS	Economic Community of Western African States
EEC	European Economic Union
EU	European Union
FDI	Foreign Direct Investment
FES	Fredrich Ebert Stiftung
FNCCI	Federation of Nepalese Chambers of Commerce and Industry
FTAA	Free Trade Areas of Americas
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GC	General Council
GDP	Gross Domestic Product
GEP	Group of Eminent Persons
GEP	Group of Eminent Persons
GMSP	Greater Mekong Subregional Economic Cooperation Programme
ICRIER	Indian Council for Research on International Economic Relations
IGEG	Inter Governmental Expert Group
IGG	Inter Governmental Group

ILBFTA	Indo-Lanka Bilateral Free Trade Agreement
IMF	International Monetary Fund
IOR-ARC	Indian Ocean Rim Association for Regional Cooperation
LDCs	least developed countries
LLDCs	landlocked LDCs
MERCOSUR	Southern Common Market
MIT	Massachusetts Institute of Technology
MTNs	Multilateral Trade Negotiations
NAFTA	North American Free Trade Area
NEFAS	Nepal Foundation for Advanced Studies
NTBs	non-tariff barriers
NTMs	non-tariff measures
OECD	Organisation for Economic Cooperation and Development
OPANAL	Agency for Prohibition of Nuclear Weapons in Latin America and the Caribbean
ORC	Other Regulations of Commerce
ORRC	Other Restrictive Regulations of Commerce
OSCE	Organisation for Security and Cooperation in Europe
PDR	People's Democratic Republic
PTA	Preferential trading arrangement
QRs	quantitative restrictions
RIA	Regional Integration Arrangement
RIS	Research and Information Systems for the Non-Aligned and Other Developing Countries
ROO	Rules of Origin
RTAs	Regional Trade Agreements
SAARC	South Asian Association for Regional Cooperation
SACU	South Asian Custom's Union
SADC	Southern African Development Community
SAEU	South Asian Economic Union
SAFTA	South Asia Free Trade Area
SAPTA	SAARC Preferential Trade Agreement
SL	Sri Lanka
TMS	Trade, Manufactures and Services
UBSPD	University Bookstore Publishers' Distributors
UEMOA	Union Economique et Monaitaire de l'Afrique Occidentale
UK	United Kingdom
UN-ESCAP	United Nations – Economic and Social Commission for Asia and the Pacific
UR	Uruguay Round
US	United States
USA	United States of America
USTR	United States Trade Representative

WP	Working Party
WTO	World Trade Organisation

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This Discussion Paper is the sixth in the series of such papers being jointly published by South Asia Watch on Trade, Economics and Environment (SAWTEE), Kathmandu and CUTS-Centre for International Trade, Economics and Environment (CUTS-CITEE) Jaipur, since the year 2000. The major objectives of these papers are to bring critical issues relating to multilateral trading system, globalisation and liberalisation facing South Asia out in open to provoke an informed debate among the key stakeholders.

These discussion papers are being published under a project titled *Progressive Regional Action and Cooperation on Trade (PROACT)* jointly implemented by SAWTEE and CUTS with the support from HIVOS. The programme's objective is to sensitise the stakeholders and build their capacity on trade policy issues from a Southern perspective. The activities included organisation of regional trading workshops, publication of discussion papers, briefing papers and newsletters.

This Paper has been researched and written by Dr. Saman Kelegama, Executive Director, Institute of Policy Studies (IPS) Colombo; and Mr. Ratnakar Adhikari, Executive Director, SAWTEE. It draws heavily on the current literature available both within the region and outside, which have been duly acknowledged. We would also like to acknowledge that this paper would not have been completed without the support of our colleagues and partners, who provided their invaluable comments, which were extremely useful in finalising this Paper.

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EXECUTIVE SUMMARY

As mandated by the Eleventh Summit of South Asian Association for Regional Cooperation (SAARC) held in Kathmandu in early January 2002, the draft treaty of South Asian Free Trade Area (SAFTA) is supposed to be submitted to the forthcoming Summit. Since the text of the treaty (in whatever form) has not been made public so far, it is difficult to tell how it would look like. Some of the major concerns voiced by civil society organisations are as follows: Has it taken into consideration the World Trade Organisation (WTO) requirements for compliance?, Has it taken into account the concerns of least developed countries of the region?, and has it considered the existing format of sub-regional arrangements? The last question is more complex than one thinks because if the bilateral and other trade agreements are going to be integrated with SAFTA then they will have to be the starting point for negotiations which will not be acceptable to all member countries.

At the same time, the dust is yet to settle on the global debate between the protagonists and antagonists of regional trading arrangements (RTAs) [1] as to whether they are building blocks or stumbling blocks for multilateral trade liberalisation. While one school of thought argues that provided members of RTAs are open to the outsiders, they abet multilateral trade liberalisation. However, the concept of open regionalism too has received rough treatment in the past mainly because studies have shown that there is an incentive for RTA members to block the entry of outsiders.

Proponents of another school of thought argue that proliferation of RTAs has resulted in 'spaghetti bowl' phenomenon and they have assumed 'hub and spoke' pattern causing serious damage to multilateral trade liberalisation. However, their arguments too have been criticised on the ground that when the first best option (multilateral trade liberalisation) is not feasible, countries are bound to settle for the second best option (trade liberalisation at the regional level). Clearly, RTAs can never be worse than no liberalisation at all, agreed that they might not be as effective as multilateral trade liberalisation in terms of increasing global welfare.

Keeping aside the economic arguments one has to also look at the legal issues relating to RTAs within the WTO, which seems to have accepted the argument that RTAs are generally building blocks to multilateral trade liberalisation. If that were not the case, RTAs would have never found a place in the legal text of the General Agreement on Tariffs and Trade (GATT).

Legal provisions dealing with RTAs are highly convoluted, reflecting differences of opinion among the trade negotiators and drafters with different backgrounds. While developed countries are only allowed to enter into RTAs as per the conditions outlined in Article XXIV of the GATT and Article V of the General Agreement on Trade in Services (GATS), developing countries can enter into an RTA through a special route called "Enabling Clause" which was agreed during the Tokyo Round of GATT negotiations.

The intention of the drafters of Article XXIV, which was the first ever text to provide legal recognition to the concept of RTA, was to ensure that the RTAs would go all the way to liberalise trade within their member states and do not create barriers to trade for outsiders. Therefore,

liberalisation of "substantially all the trade" is considered as the touchstone for determining the compatibility of RTAs with the GATT/WTO provisions.

However, the procedure for determining the compatibility of RTAs with the GATT provisions has become more complex than anyone had ever thought. By June 2002, a total of 172 RTAs have been notified to the WTO, out of which Committee on Regional Trade Arrangement (CRTA) has provided approval to only two agreements. The decision-making paralysis at the CRTA is due to the fact that this Committee comprises representatives from all the countries with diverse backgrounds often having extreme positions.

South Asian endeavour at regional cooperation as such dates back to 1981, even though the first meeting of SAARC was held in Dhaka in 1985. However, even after 21 years from the date of its conceptualisation, it has not been able to achieve much – neither in terms of increasing intra-regional trade nor in terms of being noticed as a bloc during the multilateral trade negotiations. At times one even wonders whether or not there is a political will to strengthen SAARC as a common forum for all the South Asian countries. Series of bilateral and sub-regional agreements formed among the members of the SAARC are undermining its existence as a credible institution. Moreover, some of the South Asian countries are members to more than three RTAs, which calls into question the commitment of these countries to the cause espoused by SAARC.

SAARC has embarked upon the path of regional trade liberalisation through a preferential trading arrangement, viz., SAARC Preferential Trading Agreement (SAPTA), realising both the benefits of cooperation and the costs of non-cooperation. However, the progress in achieving trade liberalisation has been glacially slow. Although tariff concessions have not been negligible, they have been introduced on items that represent no more than 1 per cent of the total trade of the seven-country grouping.

The Ninth SAARC Summit held in Male in 1997, constituted a Group of Eminent Persons (GEP), which was mandated to undertake a comprehensive appraisal of SAARC and to "identify measures, including mechanisms to further vitalise and enhance the effectiveness of the association in achieving its objectives." It has come out with the proposal for the formation of SAFTA by 2010 and for the eventual formation of South Asian Economic Union (SAEU) by 2020.

However, there is every reason to be skeptical about the possibility of achieving these lofty goals given the considerable backtracking that has taken place over the years. Further, the GEP recommends an across-the-board reduction of tariffs by 12.5 percent annually to achieve their objective of eliminating restrictions on substantially all trade. This is a laudable strategy, but given the protracted product-by-product negotiations, which took place under SAPTA, this may not be acceptable to all member states.

In this context, a few thoughts on political economy of regional integration in the context of South Asia are in order. Firstly, asymmetry in the region is highlighted by some as the major impediment to growth of SAARC as a forum for regional economic cooperation. However, regional groupings like the European Union (EU), North American Free Trade Area (NAFTA), Association of South East Asian Nations (ASEAN) and Southern Common Market (MERCOSUR) have the similar problems and yet they have been able to prosper. Secondly,

lack of leadership is another problem facing South Asia. India, due to its size and economic power should be the natural leader of the region. This view is not shared by many, and Pakistan for one is not prepared to accept it at any cost.

Thirdly, despite all rhetoric on economic cooperation, as long as Pakistan and India remain locked up in adversarial relationship, security issues will dominate over all other issues. Fourthly, there is very little room for the civil society organisations to feed into the SAARC process despite much hype about Track II and Track III approaches. In a process where governments claim the monopoly of wisdom and there is hardly any openness and discussions during the various stages of policy formulation, pitfalls are bound to surface.

Therefore, it is necessary to take a close look at these problems facing SAARC. SAARC need not take a complacent view by stating that Europe took 50 years to achieve Economic Union and ASEAN is talking about achieving an FTA by 2008 only, but rather look for a more realistic path in the current problematic environment. Therefore, the fundamental question this Discussion Paper is trying to address is whether or not the optimism relating to SAARC's future role in promoting economic cooperation is indeed warranted.

We have divided this Discussion Paper into five chapters. Chapter I provides some background (theoretical) notes on regional integration. In Chapter II, we examine the current status of the debate on regionalism, i.e., whether it strengthens or weakens the multilateral trading system that is promoted by the WTO. Chapter III takes a comprehensive look at the WTO rules and regulations pertaining to RTAs. After examining the theoretical background in the first three Chapters, we analyse the ground level situation in regard to regional integration in South Asia and the current status in Chapter IV. In the concluding Chapter, we examine the most pertinent political-economy issues of regional integration in South Asia.

We hope this document will provide some food for thought to various stakeholders keenly interested in regional and multilateral issues surrounding the discourse on regional economic integration in general and that of South Asia in particular.

CHAPTER I

INTRODUCTION

1.1 Background

That the eleventh Summit of South Asian Association for Regional Cooperation (SAARC) directed the Council of Ministers to finalise the text of the Draft Treaty Framework of South Asia Free Trade Area (SAFTA) by the end of 2002 for eventual signing by Ministers did not come as a surprise to the observers keenly watching developments relating to regional economic cooperation in the South Asia region. This was rather considered as a formalisation of a much-awaited decision. If targets proposed by the Group of Eminent Persons (GEP)[2] are to be considered the guide for SAARC, by the year 2010, SAFTA will be fully operational, by 2015 South Asian Customs Union (SACU) shall be formed and by the year 2020, South Asian Economic Union (SAEU) will become a reality. However, the fundamental question this Discussion Paper aims to address is whether or not such optimism is warranted.

The fundamental question this Discussion Paper is going to address is whether or not optimism about regional economic cooperation in South Asia is really warranted

There are a number of sub-questions related to the main question. They are: first, given the political rivalry between the two major players in the region, is it possible to move ahead with the idea of regional integration at all? Does the region have the required capacity and resources (financial, human, institutional and infrastructure related) to handle the regional integration efforts? Given the fact that deeper economic integration requires national government to hand over some of its major policy making powers to a supra-national authority, are the politicians of the region prepared to make such a sacrifice? These are major political economy issues in the context of regional integration.

Second, keeping the political economy factors aside, we address two key questions: How to make sure that regional integration arrangement within South Asia results in more trade creation and less trade diversion and eventually acts as a building block rather than stumbling block to multilateral trade liberalisation. Given the overwhelming arguments supporting the notion that South-South regional cooperation leads to income divergence than convergence, how could South Asia region design a framework to reap the benefit of regional integration?

Third, will the regional integration effort, especially in the areas of trade and commerce, be compliant with the multilateral trading system espoused by the World Trade Organisation (WTO)? This is a vital question because the first challenge before the drafters of the SAFTA Treaty is to ensure that the agreement is going to be compatible with the relevant provisions of the WTO. It is worth emphasising here that five Members of SAARC are already Members of the WTO and two (Nepal and Bhutan) are in the process of accession.

1.2 Stages of regional integration

South Asian countries have not even reached the formative stage of five-staged regional integration arrangement

What are the stages of regional economic integration SAARC countries have to pass through before reaching the eventual goal of economic integration? SAARC countries at the onset decided to use the neo-liberal model of regional integration that is associated with the European Union (EU), which has five stages. These five stages are well known and have been elaborated in international economic textbooks. We summarise them below in Box 1.1.

Box: 1.1

Five stages of regional integration

Various stages of regional integration can be broadly divided into two tiers, namely, shallow integration and deep integration. The first three stages of regionalisation, which directly and exclusively affect international trade of member countries, are collectively known as shallow integration. The final two stages of regionalisation, which deal with maintaining common commercial economic policies within the member countries of the regional arrangement, are collectively known as deep integration.

Preferential trading area (PTA) is the first tier arrangement. In this arrangement, trading partners grant partial non-discriminatory tariff reductions to each other. They tend to leave their other tariffs, viz., non-tariff barriers (NTBs) and para tariffs unchanged, but there are PTAs where all other tariffs barriers are removed.

In a *free trade area* (FTA), which is the second tier, members of a preferential trade area eliminate all tariffs and non-tariff barriers (NTBs) among themselves, but each member can set its own tariff rates on imports from non-members [like the Association of South East Asian Nations (ASEAN) and North American Free Trade Area (NAFTA)].

The third tier is a *customs union* (CU) in which members go beyond removing tariff barriers among themselves and set a common level of trade barriers vis-à-vis non-members (like the EU).

The fourth tier is a *common market* and is considered the first deep integration stage. This stage attempts to harmonise some institutional arrangements and commercial and financial laws. Beyond free exchange of goods and services, a free common market entails free movement of factors of production, viz., capital and labour.

The fifth stage is the *economic union* and goes a step ahead of the free movement of goods, services and factors. An economic union, the last tier, involves integrating national economic policies, including taxes and having a common currency.

Adapted from: Das, Dilip K. (2001): 10-13

1.3 Motivations for the formation of RTAs

Europe's overriding objective, which was brilliantly achieved, was political and military: to use economic integration to overcome the historic animosities so as to render future wars impossible

Where do the nation states derive motivation from to establish an RTA? This will help one comprehend the motivation behind the establishment of a FTA and eventual establishment of an economic union in the South Asia Region.

1.3.1 Toning down political rivalry

Most of the RTAs take European integration as the template for regional integration, little realising the uniqueness with which Europe was (and is still) blessed. Europe's overriding objective, which was brilliantly achieved, was political and military: to use economic integration to overcome the historic animosities of its chief protagonists and thus render future wars impossible.[3] Indeed, the preamble to the 1951 treaty establishing the European Coal and Steel Community, out of which EU grew, states its aim as follows: "To create, by establishing

an economic community, the basis for broader and deeper community among peoples long divided by bloody conflicts."[4]

A second driving force in Europe was the common enemy embodied by the Soviet Union. The United States (US), driven by its own strategic priorities of deterring the Soviet Union and avoiding another fratricidal war in Europe itself, was willing to accept some negative economic effects from the European unity and even the build-up of a potential future rival. Despite US support for European integration, a subtext of the latter has been Europe's own quest for independence from the pervasive influence of the US. All participants in the European integration process have been democracies. Indeed, several countries in the region – notably Spain and Portugal – were deliberately shunned until they shed their dictatorial regimes.[5]

Security also played an important role in initiating regional integration in the Southern Cone. The Argentine and Brazilian militaries had long perceived each other as potential threats. Economic agreements covering steel and automobiles were signed in the mid-1980s as part of an attempt to reduce tensions, and the creation of Southern Common Market (MERCOSUR) in 1991 reinforced this process.

Concern for security also played an important role in the formation of other regional groupings like ASEAN and MERCOSUR

The political impetus to European and Southern Cone integration was thus based on the belief that increasing trade would reduce the risk of intra-regional conflict. Similar motives, *inter alia*, were found in the creation of the ASEAN – to reduce tension between Indonesia and Malaysia.[6]

Unfortunately, the assertion that regional economic integration reduces political tension between the participating countries is not a rule of thumb. Some economic integration arrangement could result in political conflict after regional integration, mainly as a result of huge income transfers from the poorer countries to the richer ones. Conflict within regional integration agreements can be illustrated, among others, by the example of the East African Common Market. In this case, Kenya was receiving more than proportionate income transfers from Uganda and Tanzania, which induced a fear that there would be increasing agglomeration of manufacturing in Nairobi, which had a head start on industrialisation compared with the smaller industrial centres of Tanzania at Dar es Salaam and of Uganda at Jinga. Arguments about compensation for the income transfers contributed to the collapse of the Common Market, the closing of borders, and the confiscation of Community assets in 1978.[7]

Sometimes political impetus for intra regional cooperation can also be provided by a common extra-regional threat

Sometimes political impetus for intra regional cooperation can also be provided by a common extra-regional threat. For example, two subtle motives for the formation of European Economic Community (EEC) were: a) to counter the potential spread of communism in Western Europe coming from Eastern Europe; b) to counter the hegemony of the US in global economic and political spheres. ASEAN also had as one of its goals to prevent Communism spreading from China to East Asia.[8] Another good example was the formation of the Southern African Development Coordination Conference in 1980 to provide a united front among the small countries of the region against the apartheid regime in South Africa. Part of the strategy was to reduce economic dependence on South Africa both as a trading partner and to use the Southern African Development Coordination Conference as a conduit to trade with the outside world.[9]

1.3.2 Bargaining power

Smaller countries, in theory, have a greater bargaining power in international negotiations when they negotiate as a group

"United we stand", as the saying goes, and by joining hands together weak countries can become stronger. Just as workers unite by forming trade unions to have better bargaining power, smaller countries too, in theory, have a greater bargaining power in international negotiations when they negotiate as a group. It is a lot easier for the smaller countries to get noticed and be able to cut deals with the major economic power when they act in a unified manner.

However, in practice this has really not been the case. Barring the European Union and a few exceptions under some circumstances, other regional groupings have failed to make a concerted and unified position in international negotiations. For example, ASEAN does not act as a group in the WTO negotiations, which became clear during the run up to Doha Ministerial Conference. While countries like Singapore and Thailand were in favour of launching a new round of multilateral trade negotiations, Malaysia remained singularly opposed to this issue till the last moment. Similarly, many African regional groupings did not have the same positions during the various stages of negotiations at the WTO.

Caribbean Community and Common Market (CARICOM), the alliance of smaller Caribbean island states, is an exception among the developing countries groupings inasmuch as it negotiates in most of the international fora, including the WTO, in a unified manner. CARICOM is not only focused on achieving regional integration – rather its objective is common action. Without solidarity, it would be quixotic for any single island to spend resources on international negotiations, and so it was evident that there were gains from pooling the costs of negotiations. CARICOM has been strikingly successful in getting its members noticed. For example, they have taken the lead in formulating and articulating the position of the African, Caribbean, and Pacific (ACP) countries group in negotiating the Lome Convention.[10]

1.3.3 Economic motives

Removal of trade barriers is like a market enlargement – separate national markets move toward integration in a regional market

The economic effects of regional agreements are of two main types. The first are "scale and competition" effects. Removal of trade barriers is like a market enlargement –separate national markets move toward integration in a regional market. This allows firms to benefit from greater scale and attract investment projects, mainly in the form of Foreign Direct Investment (FDI) for which market size is important. Removing barriers also forces firms from different member countries into closer competition with each other, possibly inducing them to make efficiency improvements. Although these are major sources of benefit, they are not always achieved. The effects depend on design and implementation of the agreement. Some of these benefits may be achievable with unilateral trade liberalisation, although the same may not always be politically feasible.[11]

The second source of economic change is "trade and location" effects. The preferential reduction in tariffs within a regional agreement will induce purchasers to switch demand toward supply from partner countries, at the expense of both domestic production and imports from non-members. This is trade creation and trade diversion (discussed in Section 1.6 below). Governments will lose tariff revenue, and the overall effect on national income may be positive or negative, depending on the costs of alternative sources of supply and on trade policy toward non-member countries.

In some circumstances, relocations can be a force for convergence of income levels between countries

Changes in trade flows induce changes in the location of production between member countries of a regional agreement. These relocations are determined by the comparative advantage of member countries, by agglomeration or clustering effects, and by possible technology transfer between countries. In some circumstances, relocations can be a force for convergence of income levels between countries. Labour-intensive production activities may move toward lower-wage countries, raising wages in those countries. In other circumstances, relocations can be a force for divergence. Industry may be pulled toward a country with a head start or with some natural advantage, driving up incomes ahead of other countries leading to income divergence. It is more likely that the North-North or North-South RTAs lead to income convergence. However, South-South RTAs are likely to result in income divergence.

An emerging economic view is that RTAs can increase world income and abet multilateralism so long as they remain open to new members, avoid raising external trade barriers, enhance intra-bloc growth through scale economies, stimulate competition, reduce transport costs, avoid protectionist rules of origin or anti-dumping regimes and generally force recalcitrant interventionist members to liberalise more rapidly than they would otherwise do.[12] We will discuss this issue at length in Chapter II.

1.4 Sustainability of South-South RTAs

South-South regional integration arrangements are formed with much enthusiasm, but they tend to break up fairly quickly. Several factors are responsible for this. Some of them are highlighted below:

Where the intra PTA trade is very low, it cannot create the required impact and stimulate economic growth thereby ensuring prosperity

- Low intra-regional trade: Most South-South PTAs have a low level of intra-regional trade. For example, in 1996, intra-EU exports were 62 percent and intra-NAFTA exports were 47 percent. In the middle income PTAs, MERCOSUR had 23 percent, ASEAN 20 percent, dropping still further for low income PTAs, at 9 percent for Economic Community of Western African States (ECOWAS), and 1.9 percent for Union Economique et Monaitaire de l'Afrique Occidentale (UEMOA).[13] Table 1.1 compares export trade among, three North dominated PTAs/RTAs and three South-South PTA/RTAs. It is obvious that where the intra PTA trade is very low, it cannot create the required impact and stimulate economic growth thereby ensuring prosperity. With low volume of intra-regional trade, there is hardly any incentive for the member countries to fully implement the agreement on preferential tariffs.

Table 1.1 Exports within the regional trade blocs (as % of total exports)

	1970	1990	1995	1999
APEC	57.8	68.3	71.9	71.9
EU	59.5	65.9	62.4	62.6
NAFTA	36.0	41.4	46.2	54.6
MERCOSUR	9.4	8.9	20.3	20.5
ASEAN	22.9	19.8	25.4	22.2
SAARC	3.2	3.2	4.4	4.7

Source: Mahabub ul Haq Foundation (2002): 109.

- Competing for the same market: Major countries of the South export the same or similar products to the same markets – mainly Organisation for Economic Cooperation and Development (OECD) countries. This leads to mutual distrust among the members of the FTA that one country might

outmaneuver the other. One can take the example of South Asia where readymade garment is the major export of five out of seven countries – Bangladesh, India, Nepal, Pakistan and Sri Lanka. All of them export their garments to either the EU or the US market. Entering into an FTA like SAFTA will entail loss of market for the lower income countries because their industries will either go bankrupt or will be bought over by the larger and more efficient companies from bigger countries. In such a situation, small countries may have an incentive not to cooperate.

- Heterogeneity: Most Southern countries are politically and economically a heterogeneous group. Let us take the example of ASEAN (or ASEAN Free Trade Area, AFTA) where members vary greatly in the composition of their exports (for instance, industrial versus agricultural goods) and their current level of protection. Consequently, going to zero tariff on substantially all goods will entail very asymmetric – and therefore – politically difficult – 'concessions' in terms of both tariff cutting and 'winning the losing' sectors.[14] This is very much the case with SAARC as well.

Going to zero tariff on substantially all goods will entail very asymmetric – and therefore – politically difficult – 'concessions' in terms of both tariff cutting and 'winning the losing' sectors

- High coordination cost: Implementing FTA is a costly exercise; it requires high coordination cost to administer strict rules of origin requirement and implementation of reform process. This does not only demand financial resources, but also human resources, technical expertise and skills. Since these resources are lacking in the Southern countries, FTAs formed exclusively within and among them tend to suffer a setback. As argued in Chapter V, there can be periods when the cost of cooperation is higher than the cost of non-cooperation. If the negotiations on a FTA become protracted, the cost of non-cooperation does not become an issue.

- Loss of government revenue: For the North, which hardly relies on tariff as a source of revenue[15] there is only negligible loss in government revenue even after the implementation of an FTA. However, for many countries in the South – which most often run high budget deficits – trade taxes are an important source of government revenue, and membership of an FTA leads to loss of tariff revenue. This arises directly – as tariffs on intra-FTA trade are reduced – and also indirectly, when trade diversion occurs, such as when importers switch away from external imports subject to tariffs.[16] Table 1.2 provides the estimate of tariff revenue Southern African Development Community (SADC) FTA. The first sector to be hit by the loss of revenue is the social sector, which is politically sensitive. Thus, there is an incentive for the countries not to wholeheartedly implement the FTA, unless some mechanism is devised for compensating the revenue loss of those countries, which are dependent on customs revenue for financing large chunk of their budgets.

Table 1.2: Customs revenue collected as a percent of total government revenue in 1996 and the implications of an FTA for SADC Members

Member country	Customs duty as % of total tax revenue	Estimated change in customs duty	
		% custom duty	% total tax revenue
Malawi	14.3	-36.7	-5.3
Mauritius	29.8	-18.2	-5.4
South Africa	3.6	4.9	0.2
Tanzania	24.0	-8.3	-2.0
Zambia	12.3	-45.3	-5.6
Zimbabwe	18.4	-53.3	-9.8

Source: World Bank (2000:45)

- Asymmetric trade creation and trade diversion: When one economy is relatively big and more competitive vis-à-vis other (s), the more competitive nation gains more than proportionately and the less competitive nation loses more than proportionately after the formation of an FTA. One can take two East African countries Kenya (more competitive) and Uganda (less competitive) – the example that we took earlier – to elaborate the point. Kenya not only exports more because of access to the Ugandan market, but also because of the preferences afforded by an FTA, whereas Uganda not only loses by the flooding of imports from Kenya, which swamps its domestic manufacturers, but also because it cannot compete in the Kenyan market (even at a zero duty) because of greater comparative disadvantage. This leads to income divergence, unlike in the case of rich (or less poor) countries, where income convergence is inevitable (e.g., Spain and Portugal after joining the EU). Therefore, poorer countries, which are at comparative disadvantage are less likely to cooperate. In fact, the collapse of the East African Community in 1977 is ascribed to the failure of poorer countries like Uganda and Tanzania to reap the benefits of trade liberalisation, while the entire benefits accrued to the relatively higher income country – Kenya.[17]

- Overlapping membership: Many Southern countries are members to more than one trade agreement (FTAs or CUs). For example, Chile is party to 11 trade agreements, Panama is member of nine agreements, Mexico eight, Bolivia, Costa Rica and Nicaragua of five; and El Salvador, Guatemala and Honduras four each. Similarly, in Africa small countries like Namibia and Swaziland are members of four agreements, Tanzania, Lesotho, Mauritius and Seychelles of three each. While South Asia does not have a problem of that magnitude, some of the countries in the region are party to more than three PTAs.[18] Multiple memberships create complexity, for example, overlapping rules of origin, which can hinder decision-making of investors and exhaust the scarce political capital at the disposal of the countries. Since most of these countries are also member of the WTO where negotiations require great deal of political capital to be spent, at the end of the day they could be left exhausted and confused.

Multiple memberships create complexity, for example, overlapping rules of origin, which can hinder decision-making of investors and exhaust the scarce political capital at the disposal of the countries

- Political rivalry: Unlike Europe (which could not only form an FTA and later got converted into a Customs Union) setting aside political difference between its member countries (e.g., France and Germany), Southern countries have not been able to set aside their political differences even on petty issues. They are not yet fully convinced of the peace dividend an FTA

eventually ensues. For example, the territorial dispute between India and Pakistan has held the process of SAPTA at ransom. Fear is ripe that such rivalry is likely to slow the implementation of SAFTA, even after its eventual signing (discussed in Chapter V).

Signing an FTA is not a difficult task, all it requires is the willingness among the politicians of the founding members to ask their bureaucrats and experts to calculate the cost and benefits and prepare an agreement to be signed. The main challenge lies in implementing the same. The economic, political and social costs of sustaining an FTA are very high and all the Southern countries are not necessarily capable of incurring them. The problem is further compounded by multiple memberships thus creating 'spaghetti bowl'[19] like phenomenon. Das (2000), therefore, rightly comments "Not all the RTAs were negotiated with the sincere trade-expansion and economic integration intentions. To be sure, some had mere vague aspirations".[20] The majority of South-South RTAs fall into this category.

1.6 Trade creation and diversion

It was not until 1950s that, under the stimulus from Jacob Viner, professional economists began to give serious thought to the conditions under which the allocation of world resources is improved by regional trade arrangement

When the Article XXIV was drafted during the GATT negotiations in the late 40s, the draftspersons were not aware of the possible impact their creation could have on global economy in general and trade liberalisation in particular. One cannot, however, reproach the draftspersons for being bad economists; it was not until 1950s that, under the stimulus of a few pages book by Jacob Viner,[21] professional economists began to give serious thought to the conditions under which the allocation of world resources is improved by regional trade arrangement.[22] That is the theory of trade creation and trade diversion.

Table 1.3 explains, in simple terms, how regional integration could lead to trade diversion or trade creation. In the table, country A is the least efficient producer. When it imposes tariff on products originating from country B or C, it is hurting its consumers but protecting its manufacturers. When it enters into an FTA with Country B, it results in *trade creation*, whatever may be the level of tariff and is able to import goods from country B – which provides relief to its consumers but hurts its local producers. However, since it continues to impose tariff from country C, the most efficient producers of all, it prevents the producers of this country from entering A's market, thus resulting in *trade diversion*. It is this trade diversion that economists are worried about. Further, if the Custom Union is formed between A & B, both the countries will have a common external tariff thereby preventing the producers of country C entering both countries' market. But as explained by some others, when global free trade is not practically possible, the trade creation effect of the FTA could be enormous.

Table 1.3: Trade creation and trade Diversion: An illustration

Price under various circumstances	Country A (home)	Country B (partner)	Country C (Rest of the World)
Price (without tariff and FTA)	300	250	200
Price (with 100% MFN tariff)	300	500	400
Price (with 60% MFN tariff)	300	400	320
Price (with 100% tariff, but with an FTA between countries A & B)	300	250*	400**
Price (with 60% tariff, but with an FTA between countries A & B)	300	250*	320**

* = Trade creation
** = Trade diversion

Cross-country evidence shows that four pre-conditions are required for successful regional trading arrangement (Srinivasan, 1995): *first*, pre-FTA tariffs should be high; *second*, the members of the FTA should be important trading partners before entering into an arrangement; *third*, there should be complementarity in demand, i.e., countries would need to have difference in economic structures; *fourth*, the countries should have different factor endowments. If such preconditions are not valid, the potential gains from regional trading arrangements will not be very significant for most of the countries. [23] However, this view has been criticised on grounds of being under a *static* framework.[24]

A *dynamic* perspective would take into account the trade creating opportunities opened up by PTAs and FTAs. Recent evidence suggests that when participating countries actively promote policies geared towards overcoming of initial difficulties through carefully sequenced cooperation agendas, put in place regional division of labour, jointly exploit natural resources, take cognizance of locational advantage and promote intra- regional investment, the net outcome from trade creation and trade diversion is usually positive. [25]

Issues for comment

- What are the reasons for the SAARC's inability to move forward in terms of achieving regional economic cooperation?
- Given the fact that MERCOSUR is considered a major exception among South-South RTAs, what are the lessons to be learned from this RTA by the SAARC?
- How important is the common extra-regional threat for the formation of an RTA, especially in the context of South Asia?
- Which of the economic motives for the formation of an RTA is more important in the context of the SAARC – 'scale and competition' or 'trade and location' effects?
- How important is it to consider the potential trade creation and trade diversion effects of South Asian regional integration efforts?

CHAPTER II

REGIONALISM: BUILDING BLOCK OR STUMBLING BLOCK?

2.1 Introduction

At the turn of the 20th Century, both globalism and regionalism are coexisting in the global trading system. If anything, regionalism is burgeoning. These developments raise important questions for the global trading system. During the 1990s, it was widely assumed that building complementary between regional and multilateral institutions was the only way to grapple with the complexities of the fast changing global economic and trade realities. However, it has become necessary to take a good look at this stand and to question this easy assumption. Does regionalism have a direct, effective, and systemic link with trade liberalisation? The opposite can also be true, i.e., regionalism could be fragmenting global trade, and in the process creating a new global disorder characterised by growing rivalries and marginalisation.[26]

It is widely assumed that building complementary between regional and multilateral institutions is the only way to grapple with the complexities of the fast changing global economic and trade realities

Economists, political scientists and policy makers are still working very hard to find out what RTAs really mean to the global economy in general and participating countries in particular. However, the picture is becoming increasingly complex as RTAs proliferate, change their goals, produce overlapping blocs, and take on a so-called 'hub and spoke'[27] pattern with one major country at the centre of several blocs.[28] It is not the purpose of this Chapter to reach a conclusion on whether RTAs are building blocks or stumbling blocks to multilateral trade liberalisation, given the mutli-polar view of economists on this issue. At the very outset, we would like to point out that there is no black and white answer to the question and there are a lot of grey areas that need detail study.

The assumption that regionalism would lead to globalisation need not be correct

The assumption that regionalism would lead to globalisation need not be correct. Cogent arguments exist on both the sides.[29] However, the discussion in this area, especially among the economists, reached a critical point when two schools of thought emerged. The first school of thought, led by Larry Summers (former Treasury Secretary of the USA and currently President of Harvard University) maintains the view that RTAs are building blocks towards multilateral trade liberalisation. The second school of thought led by Prof. Jagadish Bhagwati (Professor of Economics and Political Science at Columbia University, USA) argues that RTAs are stumbling blocks to multilateral trade liberalisation. Some other economist, however, have chosen to remain neutral.

2.2 Arguments in favour of RTAs as building blocks

RTAs contribute to both internal and international dynamics that enhance rather than reduce the prospects for global liberalisation

As per Larry Summers, any "ism" (bilateralism, regionalism and multilateralism) is good as long as its ultimate objective is trade liberalisation. Supporters of this school of thought, prominently Bergsten (1997) argue, "Regional arrangements promote freer trade *and* multilateralism in at least two sense: that trade creation has generally exceeded trade diversion, and that the RTAs contribute to both internal and international dynamics that enhance rather than reduce the prospects for global liberalisation. The internal dynamic is particularly important for developing countries: regional commitments, which can be negotiated much faster than global pacts, lock in domestic reforms against the risk that successive governments will try to reverse

them. Internationally, the RTAs often pioneer new liberalisation ideas that can subsequently be generalised in the multilateral system. Moreover, regional liberalisation creates incentives for other regions and individual countries to follow suit and thus to 'ratchet up' the global process".[30] Moreover, as suggested by Winter (1996), "Regionalism, by allowing stronger internalisation of the gains from trade de-restriction, seems likely to be able to facilitate freer trade in highly restrictive circumstances or sector."[31]

The proponents of regionalism assert that it often has important demonstration effects

The proponents of regionalism assert that it often has important demonstration effects. Regional initiatives can accustom officials, governments, and nations to the liberalisation process and thus increase the probability that they will subsequently move on to similar multilateral actions. "Learning by doing" applies to trade liberalisation as well as to economic development itself, and can often be experienced both more easily and more extensively in the regional context with far fewer negotiating partners.

They further contend that it has had positive rather than negative political effects. Trade and broader economic integration has created EU in which another war between Germany and France is literally impossible. Argentina and Brazil have used MERCOSUR to end their historic rivalry, which had taken on nuclear overtones in recent decades. Central goals of Asia Pacific Economic Cooperation (APEC) include anchoring the United States as a stabilising force in Asia and forging institutional links between such previous antagonists as Japan, China and the rest of East Asia.[32]

Even if the argument that RTAs can potentially result in reducing global trade and, therefore, global welfare is correct, one must know the counterfactual

Similarly, Das (2001) argues, "Even if the argument that RTAs can potentially result in reducing global trade and, therefore, global welfare is correct, one must know the counterfactual. If an RTA is reducing global welfare, it is doing so in comparison to what? To be sure, in comparison to complete free trade, RTAs are clearly the second best. But compared to the global trading system in which tariffs and NTBs were rampant, the case against RTAs is generally far from clear." He further maintains, "formation of an RTA is sure to have some trade diversion, but while forming or joining an RTA countries expect trade diversion losses to outweigh the trade creation gains."[33]

Krguman (1991) is of the view that a series of regional blocs each covering one continent would produce a first-best outcome equivalent to global free trade. He inferred a notion of "natural blocs" – blocs for which low trade costs made regionalism a natural and beneficial policy.[34] However, this conception has been challenged later. His model cannot be considered a practical model in the sense that FTAs are no more confined within a continent. Examples include US' FTA with countries as far as Singapore, Jordan and Chile and Korea's attempt to establish an FTA with Chile. Therefore, it is reasonable to assume that RTAs are clearly the second best (more on Section 2.6).

The favourable impact of an RTA is subject to the proviso that RTAs are able to achieve a deeper degree of economic integration than the multilateral trading system

However, the favourable impact of an RTA is subject to the proviso that RTAs are able to achieve a deeper degree of economic integration than the multilateral trading system. This is well within the realm of feasibility because RTAs usually entail neighbouring like-minded countries. A smaller forum [with homogenous or semi-homogenous membership] makes it possible to establish the necessary centralised institutions or federalising policy-making and enforcement institutions.[35] However, economists also argue that it will be difficult to conclude negotiations between a group as diverse as the Free Trade Areas of Americas (FTAA), which is being joined by 35 countries and where the socio-

political as well as economic realities of the countries are as diverse as the WTO membership.

A group of trade economists follow the logic that expansion of RTAs could have positive effects on the global economy provided the emerging RTAs are "open" to trade from outside. One key benefit to the global economy comes from the impact of RTA in stimulating domestic growth, which in turn increases the demand for extra-regional exports.

A major analytical contribution dealing with this issue is of Baldwin (1995). Focusing exclusively on the incentive to seek entry on the part of outsiders, Baldwin identifies a "domino" effect, which may yield global free trade through PTA expansion. Using a variant of what have come to be known as models of economic geography, Baldwin shows that under the "domino" effect, more and more outside countries have an incentive to become insiders as PTA expands. The countries are assumed to differ in a way that the PTA is not equally attractive to them. Initially, it attracts one member who finds the entry worthwhile. The addition of this member enlarges the internal market and makes it more attractive to yet another outside country at the margin. Once this country joins, yet another country finds accession profitable, and so on until the PTA becomes global.[36] Consequent to expansion of membership in a PTA, trade diversion obviously gets minimised. In the words of Baldwin (1997):

Under the "domino" effect, more and more outside countries have an incentive to become insiders as PTA expands

> "Idiosyncratic incidents of regionalism triggered a multiplier effect that knocked down bilateral import barriers. Forming a preferential trade area, deepening an existing one, produces trade and investment diversion. This diversion generates new political economy in non-participating nations, i.e., pressure for inclusion. The pressure increases with the size of the trade bloc, yet bloc size depends upon how many nations join. Clearly, a single incidence of regionalism may trigger several rounds of membership requests from nations that were previously happy as non-members. If the trade bloc is open to expansion, regionalism may spread like wildfire. If the enlargement burn-path is barred, the new political economy flames may find vent in preferential arrangements among excluded nations."

As per Baldwin (1997), this domino theory is derived from the expansion of the EU. He then goes on to explain the American dominos. Indeed, the possibility of facing exclusion due to US-Mexico trade, when the trade talks were going on between the US and Mexico, Canada requested the parties to trilateralise talks which led to the birth of NAFTA. Similarly, when other Latin American countries, which were interested to join NAFTA only received lukewarm response from President George Bush (Senior), four of them decided to form MERCOSUR. The pressure for inclusion was so much that Bolivia and Chile joined MERCOUSR as its associate members. Now that FTAA has been announced, covering the entire Western Hemisphere, virtually every country in the Americas is looking forward to joining the same. Asian dominos have not fallen so much because ASEAN has only expanded its membership to 10. However, the first ever FTA, which Japan entered into with Singapore and the one Korea is planning with Chile are likely to knock down dominos of a greater magnitude.[37] ASEAN plus three is another example of this.

Once Japan comes to the regional scene in a big way, it is predicated that Asian dominos too will start falling in days to come

Sapir (2001), who conducted a study on the issue of domino effect in Europe, further supports the evidence of the prevalence of domino effects. *A la* Sapir, "The empirical findings of the study support the hypothesis that 'domino effects' have played an important role in

Europe. These effects may be partly responsible for the successive enlargement of the European Community from its original six to its present 15 members."[38]

However, one important condition for the application of domino theory is that the incumbent members should be "open" to include new members. If they have incentives to create barrier to entry to the new country in the group, domino theory does not work.

Proponents of open regionalism view it as a device through which regionalism can be employed to accelerate the progress toward global liberalisation

Therefore, the concept of "open regionalism" was propounded. Bergesten (1997), one of the pioneers of the concept, argues:

> The concept represents an effort to achieve the best of both worlds: the benefits of regional liberalisation, which even the critics acknowledge, without jeopardising the continued vitality of the multilateral system. Indeed, proponents of open regionalism (including the author) view it as a device through which regionalism can be employed to *accelerate* the progress toward global liberalisation and rule-making.[39]

APEC was modelled on this concept based on the suggestions of the Eminent Persons Group (EPG), which was chaired by Bergesten himself. As per EPG, in order to achieve the goal of "open" regionalism, following alternative approaches have been suggested:

- the maximum possible extent of unilateral liberalisation;
- a commitment to continue reducing its barriers to nonmember countries while it liberalises internally on a most favoured nations (MFN) basis;
- a willingness to extend its regional liberalisation to non-members on a mutually reciprocal basis; and
- recognition that any individual APEC member can unilaterally extend its APEC liberalisation to non-members on a conditional or unconditional basis.[40]

The practical problems of this concept have been highlighted by the current status of the APEC and the IOR-ARC where the progress has been far from satisfactory

However, Bergesten's idea of open regionalism seems contradictory and vague. Prof. T.N. Srinivasan has very correctly noted: "if regional liberalisation is to be extended on the same time table 'in practice and in law' to non-member countries on an MFN basis, it would be multilateral and not regional. If that is the case, why should any group initiate it on a regional basis in the first place?"[41] He goes on to call 'open regionalism' as an oxymoron. The practical problems of this concept have been highlighted by the current status of the APEC and the Indian Ocean Rim Association for Regional Cooperation (IOR-ARC) where the progress has been far from satisfactory.[42]

2.3 Arguments describing RTAs as stumbling blocks

As early as in 1992, Prof. Jagadish Bhagwati, who claims himself to be a multilateralist and a critique of regionalism, posed the following question: *is regionalism truly a building, rather than a stumbling, bloc towards multilateral free trade for all: in other words, will it fragment, or integrate, the world economy?*[43] Bhagwati calls "the revival of regionalism" as "unfortunate". He emphasises the need "to contain and shape it in ways that it becomes maximally useful and minimally damaging, and consonant with the objectives of arriving at multilateral free trade for all."[44]

Expanding on these arguments, Panagariya (1998) uses two different analyses, through formal model as well as informal arguments to prove that regionalism is a stumbling block to multilateral trading system. He

takes two formal models by Levy (1997) and Krishna (1998)[45]. As per Levy's model, if the voters in two different countries, which are the members of both FTA and multilateral trading system were given a choice to vote, they felt that FTA cannot make previously infeasible multilateral liberalisation feasible. Krishna uses a three-country, partial-equilibrium, oligopoly model in which trade policy is chosen to maximise national firms' profits. He shows that more trade diverting the FTA between two countries in this set up, the greater the backing it receives and the more it reduces the incentive to eventually liberalise with the third country. With sufficiently large trade diversion, an initially feasible multilateral liberalisation can be rendered infeasible by the FTA option.[46]

More trade diverting the FTA between two countries, the more it reduces the incentive to eventually liberalise with the third country

Similarly, using a three-country, two-goods general equilibrium model, Lipsey demonstrated that, after the union is formed, the gain in consumption due to the reduction in the prices of the imported good by a union member could more than outweigh the loss from switching imported goods from the low-cost outside country to the high-cost union partner.[47]

He then analyses the informal arguments in the following sequence. Firstly, it has been suggested by Summers (1991) and others that multilateral negotiations will move more rapidly if the number of negotiators is reduced to approximately three via bloc formation. This argument gained some popularity at the time the Uruguay Round (UR) negotiations were stalled but has lost force since the successful completion of the Round. The argument is that due to a large number of members involved at the WTO and the associated "free rider problem", negotiations at the WTO are slow and difficult. If the world is first divided into a handful of blocs, multilateral negotiations will become easier.

Secondly, PTAs may serve as a threat to force unwilling parties to negotiate in earnest at the multilateral level. As per this argument, the EU was dragging its feet too long for the conclusion of the UR, but when President Clinton called for the formation of a free trade with APEC, the EU decided to conclude the negotiations during the UR. However, Bhagwati (1996) disagrees with this interpretation. He asserts that the UR could conclude only because the US wisely decided to close the UR deal, taking the offer on the table rather than seeking more concessions.

Thirdly, it is argued that due to their high visibility, PTAs can energise and unify protectionist lobbies, turning them into effective obstacles against multilateral liberalisation. Finally, there is the related issue of attention diversion and scarce negotiating resources. If the US President and his Trade Representative are preoccupied with cutting deals in Latin America, they will have less time and motivation of multilateral negotiations.[48] World Bank (2000) study further elaborates this point:

Due to their high visibility, PTAs can energise and unify protectionist lobbies, turning them into effective obstacles against multilateral liberalisation

> Successful trade negotiations also require political will and administrative effort. Reserves of administrative skill, political capital, or imagination are finite; if they are devoted to a Regional Integration Arrangement (RIA) they are not available for multilateral objectives. These arguments were advanced to explain both EU and US behaviour during the Uruguay Round, but they must be several times more important for developing countries. Negotiating a RIA, especially with the major power that has its own objectives, will absorb a huge portion of policymaking skills of a developing country. Perhaps one of the opportunity-costs of RIAs is that less negotiating and political capital are available for multilateral negotiations.[49]

However, this argument can be easily refuted now because the US has recently concluded the negotiations of FTAA, but still has the energy, resources and commitment to make WTO a powerful institution and both the present President and United States Trade Representative (USTR) have reassured the international community of their commitments to strengthen multilateral trade liberalisation. It can also be argued that the learning curve of being able to cut deals at the multilateral forum become steeper because of the successful conclusion of the RTAs resulting from accumulation of negotiating skills.

It is difficult to claim that the target of free or a liberalised trade is easier to reach in large regional agreements

Das (1999) argues that growth in regionalism does not necessarily have to lead to a short cut to free trade or a liberalised trading regime. It is difficult to claim that the target of free or a liberalised trade is easier to reach in large regional agreements like the FTAA and the APEC forum with memberships as large as 35 and 21, respectively. These two and other large regional groupings contain economies as different in size, outlook and level of development as any in the WTO.[50]

Panaghariya (1998) crticises "open regionalism". According to him, the open-membership criterion has three important limitations, which give critics reason to be sceptical of open regionalism. His arguments can be summarised in the following manner:

- Discrimination against non-members at any point in time remains in place by definition as long as the regionalism is of Article XXIV variety.
- Openness is not as innocuous as it sounds – the admission price can include several unpleasant "side payments" that are essentially unrelated to trade.
- Open membership does not necessarily translate into speedy membership.[51]

If the benefits from membership of an exclusive club are derived partly by making outsiders worse off, then the club will not throw open its doors to all comers

Further, Ben Zissimos and David Vines (2000) assert: "If the benefits from membership of an exclusive club are derived partly by making outsiders worse off, then the club will not throw open its doors to all comers. Facilitating trade between bloc members has exactly this effect. The purchasing power of bloc currencies increases, whilst that of outsiders declines. Consequently, trade blocs do not have an incentive to allow all applicants to join, because some of the benefits of membership come from being able to purchase the products of outsiders more cheaply on world markets. So there is a limit to the expansion that can be expected from existing blocs, and free trade between all countries will not arise."[52]

Open membership also raises the issue of broadening versus deepening. Broadening the membership of any regional grouping inherently complicates the process of deepening its integration. Too many new members can make decision making more time consuming and cumbersome. APEC realised this and imposed a moratorium in expanding membership in early 1998.[53]

On the whole, there seems to be four major arguments in support of the claim that RTAs are stumbling blocks to multilateral trade liberalisation. Firstly, open regionalism may be a myth in the sense that when a new member accedes to an RTA, the preferences enjoyed by existing members are eroded, thus creating an incentive to limit the membership. Secondly, as many RTAs are strongly emphasising investment liberalisation, this may create a vested interest against trade liberalisation amongst mobile firms once they establish costly plants and marketing systems in other member countries. Thirdly, governments and officials often suffer from 'negotiation exhaustion'

which could cause long delays in taking further steps, if not indefinite postponement. Fourthly, closer integration may generate a backlash against erosion of national sovereignty.[54]

2.4 Contemporary debate on regionalism: Other viewpoints

According to Winters (1996), "Regionalism vs. Multilateralism" switches the focus of research from the immediate consequences of regionalism for the economic welfare of the integrating parts, to the question of whether it sets up forces, which encourage or discourage evolution towards globally freer trade. The answer is "we don't know yet." One can build models that suggest either conclusion but to date these are sufficiently abstract that they should be viewed as parables rather than sources of testable predictions.[55]

To date these are sufficiently abstract that they should be viewed as parables rather than sources of testable predictions

A comprehensive study done by the World Bank (2000) on the debate relating to regional integration, titled *Trade Blocs* finds out that regionalism is generally a building bloc to multilateral trade liberalisation. It goes on to explain how benefits of trade creation resulting from an RTA outweigh the costs of trade diversion. This study is of the view that North-North regional integration agreements can produce beneficial effects for all the participating countries because it results in income convergence among the participating countries. Citing the example of EU before the accession of relatively poorer countries, it maintains that they were the clear gainers from RIAs.

The study further points out that even North-South RIAs are beneficial in as much as poorer countries catch up with richer countries in a short time span. The income convergence in the EU after the entry of Greece, Portugal and Spain, and the success story of Mexico after joining NAFTA are provided as examples to prove this point. The study, however, sounds a strong note of caution on the formation of South-South RTAs. It cites the example of East African Common Market (which we mentioned earlier in the text) in which income divergence did actually take place. As per the study, South-South RTA causes income divergence among the participating nations. However, the study considers MERCOSUR as an exception, which has set an example as a successful South-South RTA.[56] It is worth noting that ASEAN countries too have been growing very fast, barring a temporary period of slackness due to the East Asian crisis. However, they did not grow because of regional integration *per se* but due to a number of other favourable factors.[57]

Emergence and/or solidification of regionalism is unstoppable – all one should look at is the choice of design

As per the study, emergence and/or solidification of regionalism is unstoppable – all one should look at is the choice of design. There are two economic effects of regionalism, namely, competition and scale effect and trade and location effect (discussed in Chapter I).

Regionalism – by internalising an important externality – plays a key role in expanding and preserving the liberal trading order

Complementarity between regionalism and multilateralism is also stressed by Ethier (1998), who argues that "the new regionalism is in good part a direct result of the success of multilateral liberalisation, as well as being the means by which new countries trying to enter the multilateral system (and small countries already in it) compete among themselves for direct investment". He also suggests that regionalism – by internalising an important externality – plays a key role in expanding and preserving the liberal trading order.[58]

Commenting on complementarity of regional liberalisation on services with multilateral liberalisation, Hoekman (1995) suggests that both conceptual considerations and the available data on trade and

investment flows suggest that RTAs in the area of services should be easier to negotiate and be more far-reaching than a multilateral agreement. However, he admits that the two approaches are substitutes. Reviewing existing agreements, he concludes that sectors that are (included) excluded from RTAs are also (included) excluded from multilateral liberalisation. This suggests that "the GATS is likely to be seen as complementary to the regional arrangements by major service industries in OECD countries."[59]

After analysing all the arguments that were discussed, we are of the view that there is no need to be unnecessarily nervous about regionalism and its potential to derail the multilateral trade liberalisation. We conclude the debate on regionalism with the following statement made by Baldwin (1997):

> Does recent regionalism threaten the future of the world trading system? My guess is that because trade is already quite free in the major trading nations, few regional liberalisations are capable of creating important anti-liberalisation forces (the exceptions are likely to be South-South FTAs). For this reason, most regional deals will weaken the key opponents of free trade (import competitors) while simultaneously strengthening its key proponents (exporters). Regional integration will, therefore, foster multilateral liberalisation and vice versa, just as it has done for the past 40 years. If this is right, regional deals are not building blocks or stumbling blocks. Regionalism is half of the trade liberalisation 'wheel' that has been rolling towards global free trade since 1958. [60]

2.5 The second best theory

Before moving forward to find out why RTAs are considered the second best instrument, remarks made by former US president, Ronald Regan, are worth considering. Just prior to the launching of the eighth round of multilateral trade liberalisation (UR) under the aegis of GATT, he remarked:

> To reduce the impediments to free markets, we will accelerate our efforts to launch a new GATT negotiating round with our trading partners, and we hope that the GATT members will see fit to reduce barriers for trade….But if these negotiations are not initiated or if insignificant progress is made, I am instructing our trade negotiators to explore regional and bilateral agreements with other nations.[61]

If multilateral free trade is not attainable, the regional route is the second best option to follow

This shows the clear preference of president Regan, like other political leaders interested in seeing a world free of trade barriers, to multilateralism. However, as is explicitly made clear in the above argument, if multilateral free trade is not attainable, the regional route is the second best option to follow.

There is absolutely no doubt concerning the fact that multilateral trade liberalisation is clearly superior to RTAs in terms of welfare effects. However, if multilateral liberalisation is not possible, either due to heterogeneity of members or due to acrimonious nature of negotiations, the alternate way to move forward is to form or strengthen RTAs. It is more so because of the mercantilist stand taken by many countries towards trade liberalisation where reciprocity of concessions as opposed to unilateral liberalisation, is the name of the game. In multilateral, MFN based trade liberalisation there is always a problem of free riding and foot dragging. Protagonists of "stumbling block" side of the argument claim that RTAs are worse with regard to free riding and

foot dragging, but they refrain from mentioning compared to what? Can RTAs be worse than no liberalisation at all? Certainly not, on the contrary they are far superior to no liberalisation or very restricted liberalisation.

Creation of the common market to the coming of the single market, did much to stimulate the three big post-war multilateral trade negotiations

One should not also forget the fact that successive milestones in European integration, from creation of the common market to the coming of the single market, did much to stimulate the three big post-war multilateral trade negotiations (the Kennedy, Tokyo and Uruguay Rounds). The creation of NAFTA and APEC helped persuade Europe to conclude the UR.[62] When EU was dragging its feet and impeded the process of conclusion of UR of multilateral trade liberalisation, the USA went ahead towards forming NAFTA, which contributed to bringing EU back to the negotiation to conclude the UR.

It is also argued that, in order to avoid free-rider problem associated with MFN-based trade liberalisation, member countries of the WTO have chosen regional economic integration

Similarly, in 1994, Jonquieres noted: "Last year's [APEC]… summit was prompted by a common desire to kick-start the Uruguay Round negotiations, which were then stalled. Many APEC members believe that by presenting a united front…and hinting that the grouping could become an alternative to the GATT if the round failed, they prodded the EU into making the concessions needed to conclude the world trade talks."[63] It is also true that, as mentioned above, due to "free riding" and "foot dragging" problems inherent in multilateral trade liberalisation, countries want to pursue liberalisation on regional and/or bi-lateral bases.

We are of the view that the increase in intra-regional trade between the regional partners shows that benefits of trade creation outweigh costs associated with trade diversion. Regional economic integration has served the useful purpose of creating a thread for multilateral trade liberalisation on several counts. If that were not the case, the size and number of RTAs would not have grown with leaps and bounds as is happening, especially after the formation of the WTO. Indeed, RTA is the favourite of all the countries of the world – whether they are members of the WTO or not. However, the political economy of building and sustaining an RTA is an important issue, and we discuss this in the context of SAFTA in Chapter V.

Issues for comment

- How powerful is "domino effect" argument for the formation of RTAs in Asia, given the fact that it seems to have worked perfectly well in Europe and North America?
- Can the concept of "open regionalism" act as a bridge between regionalism and multilateralism?
- Is the difficulty of cutting deals individually at the multilateral level the major reason for the formation of RTAs?
- Is the "spaghetti bowl" phenomenon a matter of great concern for the economists who are in favour of multilateral trade liberalisation?
- Will the eastward expansion of the EU and ambition of APEC, if materialised, pose serious threat to the multilateral trading system?

CHAPTER III

WTO RULES RELATING TO REGIONAL TRADE AGREEMENTS

3.1 South Asian regional integration and the WTO

SAARC Preferential Trade Agreement (SAPTA), the precursor to SAFTA has already been notified to the WTO. However, it has been notified under what is technically known as "Enabling Clause"[64] which, *inter alia*, allows a group of developing countries to form an RTA among them. One can consider SAPTA to be compliant with the relevant WTO provisions. It is just because of the fundamental flaw in the present examination/decision making process of the Committee on Regional Trade Agreements (CRTA),[65] that the WTO has not given a 'certificate of approval' to SAPTA. It is not surprising because economic groupings such as EU and the NAFTA too have not received the approval from the CRTA so far.

Notifying a regional trading arrangement under the Enabling Clause could limit the possibility of trade expansion within the region

However, notifying an RTA under the Enabling Clause could limit the possibility of trade expansion within the region and may in turn become counterproductive for the region as a whole. Since all the serious RTAs are notified under the Article XXIV of the GATT and/or Article V of the GATS, South Asian countries should also strive to fulfill the conditions outlined in these two relevant provisions so as to ensure greater degree of policy lock-in on the one hand, and providing security and predictability to the RTA on the other. Moreover, if and when South Asia becomes a major global player in international trade, developed countries would not allow it to continue taking shelter under the Enabling Clause. This Chapter provides a detailed account of all these legal issues related to RTAs. Clearly, the compatibility of a RTA like SAFTA with WTO rules and regulation is an issue that needs detailed scrutiny. In this Chapter we intend to go into details of WTO rules relating to RTAs.

3.2 Historical perspective

Non-discrimination is the cornerstone of multilateral trading order as envisaged by the MFN principle (Article I) and National Treatment Principle (Article III) of the GATT

Principle of non-discrimination is the cornerstone of the GATT, which has been carried forward as it is, in the WTO Agreements. Article I of the GATT establishes the central requirement that signatory governments are required to extend unconditionally to all other contracting parties any advantage, favour, privileges or immunity affecting customs duties, charges, rules and procedures, that they give to products originating in or destined for any other country. This is referred to as the much-vaunted MFN principle. The Article reads thus:

> "With respect to customs duties and charges of any kind…any advantage, favour, privileges or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Contracting Parties."

Considering the fact that MFN provision relating to border measures may not be sufficient to make the contracting parties to firmly institute a system of non-discrimination in letter as well as in spirit due to some possibility of them discriminating goods of foreign origin vis-à-vis national ones, the Article III of GATT clearly mentions that once the foreign goods have cleared the border they should be provided the same treatment as domestic goods. As per this Article, foreign goods

should be provided treatment "no less favourable than domestic like products". This treatment, which is another form of non-discrimination, is referred to as "national treatment."

RTAs, comprising Free Trade Area and Customs Unions are the single major derogation from the MFN principle

However, RTAs, comprising FTAs and CUs as contained in the Article XXIV of the original GATT Agreement (GATT 1947), are the single major derogation from the MFN principle whereby the Members of an RTA can agree to provide concessional treatment to goods or services in a discriminatory manner, i.e., without having to extend the same treatment to other WTO Members on an MFN basis.

The question as to why the drafters of the GATT did permit the contracting parties to form an RTA is a genuine one and the reason for this is still far from clear. Some assume that the belief that the conditions inserted into Article XXIV would ensure that RTAs would become complementary to the multilateral trading system, could be the single major motivation.

Preferential treatment on trade dates back to the colonial era, when most European countries, particularly Britain, used to provide preferential treatment to goods imported from their colonies and dominions. Commonly known as "imperial preference," this was aimed at increasing the dependence of colonies to their imperial masters and maintaining a firm grip over the formers' economies. When the discussion was going on between the US and Britain over a free trade agreement during the interwar period, the USA objected to such a discriminatory policy.[66] Despite the objection from its transatlantic trading partner, Britain continued to provide preferential treatment to its colonies and dominions.

Likewise, some developing countries like Syria and Lebanon (both founding members of the GATT) had their own FTA even prior to the coming into being of the GATT Agreement, which they wanted to preserve. Despite initial reluctance of the US to maintain such preference, it finally gave in thereby paving the way for the inclusion of Article XXIV into GATT discipline. Former GATT Director-General and drafter of the original Article XXIV, Oliver Long, has said that the founders of GATT did not have in mind an RTA of the dimension of the EU, and it has even been suggested that the original EEC may have been GATT-illegal but that GATT 'blinked', which set a precedent for being soft on other RTA proposals.[67]

3.3 Existing legal provisions[68]

Article XXIV included in the historic GATT accord is the first ever-legal notion relating to RTA being incorporated in the multilateral trade regime. During the Tokyo Round of Multilateral Trade Negotiations (MTNs), a package to better integrate developing countries into the global trading system known as "Enabling Clause" was agreed upon by the GATT. As per this, developing countries were allowed to enter into RTAs even if they did not necessarily fall into Article XXIV. Similarly, during the UR, when Services were included into the WTO, a separate exemption to RTAs was provided under Article V of the General Agreement on Trade in Services (GATS). Finally, there are some waivers included in Article IX of the Marrakesh Agreement Establishing the WTO, which provide similar effects as the Enabling Clause and are derogations from the principle of MFN.

Article XXIV of the GATT 1994 recognises two different types of RTAs, namely, FTA and CU

Article XXIV of the GATT 1994 recognises two different types of RTAs, namely, FTA and CU. Paragraphs 4 through 9 deal with substantive provisions relating to these arrangements. For the sake of simplicity

and better sequencing, we shall now analyse the relevant paragraphs of Article XXIV.

3.3.1 Paragraph 4 of the Article XXIV

Paragraph 4 of Article XXIV states the objective and purpose of RTAs in the following words:

> "The Contracting Parties recognise the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries' parties to such agreements. *They also recognise that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other Contracting Parties with such territories"* (italics added).

WTO members are divided on whether or not the second sentence of Article XXIV:4 creates a separate obligation

An issue has arisen as to the scope of this Article. Members differ on the interpretation of whether or not the second sentence of the paragraph 4 creates a separate obligation, which has to be respected by WTO Members wishing to form FTAs or CUs. Opinions differ to a significant extent. Usually, third countries (countries outside the RTAs) have insisted that it creates a separate obligation, which has to be complied with independently of other provisions of Article XXIV. However, members entering into RTAs do not share this view. The EU in particular has always disputed this view, which maintains that if Article XXIV:4 were to be held to create a separate obligation, it would render the first sentence of Article XXIV:5 meaningless.

This view was rejected by some members of the Working Party (WP) of the EEC, who thought the EEC's interpretation would permit it to raise barriers to the trade of third countries. Accordingly, most members of the Sub-Group[69] were not prepared to accept this interpretation. They believed that paragraph 4 established the basic principles, which a CU should apply to be consistent with the objectives of GATT. Where questions arise as to the application of the provisions of paragraphs 5 to 9 in particular cases, such questions should be resolved in a manner consistent with the principles embodied in paragraph 4. Some members of the Sub-Group felt, furthermore, that the contracting parties would have to verify whether the application of paragraphs 5 to 9 is consistent with the aim of a CU as defined in paragraph 4.

Some members felt, that the contracting parties would have to verify whether the application of paragraphs 5 to 9 is consistent with the aim of a CU as defined in paragraph 4

The Understanding on the Interpretation of Article XXIV addresses this issue, but in very general terms. It provides that:

> "[c]ustoms unions, free-trade areas, and interim agreements leading to the formation of a customs union or free-trade area, to be consistent with Article XXIV, must satisfy, *inter alia*, the provisions of paragraphs 5, 6, 7 and 8 of that Article."

Instead of clarifying the situation, the Understanding made the situation even murkier. It did not answer the question, which other provisions have to be complied with. Issue as to whether the second sentence of Article XXIV:4 creates a separate obligation was addressed in *Turkey - Restrictions on Imports of Textile and Clothing Products*.[70] The fundamental issue in that case was whether Article XXIV of GATT 1994 obligated members of the WTO which are parties to an RTA (CU) to have the same commercial policy towards third countries and, if it did, whether it justified the introduction of quantitative restrictions (QRs) prohibited by Article XI of the GATT 1994 and the Agreement on Textiles and Clothing.

Turkey argued that Article XXIV:4 did not create a separate obligation, and that the obligations which had to be complied with by members were set out in paragraphs 5-8 of the Article. India, which filed the case against Turkey, argued that the guiding principle in Article XXIV:4 had to be respected by all members of the WTO entering into RTAs, otherwise WTO rules would be abused and rendered ineffective. India's argument was supported by a number of countries, which were also of the view that the Article XXIV:4 created a separate obligation which had to be respected by all members.

The parties to RTAs should, to the greatest possible extent, avoid creating adverse effects on the trade of other members

Members had established a standard, separate, and distinct position from the standard imposed under Article XXIV:5, for the implementation of the phrase "not to raise barriers to the trade of other Contracting Parties" in Article XXIV:4. This is because the preamble of the Understanding on Article XXIV provided, among others, that in the formation or enlargement of RTAs "the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members". The Panel rejected India's argument on this point. It held that Article XXIV:4 did not create a separate obligation. The Appellate Body (AB) endorsed the Panel's ruling on this point.

Despite the ruling of the Panel and the support provided by the AB to the same, the issue should not be considered as "settled" once and for all. Some members may like this issue to be re-visited in the context of the negotiations on RTAs. They view that third parties' rights would be better protected if Article XXIV:4 were held to create a separate obligation which has to be respected by members of the WTO independently of other provisions of the Article.

3.3.2 Paragraph 5 of the Article XXIV

Article XXIV:5, which deals with relationship of parties to CUs and FTAs with non-members, is one of the most controversial provisions in the GATT

Article XXIV:5, which deals with relationship of parties to CUs and FTAs with non-members, is one of the most controversial provisions in the GATT. Perhaps the general intent of the draft persons of the GATT was to protect the interests of third countries and prevent parties to an RTA from imposing unjustified restrictions on trade. Nonetheless, interpretative problems that have been experienced with the Article include:

- the meaning of the phrase "as between the territories of Contracting Parties" contained in the chapeau of the Article;
- the meaning of the phrase "duties and other regulations of commerce" imposed at the institution of any such union/maintained in each of the constituent territories;
- scope of the requirement relating to the obligation that duties and other regulations "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories"; and
- the meaning of the phrases: "interim agreement", "reasonable period of time" and "plan and schedule"

Another issue of contention is the meaning of duties and other restrictive regulations of commerce

It is unclear as to what exactly the phrase "as between the territories of Contracting Parties" in the chapeau of the Article means. There is lack of clarity on whether it is applicable only to agreements entered into by GATT contracting parties or the ones entered into by a contracting party and a non-contracting party. However, there seems to be consensus emerging on the issue that agreements entered into between a contracting party and a non-contracting party should be handled under the provisions of Article XXIV:10, which requires a two-thirds majority for approval.

Similarly, another issue of contention is the meaning of duties and other restrictive regulations of commerce. There is very little controversy about the term "duties". However, there is no consensus on the meaning of "other restrictive regulations of commerce." Whether certain trade policy instruments such as QRs, ROO, variable levies, customs user fees, and duty remission schemes should be considered to be Other Restrictive Regulations of Commerce (ORRCs) within the meaning of Article XXIV:5, is still a moot question.

Regarding quantitative restrictions, the issue is whether QRs, which are generally prohibited under the GATT, could be properly regarded as Other Regulations of Commerce (ORC)? In the examination of the Treaty of Rome, [71] the EEC disagreed with a number of countries which had expressed the opinion that QRs fell outside the scope of Article XXIV:5. The text of Article XXIV:5 is quite unhelpful, as it does not give any indication whether QRs are outside the scope of the Article. The Understanding did not also clarify the issue. This issue was, however, considered by the Panel in the *Turkey – Textile* case. Turkey, which had introduced QRs upon the CU agreement with the EU, argued that there was nothing in the terms of Article XXIV:5 which prohibited parties to an RTA from introducing QRs. However, India challenged Turkey's interpretation of Article XXIV:5. It maintained its view that parties to RTAs cannot introduce measures, which are prohibited under the GATT, otherwise it would lead to an incongruous situation.

The text of Article XXIV:5 does not give any indication whether QRs are outside the scope of the Article

The Panel held that QRs could be considered an ORC within the meaning of Article XIV:5. As to the central question of whether parties to an RTA are justified in introducing QRs, the Panel answered in the negative:

> [P]aragraphs 5 and 8 of Article XXIV provide parameters for the establishment and assessment of a customs union…These provisions do not, however, address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorise violations of Articles XI and XIII, and Article 2.4 of the ATC…". [72]

However, the AB reversed the Panel on this point:

> "[W]e are of the view that Article XXIV may justify a measure which is inconsistent with certain other GATT provisions. However, in a case involving the formation of a customs union, this "defence" is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of the customs union that fully meets the requirements of sub-paragraph 8 (a) and 5 (a) of Article XXIV. And, second, that party must demonstrate that the formation of the customs union would be prevented if it were not allowed to introduce the measure at issue."[73]

FTAs usually adopt stringent Rules of origin to prevent products originating in third countries from entering their markets duty-free or at concessionary rates

On the issue of Rules of Origin (ROO), FTAs usually adopt stringent ROO to prevent products originating in third countries from entering their markets duty-free or at concessionary rates. Depending on the type of ROO chosen and the threshold figures or requirements set by the parties to the FTA, ROOs could have the potential of raising or increasing barriers to external trade. The issue is whether or not ROOs should be regarded as coming within the definition of ORCs within the meaning of Article XXIV:5. There is consensus on this issue. Moreover, WTO on-going Work Programme on ROOs is likely to solve this problem.

The fundamental issue is how does one calculate the general incidence of duties and other regulations of commerce

Article XXIV:5 mentions: Duties and Other Regulations of Commerce "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories." However, the fundamental issue is how does one calculate the general incidence of duties and other regulations of commerce and make the determination whether they are not "on the whole higher or more restrictive."

Whether the Article requires an aggregated or a disaggregated analysis to be undertaken is still unclear. The view has been expressed that separate analyses have to be undertaken for tariffs and regulations of commerce. There is, however, no consensus on this issue. Another separate issue is that when considering only tariffs or other regulations of commerce, whether an aggregated analysis or disaggregated analysis should be used in calculating the restrictiveness or otherwise of tariffs or other regulations of commerce?

As noted by Professor Kenneth Dam (1970):

> "A principal decision to be made is whether the words 'on the whole' and 'general incidence' refer to each item in the common external tariff schedule or the common external tariff schedule as a whole. If the latter alternative is chosen, one must still determine whether the initial step is to calculate the height and restrictiveness of each national tariff schedule and then strike some kind of average between these national levels...Or is one first to strike some union-wide average for each tariff classification and then to determine the aggregate height of a common external tariff composed of these union-wide averages, the customs union being free to assign any duties on individual items in the common external tariff as long as the calculated union index is not exceeded?"[74]

There is also a great deal of controversy on the meaning of "applicable in the constituent territories"

There is also a great deal of controversy on the meaning of "applicable in the constituent territories." Does it refer to applied rates of duty or bound rate of duty is still a moot question. In WTO negotiations, it is the bound rate, which is relevant. This issue has been somewhat clarified by the Understanding on the Interpretation of Article XXIV, which states: "Applied rates are the benchmark rates to be taken into account in determining the general incidence of duties."

Similarly, the controversy regarding the meaning of "interim agreement" still remains unresolved. The real meaning of "interim agreement" should be an agreement establishing a CU or FTA, which does not immediately commit the parties to abolishing barriers to substantially all the trade between them. In practice, very few agreements commit the parties to abolishing barriers to their trade immediately.

Another question relates as to what should a "plan and schedule" contain

Another question relates to what should a "plan and schedule" contain? The requirement that interim agreements must be submitted with a plan and schedule is meant to ensure that parties do not circumvent their obligations under Article XXIV by maintaining indefinitely an RTA which does not comply with the terms of Article XXIV. While the plan and schedule must not necessarily be comprehensive, they must be such as to permit an initial factual appraisal of the agreement.

Finally, the meaning of "within a reasonable period of time" is also subject to different interpretation offering breeding ground for controversy. Dam (1970) remarks:

> As the transitional period of successive regional agreements reviewed in the GATT became longer, and as the commitments to arrive at completed customs unions or free-trade areas become less definite, the credibility of the legal threat of GATT disapproval vanished. [75]

In the past, there was a lot of controversy as to the meaning of this requirement. The transitional period of some agreements exceeded 20 years, sometimes over 30 years. The Understanding on the Interpretation of Article XXIV provides that it should not normally exceed 10 years.[76] However, to what extent member countries would abide by this interpretation is still an unresolved issue.

3.3.3 Paragraph 6 of the Article XXIV

Article XXIV:6 of the GATT 1994 deals with *provision for compensation* if the provisions contained in paragraph 5 is violated. The rationale for the subsection seems to be that non-members of an RTA should not be made to lose their trade benefits within the multilateral trading system, just because a group of countries have decided to further liberalise trade among themselves. Where a CU increases the tariff on a bound item, it is expected to enter negotiations with parties having initial negotiating rights and a principal supplying interest. Three main interpretative difficulties have been experienced:

Article XXIV:6 of the GATT 1994 deals with provision for compensation if the provisions contained in paragraph 5 is violated

First relates to the question as to how to deal with an increase in a bound rate of duty in some constituent members of the CU, when other members have reduced the duty for that specific item. The Understanding on the Interpretation of Article XXIV provides "due account shall be taken of reductions of duties on the same tariff line made by other members of the customs union."

A second issue is whether reverse compensatory adjustment is recognised under WTO rules. The EC made an argument that it was entitled to receive compensation from the contracting parties of the GATT as the acceding countries had to lower their import tariffs on a broad range of industrial goods. The reductions in this sector more than offset any increases in tariffs on agricultural products. The Understanding on the Interpretation of Article XXIV provides "GATT 1994 imposes no obligation on members benefiting from a reduction of duties consequent upon the formation of a customs union, or an interim agreement leading to the formation of a customs union, to provide compensatory adjustment to its constituents."

The final problem relates to timing, i.e., when should compensatory negotiations under the procedures outlined in Article XXVIII of the GATT 1994 take place. In a number of cases, the parties unilaterally modified their concessions contrary to the provisions of Article II of the GATT 1994 before commencing compensatory negotiations. In the examination of the CU between the EC and Turkey, Thailand criticised the parties for not following established procedures.

As per the Understanding on the Interpretation of Article XXIV compensatory negotiations should be commenced before the parties modify or withdraw their tariff concessions

The Understanding on the Interpretation of Article XXIV resolves this issue by making it clear that compensatory negotiations *should be commenced* before the parties modify or withdraw their tariff concessions under Article II of the GATT 1994. It would appear that there is no obligation on the parties to *conclude* the negotiations before withdrawing or modifying their concessions.

3.3.4 Paragraph 7 of the Article XXIV

Paragraph 7, which deals with notification requirements, is one of the most abused provisions of the Article

Paragraph 7, which deals with notification requirements, is one of the most abused provisions of the Article and its provision has been routinely ignored by GATT/WTO members. Members of the WTO are obliged to "promptly notify" their agreements to the WTO and attach any relevant information, which would enable the General Council (GC) to make any recommendations it deems appropriate. The objective is to give residual control to the GC over such agreements to ensure that they complemented the multilateral trading system. Drafting history confirms that there were some concerns about RTAs. By investing that power in the GC, it was thought that an effective mechanism had been found which would ensure the complementarity between the two approaches to trade liberalisation. Two main difficulties have been experienced with this provision: (i) when should notifications be made? and (ii) the extent of the powers of the GC to make binding recommendations. A cursory reading of the Article seems to suggest that members have to notify their agreements before implementing them. In practice, however, most agreements are implemented before they are notified to the WTO.[77]

These concerns led to the adoption of a decision in October 1972, which states:

> "Without prejudice to the legal obligations to notify in pursuance of Article XXIV, the Council decides to invite [Members] that sign an agreement falling within the terms of Article XXIV, paragraphs 5 to 8, to inscribe the item on the agenda for the first meeting of the Council following such signature, to the extent that the advance notice of ten days prescribed for inclusion of items on the agenda can be observed. Inclusion of the item should allow the Council to determine the procedures for the examination of the agreement."

Adoption of this decision, however, did not change the practice. Some members provided arguments in favour of delaying the notification of the agreements. Some of them even went to the extent of asserting that it might be impracticable for parties to an RTA to notify their agreement before its implementation.

It might be impracticable for parties to an RTA to notify their agreement before its implementation

The question is why is there a flagrant disregard of the provisions of Article XXIV:7? Two plausible explanations could be offered. First, because member countries know that the examination process by the GATT is too slow and would not yield conclusive results at the end. MERCOSUR was notified in 1993, but no decision has been taken so far. Economic gains would be lost if members were to wait for the decision of the WTO. Second, WTO-mandated changes before the implementation of an RTA could create difficulties for governments.[78] Related to this point is that it may be impractical to notify agreements immediately after signing, as the agreement may be changed in the course of the legislative process.[79]

What kind of recommendations could be made by the GC, given the fact that Article XXIV does not throw any useful light on this issue? The following may be considered:

a. requiring the parties to phase out their restrictions on each other's trade within a shorter period;

b. broaden the coverage of their agreement to include sectors or sub-sectors which had been excluded from the coverage of the agreement; and
c. the reduction of the general incidence of duties and other regulations of commerce.

The drafters wanted the GC to make these recommendations to the parties before the implementation of their agreements

A close reading of the provisions of the Article would seem to suggest that the drafters wanted the GC to make these recommendations to the parties before the implementation of their agreements. The purpose of this requirement is said to be a "public choice one": an attempt to ensure that participants in regional liberalisation efforts go all the way. Indeed this was designed to constrain the ability of participating countries to violate their MFN obligations selectively. Draft persons thought CUs and FTAs to be welfare-enhancing, while liberalisation in a few sectors were thought to reduce global welfare based on the concept of trade creation and trade diversion – introduced by Jacob Viner in his seminal work on CUs.[80]

3.3.5 Paragraph 8 of the Article XXIV

What follows from the discussion above is that partial liberalisation is likely to cause trade diversion, as members of the CU or FTA will simply be substituting high-cost producers in their territories with slightly better ones from other participating countries. The key question is how much liberalisation should occur before the constituent territories could be considered to have satisfied the test in Article XXIV:8 of the GATT 1994. Therefore, the key question is the interpretation of the phrase "substantially all the trade". As noted by Australia:

> "an agreed understanding of the meaning of "substantially all the trade" has so far eluded the [GATT/WTO] membership. Lack of a uniform interpretation is partly responsible for the failure of Working Parties to arrive at a unanimous decision in their examination of RTAs".[81]

The key question is the interpretation of the phrase "substantially all the trade", which could be determined through quantitative or qualitative approach

Two schools of thought have clearly emerged on this issue – the quantitative and the qualitative schools of thought. An example of the qualitative school is that there should be liberalisation of a significant proportion of the trade between the constituent territories. In the examination of the EEC Treaty of Rome, the original six member states opined that the test would be satisfied if 80 percent of the volume of trade between the parties were liberalised.[82] In the *United States - Line Pipe* case, the US argued that since NAFTA covered 97 percent of the trade between the parties, it was in conformity with the provisions of Article XXIV.8.[83] While the quantitative approach has some positive aspects, it has conspicuous drawbacks. It can permit parties to an agreement to exclude the so-called sensitive sectors such as agriculture, and textiles and clothing.

To reduce the selectivity associated with the quantitative approach, Australia suggested that the threshold figure should be 95 percent of all the six-digit tariff lines listed in the harmonised system (HS).[84] The main advantages of its proposal are that:

a. it would obviate the need to establish the extent to which trade in a given product may have been affected by other measures in place.
b. it would make it unlikely that the approach would permit the carving out of any major sector because of the strong possibility that the permitted exemptions would have to be spread out over a range of potentially sensitive sectors.
c. the approach would be easily verifiable without requiring complex econometric studies.

CRTA has not adopted the Australian proposal because members feel that there is no textual basis in the proposal and figure of 95 percent is arbitrary. CRTA could adopt the proposal, but it would mean an amendment of the current rules.

Members wanted to prevent RTAs from being selective in choosing the sector for liberalisation thereby allowing some countries to exclude sensitive sectors

The proponents of the qualitative school argue that for an RTA to be consistent with the Article, it should not exclude any major sector of economic activity. They argue that the fact that trade in the so-called sensitive sectors is usually small is no reason to exclude them from the coverage of the agreement. In the examination of the European FTA, the view was expressed that the exclusion of agriculture from the coverage of the Agreement was not in conformity with the letter and spirit of the provisions of Article XXIV:8.

The parties to the European FTA accepted that both the quantitative and qualitative elements were relevant, but they challenged the view that their agreement excluded agriculture. They pointed out that it covered a third of trade in agricultural products. In the examination of the Interim Agreements between the EC and the Czech Republic, Hungary, Poland and the Slovak Republic, the representative of Australia expressed the view that the agreement did not comply with the clause "substantially all the trade requirement", as there were significant barriers to trade in agricultural products. He asserted that for an agreement to comply with the requirement, there needed to be free trade in agricultural products. As was expected, the EC disagreed and pointed out that Australia had erroneously interpreted the terms of Article XXIV:8. As per EC: "The word 'substantially' qualified the phrase 'all the trade'. A free-trade area did not mean complete free trade; otherwise the word 'substantially' was meaningless." The view of the EC cannot be disparaged. The word "substantial" does not mean "all". Any other interpretation would be ignoring the ordinary meaning of the word "substantial".

The Understanding on the Interpretation of Article XXIV provides in its preamble that:

> "Recognising also that such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded."

However, preambular language has been the subject of intense debate. In EC - Czech Republic, Hungary, Poland and the Slovak Republic agreements, the Australian representative argued that the Understanding obliged parties to an RTA to include all sectors:

> "The WTO Understanding on the Interpretation of Article XXIV of the GATT clearly referred to a diminished contribution to the WTO system if any major sector of economic activity were excluded. Notwithstanding the "coverage" of agriculture in these Agreements, the sector was, in effect, excluded from the obligations of Article XXIV."[85]

In Turkey-Textiles dispute, the Panel expressed the view that "the ordinary meaning of the term 'substantially' appears to provide for both qualitative and quantitative components"

The EC disagreed and stated that the Australian representative had misconstrued the significance of the preambular language. It further argued that too much had been read into the Understanding and that members were not obliged to liberalise "all" their trade.

In *Turkey-Textiles* dispute, the Panel expressed the view that "the ordinary meaning of the term 'substantially' in the context of sub-

paragraph 8(a) appears to provide for both qualitative and quantitative components". The AB confirmed this view. The test in Article XXIV.8 required a certain percentage of trade to be liberalised and also the non-exclusion of any major sector of economic activity. The AB said that the test offered some flexibility. The word "substantial" does not mean "all", but it required "something considerably more than merely *some* of the trade."

The question is why the "substantially all the trade" term is required. Drafters thought that it would further the goal of trade liberalisation. If that is the case, then it is logical to insist on parties to RTAs to comply with a higher threshold as suggested by Australia. The following statement by Wilcox (1949) is very instructive:

> "A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living. A preferential system, on the other hand, retains internal barriers, obstructs economy in production, and restrains the growth of income and demand. It is set up for the purpose of conferring a privilege on producers within the system and imposing a handicap on external competitors. A customs union is conducive to the expansion of trade on a basis of multilateralism and non-discrimination; a preferential system is not."[86]

The Exceptions Clause [Article XXIV:8(a)] provides some clarification to this controversy:

> "A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that
>
> (i) *duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories*" (emphasis added).

It is not yet clear whether the lists of exceptions provided by Article XXIV:8 (a) are exhaustive or merely indicative

The provision for FTAs is quite similar. However, two main difficulties have been experienced: (a) whether the list of exceptions in the Article is exhaustive; and (b) whether a party to a CU or FTA could exempt the products from other constituent members of the RTA when it imposes trade restrictions sanctioned by the Article.

> The question now arises as to whether or not the list provided by the Exceptions Clause is exhaustive. Assuming that the list of articles in paragraph 8 is merely indicative and that parties to RTAs can impose restrictive measures such as safeguard measures, the question has arisen whether in the application of such measures, adherence to the non-discrimination principle should be observed.

In Argentina - Footwear and the United States - Line Pipe disputes, it was decided that parties to RTAs need not observe the non-discrimination principle when applying safeguard measures

In *Argentina - Footwear*[87] and the *United States - Line Pipe* disputes[88], it was decided that parties to RTAs need not observe the non-discrimination principle when applying safeguard measures, provided they observe certain conditions in excluding the exports of their partner countries. Given the overarching objective of the drafters of the GATT to ensure a high degree of liberalisation of trade between constituent members of an RTA, would it make sense to oblige them to exempt

each other's exports from the application of any trade restrictive measures?

A follow up question is whether or not parties to CUs are required to apply substantially the same duties and other regulations of commerce. Whereas there is a convergence in the views of WTO members that parties to CUs have to apply substantially the same duties and other restrictive regulations of commerce from the outset, there is a divergence in the opinions of members whether subsequent applicants have to adopt the same restrictive regulations of commerce upon their accession, if they were not applying such restrictions.

This issue came to the limelight following the enlargement of the EU to include Austria, Finland and Sweden. It was also considered in *Turkey - Textiles*, where following its CU with the EU, Turkey started applying restrictions on textiles and clothing products maintained by the EU on these products. Turkey sought to justify its measures on the basis of Article XXIV:8 (a)(ii), which obliges parties to CUs to apply "substantially the same duties and other regulations of commerce". Turkey argued that, since trade in textiles and clothing products constituted about 40 percent of its trade with the EU, it was important for them to apply the same regulations, otherwise there could be massive trade diversion such as to fundamentally weaken the common commercial policy of the EU.

In Turkey-Textile dispute, the Panel concluded that in some situations, parties to an RTA could adopt inconsistent WTO measures

After an extensive analysis of the provisions of Article XXIV, the Panel concluded that whereas in some situations, parties to an RTA could adopt inconsistent WTO measures, in this particular case, Turkey had failed to prove that it was necessary for it to adopt the challenged measures. The AB confirmed this finding of the Panel on appeal.

3.4 Enabling clause

Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (better known as the Enabling Clause) was adopted in 1979 as part of the results of the Tokyo Round. This Decision of the Contracting Parties of 28 November 1979, Para 2 (c) allows departure from the MFN principle on the following arrangement:

> "Regional or global arrangements entered into amongst the less-developed Contracting Parties for the mutual reduction or elimination of tariffs, and in accordance with criteria or conditions which may be prescribed by the Contracting Parties, for the mutual reduction or elimination of non-tariff measures, on products imported from one another."

The question that arises from the above-mentioned paragraph is whether the Enabling Clause provides an alternative legal basis for the formation of RTAs or not? The answer to this question depends on the parties to the arrangement. Clearly, RTAs entered into between one developed country with another or developed country with developing country is not covered by this arrangement, unless a waiver is obtained by the contracting parties under Article IX of Marrakesh Agreement Establishing the WTO.[89] Even among such arrangements entered into among the developing countries, one has to look into the above-mentioned test, i.e., who are the parties? If the parties to such arrangement have negligible share in the world trade, WTO members do not create much of a problem. However, if these parties have relatively higher share in the global trade, the members try to ensure

If the parties have negligible share in the world trade, WTO members do not create much problem even if the agreement is notified under the Enabling Clause

that such arrangements become a part of Article XXIV, not the Enabling Clause.

For example, when MERCOSUR was formed in 1991 and notified under Enabling Clause, the USA objected to it being notified under the Enabling Clause because MERCOSUR had almost four percent share in the global trade. Finally, it was forced to notify under Article XXIV. However, other FTAs like ASEAN Free Trade Area (AFTA), Common Market for Eastern and Southern Africa (COMESA), and PTAs like SAPTA have been notified under the Enabling Clause and no WTO member has so far raised any objection to these agreements. At the same time, it is worth noting that most of the agreements entered into between the former Eastern Bloc countries, including the Commonwealth of Independent States (CIS), have been notified under Article XXIV. Likewise, some other agreements where a country like Mexico is a party, have been notified under Article XXIV. Out of the 156 agreements notified to the WTO till September 2001, only 18 were notified under the Enabling Clause.[90]

The major requirements under the Enabling Clause is that the arrangement should be designed to facilitate and promote the trade of developing countries and not to raise barriers

However, before the enactment of the Enabling Clause, developing countries relied on Part IV of the GATT (Trade and Development) to form RTAs. ASEAN, for example, was notified pursuant to the provisions of Part IV of the GATT 1947, but was later re-notified under the Enabling Clause. The major requirements under the Enabling Clause is that the arrangement should be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties. Members invoking the Enabling Clause should ensure that their agreement is not impeding the MFN reduction or elimination of tariff and non-tariff trade restrictions. There is some flexibility for developing countries when it comes to reduction of tariffs. NTBs, however, have to be reduced in accordance with the guidelines of members.

3.5 Article V of the GATS

Article V of the GATS is the equivalent of Article XXIV in the field of trade in services. Obviously, before the GATS, the services component of RTAs was not examined. GATS provisions mirror that of Article XXIV, although it does not use the terms FTA or CU, but rather "economic integration" reflecting the broad reach of the GATS. It covers all the four modes of delivery.[91]

GATS does not use words such as FTA or CU, but "economic integration reflecting its broad reach

The guiding principle is set out in Article V:4 which provides that any economic integration agreement: "shall be designed to facilitate trade between the parties to the agreement and shall not in respect of any member outside the agreement raise the overall level of barriers to trade in services within the *respective sectors or subsectors* compared to the level applicable prior to such an arrangement" (emphasis added). With its emphasis on "respective sectors or subsectors", it is generally thought that Article V offers more protection for non-participating countries than in Article XXIV. It has been suggested that as a result of the more disaggregated (i.e., sub-sectoral) focus taken in Article V, a WTO member cannot argue – in contrast to GATT 1994 – that the average level or "general incidence" of protection has not changed, regardless of what might occur at the level of individual products (sub-sectors).

Provision on compensation is more elaborate in Article V of GATS – that compensation has to be on an MFN basis is stated clearly

Provision on compensation is more elaborate in Article V of GATS than Article XXIV of GATT – that compensation has to be on an MFN basis is stated clearly. Like Article XXIV:8, Article V:1(a) requires economic

integration agreements to have "substantial sectoral coverage", which should be understood in terms of the "number of sectors, volume of trade, and modes of supply". An agreement would not be consistent with the terms of Article V, if it provides for the *a priori* exclusion of one of the modes of supply. The reason behind this rule is to prevent members from entering into narrow discriminatory agreements, which are generally thought not to be welfare-enhancing from the view point of multilateral trading system. Members wishing to form an economic integration must be prepared to go beyond the liberalisation commitments under the GATS, if their agreement is to conform to the provisions of Article V. Article V:1(b) underscores this point by providing that the agreement should "provide for the absence or elimination of substantially all discrimination...between or among the parties, in the sectors covered under subparagraph (a) through [the] elimination of existing discriminatory measures, *and/or* prohibition of new or more discriminatory measures".

It would, however, appear that Article V:1 is limited in its terms, when a comparison is made with the provisions of Article XXIV:8 of GATT 1994, which obliges members to eliminate duties and other regulations on substantially all trade, which on one view means that no major sector of economic activity should be excluded from the coverage of the agreement. Under the GATS, there is no such requirement, as the parties are only required to eliminate existing restrictions, or in the alternative they can maintain the existing restrictions, provided they do not introduce new ones or make the existing ones more restrictive.

3.6 Procedural aspects

Under the GATT, RIAs entered into pursuant of Article XXIV are notified to the Council for Trade in Goods ("Council").[92] Once notified, the agreement is put on the agenda of the next meeting of the Council. Any Contracting Party could then request for the establishment of a WP to examine the agreement. As a general rule, the membership of the WP was open to any interested party of the GATT. The objective of the WP, after receiving questions and comments from other contracting parties and seeking clarifications thereto, was to submit a report containing conclusions and recommendation to the Council. Unfortunately, the conclusions and recommendations were not very helpful to the Council because they were largely inconclusive reflecting diverse opinions of the contracting parties. Since most of the decisions in the GATT had to be taken through consensus, it was natural for the report to remain largely inconclusive.

After the establishment of the WTO, Committee on Regional Trade Agreements (CRTA) has been constituted to streamline the approval process

The examination process under the WTO has not changed much, although attempts have been made to streamline it. The first step taken by WTO members was the decision to establish the CRTA, a standing body to replace the numerous WPs established on an *ad-hoc* basis to examine agreements notified to the GATT. The creation of the CRTA had, in principle, two clear advantages, namely, institutional improvements and operational improvements. However, the problem of decision-making, which plagued the GATT system, remained because WTO members failed to reach consensus on the compatibility of most of the RTAs.

Unless the examination process is fundamentally changed, any concrete result is unlikely and the situation that prevailed under the GATT will continue. This view is shared by Sam Laird, who observes:

> "The real problem is the decision-making process of the CRTA as laid down in the Rules 33 of the Rules of Procedure

Lack of clarity in the relevant rules and decision-making process of the WTO are the two main reasons that explain the paralysis ascertaining consistency of RTA with relevant multilateral rules

> of the CRTA. Parties to RTAs cannot be expected to accept without question the opinion of other members of the CRTA that their agreement does not comply with the relevant rules of the WTO. The possibility of the WTO members, which are parties to the RTA defending the RTAs and those outside, opposing the RTAs is common within CRTA. Therefore, the examinations have been plagued by divergences of view on a series of systemic issues. And WTO Committees cannot move without consensus among the member countries."[93]

Two main reasons explain the paralysis in the decision-making process of the WTO regarding the consistency of RTA with relevant multilateral rules. The first relates, as mentioned above, to lack of clarity in the relevant WTO rules – which are subject to different interpretations. The second problem is the decision making process of the WTO itself, where all the decisions are taken by consensus. This means that every member has a *veto*. If a member feels that interpretation of a relevant provision will not go in its favour, it has an incentive to block the decision. Writes Kessie (2001):

> Given national sensitivities and pride, it would be rare if not impossible to find countries, which would readily accept the views of other countries that their agreement is not consistent with WTO rules. Likewise it cannot be expected that third countries, whose trade interests may have been negatively affected by the regional trade agreement, would be free from any prejudices when participation in the exercise to evaluate the consistency of the agreement with WTO rules. [94]

The discussion in the Working Group (during the GATT period) used to be highly legalistic focusing on the interpretation of each provision of the Article, paying little attention, if any, to the motive/intention of the drafters of the Article. However, two most notable procedural innovations were introduced during that period, which are praiseworthy. They included: product-by-product review and annual review of interim arrangements. But one could see that annual reviews of interim arrangements were taken seriously by members only when they moved into technical spheres from political spheres.

One of the proposals to remedy this situation is to form an independent panel of experts to examine the compatibility of RTAs with the rules of the WTO

One of the proposals to remedy this situation is to revamp the current process and form an independent panel of experts to examine the compatibility of RTAs with the rules of the WTO. The decision of the panel of experts should be submitted to the CRTA and it can only reject the panel report if there is a consensus to reject the same. [95] However, changing the rules too requires consensus among the member countries, which is hard to come by.

3.7 The way forward

The rules governing the RTA formation and examining their consistency with the relevant provisions of the GATT/WTO are as elaborate as any other rules. They were mainly guided by the common notion that RTAs should be supportive to the overall objectives of multilateral trade liberalisation, which contracting parties wanted to achieve. The main idea was that the parties to an RTA go all the way to liberalise trade to ensure that they become compatible with the relevant rules. This is to ensure that only serious RTAs pass the test. Realizing some shortcomings in the Article XXIV, contracting parties have ingenuously added some stricter criteria in the Article V of GATS.

As per the data of the WTO Secretariat as of June 2002, 172 RTAs were notified to the WTO under various provisions (See Annex 1 for

details).[96] Out of them, conformity with Article XXIV has been explicitly acknowledged by the WP, through the requisite consensus, in the case of only six agreements and only two of them are functional now.[97] WTO rules and procedures are to be blamed in part for the snail-paced approval process. However, there are so many controversial and incongruent provisions in Article XXIV that commenting on the relationship between paragraph 4 and paragraphs 5 through 9 is a fertile source of controversy.[98] The paralysis in decision-making process of CRTA is yet another problem that needs to be addressed.

The failure of the administrative organs of the WTO to decide compatibility of various RTAs notified so far has resulted in the judicial organ (Appellate Body and Panel) taking over this task to themselves. This is a very unhealthy trend, which needs to be reversed. Multilateral Trade Negotiations envisaged by the Doha Declaration offers a window of opportunity. This opportunity must be utilised by all the members of the WTO to ensure that original purpose and intent of the Article is both preserved and prevented from erosion. The proposal for the establishment of a panel of experts, and following the reverse consensus principle as in the case of the Dispute Settlement Body (DSB), is both appealing and worth considering.

Issues for comment

- Is there a need to clearly define the phrase "substantially all the trade" within the Article XXIV of the GATT? If yes, how should it be defined?
- Paralysis in the decision making process of the CRTA has resulted in the decisions regarding the compatibility of RTAs being decided by the Dispute Settlement Body of the WTO. Is this a healthy trend, and if not how could this be resolved?
- What is the reasonable period of time within which interim arrangement leading to the formation of FTA or CU should cease to exist?
- In what respect Article V of the GATS can be considered an improvement over Article XXIV of the GATT?
- Are the RTAs notified under the 'Enabling Clause' invariably non-serious in nature, and if so should SAPTA or proposed SAFTA should be notified under Article XXIV of the GATT?

CHAPTER IV

REGIONAL INTEGRATION IN SOUTH ASIA

4.1 Background

South Asia has a common destiny in the 21st century. Though comprising only three percent of the world's total area, it houses 21 percent of the world's population.[99] The irreversible process of globalisation is throwing up many daunting challenges for developing countries in general and the SAARC countries in particular.[100] One of the ways of meeting these challenges is to overcome regional apprehensions and constraints and irreversibly and speedily move towards regional cooperation and integration.[101] Like other RTAs, SAARC is aiming to reap the benefits of regional cooperation. For example, economic integration in South Asia may lead to realisation of potential economic benefits from: lower intra-regional transport and transactions costs; more favourable terms of trade; economies of scale in investment, production and distribution; and possibly higher efficiencies due to increased intra-regional competition and cooperation from increased external and intra-regional trade creation. Despite these apparent benefits, progress in achieving regional cooperation has been, at the best, very modest.

The irreversible process of globalisation is throwing up many daunting challenges for developing countries in general and the SAARC countries in particular

The SAARC, comprising seven South Asian countries: Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka, formally came into existence in 1985 with the adoption of its Charter at the first Summit in Dhaka (7- 8 December 1985). The idea of regional cooperation was first proposed through 'a regional forum' by Bangladesh in 1980, with a view to holding periodic, regional-level consultations among countries in South Asia on matters of mutual interest and possible cooperation in economic, social, cultural and other fields. The rationale was primarily predicated on the premise that regional experiences elsewhere in the globe had been highly successful and that the countries in the South Asia region would benefit enormously from such cooperation as it would strengthen their competitive position, both individually and as a group.

Box: 4.1

SAARC: A calendar of events

1981- Colombo	First formal meeting of the foreign secretaries of the region for venturing into institutionalised regional cooperation was held.
1983- New Delhi	The second stage towards regional cooperation was marked with the convening of the meeting of foreign secretaries. The Integrated Programme of Action (IPA) was launched here through the declaration of SAARC.
1985- Dhaka	The First SAARC Summit was held and the heads of state or government decided to establish SAARC. For the first eight years of its existence, hardcore economic issues, such as trade, industry, money and finance were to be kept outside the scope of cooperation under SAARC.

1991- Colombo	An Inter-Governmental Group (IGG) was set up to formulate an agreement to establish SAPTA by 1997.
1993- Dhaka	The framework agreement on SAPTA was finalised. SAARC and UNCTAD signed a Memorandum of Understanding too.
1995- New Delhi	SAPTA formally came into existence, well in advance of the date stipulated by the Colombo Summit. The SAPTA provided for a transition to SAFTA. Earlier it was envisaged that SAPTA would be achieved by the year 2005. Three rounds of negotiations have taken place under SAPTA. In the last round of negotiations, a total of 3,456 commodities were offered for tariff concessions.
1997- Male	At the Summit, the heads of state or government decided to bring forward the date of achieving SAFTA to 2001.
1998- Colombo	The Tenth Summit decided that deeper tariff concessions should be extended to products which are being actively traded or are likely to be traded among members, in order to accelerate the progress in the next round of SAPTA negotiations.
2002-Kathmandu	The eleventh Summit directed the Council of Ministers to finalise the text of the Draft Treaty Framework by the end of 2002. They also directed that in moving towards the goal of SAFTA, the member states expedite action to remove tariff and non-tariff barriers and structural impediments to free trade.
Sources:	Mahbub ul Haq Human Development Centre (2002): 111 The Rising Nepal (2002)

South Asian countries enjoy geographical contiguity, historical, social, cultural and ethnic affinities which could act as centripetal forces

The Bangladesh proposal argued that inherent logic strongly justified regional cooperation, particularly among South Asian countries, because the countries in the region enjoy geographical contiguity, historical, social, cultural and ethnic affinities which would act as centripetal forces and thus, contribute substantively to facilitate coordination and reducing transaction costs.[102] Despite the obvious rationale for regional cooperation in the area of trade and investment, progress has been glacially slow. The cost of non-cooperation in a static framework is high (Box 5.1). Further, although there is substantial informal trading, official trading among SAARC countries accounts for less than 4 percent of their total trade volumes.[103] The corresponding figure for EC is 66 per cent, 37 per cent for NAFTA and 21 per cent for ASEAN.[104]

Despite the fact that the idea for economic cooperation was mooted in 1986 at the first Ministerial Meeting on International Economic Issues (31 March – 3 April, Islamabad), the formal initiative towards regional economic cooperation was realised in 1995, when the framework agreement on SAPTA formally came into operation. The Agreement reflected the desire of the SAARC countries to promote and sustain

mutual trade and economic cooperation within the SAARC region through exchange of concessions.[105] Regional free trade was not in the agenda of SAARC in the beginning.

The formal initiative towards regional economic cooperation was realised in 1995, when the framework agreement on SAPTA formally came into operation

4.2 Objectives of SAPTA

According to the agreement, the PTA is based on the following four principles:

(a) Overall reciprocity and mutuality of advantages among contracting parties.

(b) Step-by-Step negotiations to be improved and extended in successive stages with periodic reviews.

(c) Inclusive of all manufactured products and commodities in their raw, semi processed, and processed forms.

(d) Special and favourable treatment to LDCs.

The objectives of SAPTA as stated in the preamble of the Agreement are as follows:

(a) To promote regional cooperation for the benefit of their peoples, in a spirit of mutual accommodation, with full respect for the principles of sovereign equality, independence and territorial integrity of all States.

(b) Expansion of trade which could act as a powerful stimulus to the development for their national economies by expanding investment and production, and help securing higher living standards for their population.

(c) To establish and promote regional preferential trading arrangements for strengthening intra regional economic cooperation and the development of national economies.

(d) To promote the intra-regional trade which presently constitutes a negligible share in the total volume of the South Asian trade.

4.3 Progress of SAARC on economic cooperation

In December 1988, the fourth SAARC summit gave direction to all member states to identify the specific areas where economic cooperation might be feasible

SAARC has taken important steps to expand cooperation among member countries in the core economic areas. In December 1988, the fourth SAARC summit held in Islamabad gave direction to all member states to identify immediately the specific areas where economic cooperation might be feasible. When the sixth SAARC Summit was held in Colombo in December 1991, the then heads of states of the member countries declared liberalisation of trade in the region through a step-by-step approach in such a manner that countries in the region share the benefits of trade expansion equitably.

In fact, the completion of the regional study on Trade, Manufactures and Services (TMS) in 1991 was the first significant step, which paved the way for SAARC to move forward in strengthening cooperation in trade and investment. The study also outlined a number of recommendations for promoting regional cooperation in other core economic areas.

As per the mandate given by the sixth SAARC Summit in Colombo, a high level Committee on Economic Cooperation (CEC) comprising the Commerce Secretaries of member states was established in July 1991 to act as the forum to address trade and investment issues. The committee was charged with the responsibility of, *inter alia*, monitoring the progress in the implementation of decisions relating to expansion of trade and economic cooperation under the framework of SAARC. It considered the reports of Inter Governmental Group (IGG) on trade liberalisation, Inter Governmental Expert Group (IGEG) on transition to SAFTA and Committee of Participants (COP). The Committee was also responsible for reviewing the progress in the implementation of the decisions of meetings of SAARC Commerce Ministers.

The IGG, established in December 1991 was requested to recommend measures for trade liberalisation within SAPTA

As mentioned above, the Colombo Summit in December 1991 approved the establishment of IGG to seek agreement on an institutional framework. The IGG was requested to recommend measures for trade liberalisation within SAPTA. This was proposed by Sri Lanka. Subsequently the SAPTA agreement was signed by the Council of Ministers in Dhaka on 11 April, 1993 during the Seventh SAARC Summit.

After completion of all the formalities by all SAARC member countries and subsequent to a notification issued by the Secretariat to this effect, the SAPTA Agreement entered into force on 7 December 1995. However, the first round of trade negotiations covered only 226 products, largely of little relevance to the actual trade that was taking place amongst the member countries.[106] Indeed, it has been estimated that the value of intra-regional import coverage in respect of the 226 tariff lines, which were subjected to tariff concession, amounted to a mere 6 percent of the intra-regional imports.[107]

Up to the second round of SAPTA negotiations, the number of products enjoying preferential treatment had increased to more than 2000

After the operation of SAPTA, the IGG on trade liberalisation started the second round of negotiations in 1996. This was successfully concluded after four meetings of the group in Colombo, Islamabad, New Delhi, and Kathmandu in March, September, October, and November, respectively. Up to the second round, the number of products enjoying preferential treatment had increased to more than 2000. The NTBs in the way of expansion of intra SAARC trade were also identified and listed in order to make the process more transparent. The third round of trade negotiations under SAPTA was also concluded in 1998 and after this round, the number of products enjoying preferential treatment increased to more than 5,000 commodities. During this round, tariff concessions were offered on 3,456 tariff lines.

Most member countries, despite serious limitation of product-by-product approach for tariff concessions, chose to follow the same approach during the third round

However, most member countries, despite serious limitation of product-by-product approach for tariff concessions (an array of concerns were voiced against this approach during the second round), chose to follow the same approach during the third round. Writes Udagedera (2001): "[Third Round of] negotiations were conducted mainly on a product-by-product basis while Bangladesh, India and Pakistan exchanged tariff concessions among them on a product-by-product basis as well as chapter-wise. Maldives offered a consolidated list of tariff concessions covering 368 items to all member countries irrespective of request lists submitted by them. No member country had negotiated on sectoral or across the board basis."[108] Number of products and tariff concessions exchanged by member countries during the third round of negotiations under SAFTA is provided in Table 4.1:

Table 4.1: Consolidated national schedule of concessions: Third round of negotiations

Country	B'desh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
B'desh	X	10 items (10-15%)	260 items 11 chapters	113 items chapters 3 & 16	20 items (10-15%)	7 items chapters 16 & 51	7 items
Bhutan	34 items (10%)	X	X	26 items (18%)	41 items (10-12%)	16 items (10%)	7 items (10%)
India	1816 items 28 chapters (50%)	X	X	116 items (50%)	X	18 items (20%)	25 items (10%)
Maldives	368 items to all the member countries						
Nepal	39 items (10-15%)	77 items (10-15%)	X	21 items (10%)	X	42 items (10%)	10 items (10%)
Pakistan	23 items 4 chapters (30%)	8 items (30%)	18 items (20%)	15 items (30%)	17 items (30%)	X	6 items (20%)
Sri Lanka	21 items (10-15%)	6 items (10-75%)	25 items (10%)	22 items (10%)	5 items (10-75%)	3 items (10%)	X

Source: Udagedera (2001): 22

Note that India had bilateral FTAs with Nepal and Bhutan at the time of the third round of SAPTA negotiations. Therefore, additional offers to these smaller countries were not granted by India. Since Nepal and Bhutan had reciprocated concessions to India (to the extent possible) under the bilateral FTAs, they also did not provide any concession to India during the third round of negotiations.

An analysis of the SAPTA negotiations underlines the constraints that South Asia faces in attempting to integrate as a regional entity

However, an analysis of the SAPTA negotiations underlines the constraints that South Asia faces in attempting to integrate as a regional entity. With the conclusion of the third round of negotiations in November 1998, over 5,000 tariff lines of a total of 6,500 have been covered by preference to member countries[109] (Table 4.2). However, one should not be swayed by the argument that PTA in South Asia is an effective building block towards the FTA within the region. On the contrary, there are inherent problems of using preferential trade concessions as a means of increasing trade volume within any given regional framework. Countries can appear very generous simply on the basis of the number of concessions given, but what is more relevant is the actual trade coverage of those preferences. Similarly, the depth of tariff cuts offered under a preferential agreement can again be limiting.[110] The SAPTA suffers from both these factors.[111]

Table 4.2: SAPTA preference

Offered to / Offered by	LDC	Non-LDC	Total
Bangladesh	44	558	602
Bhutan	122	68	190
India	2412	484	2896
Maldives	369	19	388
Nepal	117	252	429
Pakistan	242	284	526
Sri Lanka	52	144	196
SAARC	3418	1809	5227

Source: Weerakoon (2001): 3

The sixteenth session of the Council of Ministers agreed that member states should strive towards the realisation of SAFTA

Following the ratification of SAPTA by all member states, the sixteenth session of the Council of Ministers (New Delhi, December 1995) agreed that member states should strive towards the realisation of SAFTA. For this purpose an IGEG on transition to SAFTA comprising experts from the member countries was set up to identify the necessary steps towards moving into a FTA. The IGEG has met and held in-depth discussions and agreed on the draft terms of reference for the group and has also drawn up a broad framework of Plan of Action for achieving SAFTA.

This chronology of official developments related to SAPTA clearly brings out that: (a) the SAARC has gone about entering into the politico-economically sensitive area of trade liberalisation in a cautious and mutually acceptable manner; (b) despite its cautious and sensitive approach, the SAARC countries were able to commence the implementation of SAPTA on schedule; and (c) the SAARC countries did not see the liberalisation of intra-regional trade as an end in itself, but as a means towards improving the economic welfare of the people of South Asia.

4.4 Modalities of SAPTA

SAPTA was envisaged primarily as the first step towards the transition to a SAFTA, leading subsequently, towards a Customs Union, Common Market and Economic Union. Therefore, as a precursor to a much broader economic cooperation, SAPTA follows the following modalities:

4.4.1 Removal of trade restrictive measures

The Agreement on SAPTA has identified four types of trade-restrictive measures for progressive elimination. They include: (a) tariffs; (b) para-tariffs; (c) non-tariff measures (NTMs); and d) direct trade measures.

The Tenth SAARC Summit held in Colombo in July 1998 took note of the need to remove NTMs and to deepen the tariff concessions already exchanged

The three Rounds held so far have addressed the first two trade restrictive measures to a large extent. There was not much progress, however, on the third one, which relates to removal of NTMs, including QRs. The Tenth SAARC Summit held in Colombo in July 1998 took note of the need to remove NTMs and to deepen the tariff concessions already exchanged. It directed that these should be addressed in the next round of trade negotiations.

Since the WTO rules (Article XI of the GATT) prohibit the use of QRs (barring under certain exceptional circumstances), QRs among the SAARC member countries are not expected to continue for long. The two countries, which have not yet become members of the WTO, in any case, maintain negligible QRs.

The fourth round, which was intended to implement the Summit directive, was delayed due to the postponement of the SAARC Summit. The Eleventh SAARC Summit, which finally concluded in Kathmandu on January 6, 2002, however, instructed to conclude the meeting of the IGG on trade liberalisation for the fourth round of negotiations under SAPTA as early as possible as per the decision of the Tenth SAARC Summit in Colombo.[112] Therefore, much hope can now be placed on this round of negotiations, especially in the area of reducing NTBs.

India, which had maintained a higher number of quantitative restrictions in South Asia, decided to unilaterally remove all NTBs within SAARC countries in August 1998

Meanwhile, the Government of India, which had maintained a higher number of QRs, decided to unilaterally remove all NTBs within SAARC countries in August 1998. This amounted to over 2,000 items.[113] Then again, India moved forward to unilaterally dismantle most of the QRs on a global scale from 1999. It is interesting to note that this change in the trade policy of the government of India was brought upon by a decision of the WTO Panel under the Dispute Settlement Procedure.[114] As per the decision, India is required to phase out its QRs within the period of four years from the date of decision of the Dispute Settlement Body (i.e., by 2003). This left the Government of India with little option. The outcome was a trade policy re-orientation in India aimed at dismantling QRs, which to date continues.[115] On 01 April 2001, India removed many QRs that were applicable in its trade regime.

NTMs are proving hurdles to the smooth flow of regional trade and commerce

However, other NTMs (such as the ones used on sanitary and phytosanitary grounds and other technical requirements) are proving hurdles to the smooth flow of regional trade and commerce. These measures are not only non-transparent and difficult to comply with, but are at times arbitrary and could act as disguised restriction to regional trade. This problem becomes more severe while dealing with countries with a federal political structure where different states have different rules and regulations and they are not harmonised at the sub-national level (Box 4.2).

Box: 4.2

Problem faced by Nepalese exporters

Nepalese business organisations have strongly flayed the imposition of quarantine checks over Nepalese agricultural products by the Indian authorities, and asked the government to solve the problem at the earliest. A joint release issued by a dozen organisations, including district offices of the Federation of Nepalese Chambers of Commerce and Industry (FNCCI), says that the quarantine check and the subsequent payment of inspection fees to Indian customs officials have adversely affected exports of Nepalese goods to India.

As per the official information given by the Indian customs officials on July 10, it was decided to impose quarantine checks on agriculture seeds, plants and food items. Nepalese business organisations claim that this is against the spirit of the Nepal-India trade pact. The unilateral enforcement of quarantine checks has resulted in an increase in the price of Nepalese products in the Indian markets thereby eroding their competitiveness against local Indian products, the release said.

Source: The Kathmandu Post (2001)

4.4.2 Rules of origin

Rules of origin requirement is another area which proved to be much contentious within SAPTA since its inception

Rules of origin (ROO) requirement is another area which proved to be much contentious within SAPTA since its inception. In theory, ROO not only prevent 'trade deflection' in a regional grouping but also contributes to the development process of member countries through different trade and value addition effect.[116] However, in practice, it puts countries with inadequate domestic capacity at a disadvantageous position. Therefore, Jayasekera argues, "SAARC should explore the possibility of further relaxing its ROO in order to assist the least developed and smaller developing countries in the region.[117]

Recognising these difficulties, the SAPTA Agreement provides for differentiated ROO criteria for a developing country member and a least developed country member. The local content requirement necessary for tariff preference on an LDC product was set down to be 40 percent in case its components are sourced from within the region and 50 per cent in case they are from non-members at the commencement of SAPTA in late 1995. For a developing country member, however, the requirement was set down at 50 per cent and 60 per cent, respectively.

Now member states are in the process of giving effect to the revised ROO, accommodated within the SAPTA framework

Bangladesh, which maintains no bilateral trade treaty with any of the SAARC countries, particularly with India, felt that the local content requirement was too high. Sri Lanka, a developing country member with no substantial industrial base compared to India and Pakistan, felt that the higher local content requirement particularly discriminated against it. It was argued that there was not much of formal trade between India and Pakistan for the trade effect of this requirement to be tested as between them. Since Sri Lanka was the only other developing country left, its grievance had a basis. The matter was referred to the COP in 1998, which suggested a reduction of 10 per cent in the local content requirement of both LDC members and developing country members. The Commerce Ministers who met in Dhaka in January 1999 recommended the revision of the ROO of the SAPTA Agreement to give effect to a new local content requirement. The SAARC Council of Ministers, which convened subsequently, endorsed this recommendation for implementation. The Agreement on SAPTA was

modified to accommodate the change in the ROO accordingly. Now member states are in the process of giving effect to the revised ROO.[118]

4.4.3 Trade facilitation measures

Simultaneous with the SAPTA process, a number of trade facilitation measures have also been addressed. These measures can be broadly divided under the following sub-headings:

a) Customs: A Group on Customs Cooperation was set up in 1996 and so far has held three meetings. It was, *inter alia,* decided to harmonise Harmonised System (HS) lines and customs rules and regulations; simplify procedure for intra-regional exports; upgrade infrastructure facilities and provide training facilities. A Custom Action Plan was drawn up in Islamabad (April 1997) and agreed to by all member states.[119]

b) Transportation: The need to improve transportation infrastructure and transit facilities in the region was recognised and the 11th Session of the SAARC Council of Ministers in Colombo (8-9 July 1992) directed the CEC to take appropriate steps in this regard. Accordingly, a study was commissioned to assess the existing transport infrastructure and transit facilities, including procedural and documental issues in the region in relation to volume and composition of the existing trade in the region and to make recommendations for their improvement, with a view to enhancing trade within and outside the region. The study was completed in 1994 and has made far-reaching recommendations.[120]

c) Standards: Recognising the importance of standards and measurement, institutions involved in standards, testing and certification in the member states met in New Delhi in June 1999 to identify how national standards may be harmonised and a regional standard agreed upon. It was agreed that product standards, control and certification measures applied in the region needed to be converged.[121]

d) Taxation: A Meeting on Avoidance of Double Taxation was convened in Islamabad in 2000, which endorsed the need for a common format of double tax avoidance measures.[122]

In the context of SAPTA balance of payment and safeguard measures are the only trade remedies that are available for member countries

4.4.4 Trade remedies

Classic examples of trade remedies include: balance of payment, anti-dumping, safeguards, countervailing measures. While most of the RTAs make use of all these measures even within the member countries, some make use of only selective measures. For example, while NAFTA still has anti-dumping provisions, EU has done away with it. However, in the context of SAPTA there are only two types of trade remedies that are available for member countries, which are discussed below:

a) Balance of payments measures: As per Article 13 of SAPTA, any Contracting State facing serious economic problems including balance of payments difficulties may suspend *provisionally* the concessions as to the quantity and value of merchandise permitted to be imported under the Agreement. When such action has taken place, the Contracting State, which initiates such action, shall simultaneously notify the other Contracting States and the Committee (emphasis added).[123]

b) Safeguard measures: As per Article 14 of SAPTA, if any product, which is a subject of a concession with respect to a preference under this Agreement, is imported into the territory of a Contracting State in such a manner or in such quantities as to cause or threaten to cause, serious injury in the importing Contracting State, the importing Contracting State concerned may, with prior consultations, except in critical circumstances, suspend provisionally without discrimination, the concession accorded under the Agreement. When such action has taken place, the Contracting State which initiates such action shall simultaneously notify the other Contracting State (s) concerned and the Committee shall enter into consultations with the concerned Contracting State and endeavour to reach mutually acceptable agreement to remedy the situation.

4.4.5 Special and differential treatment for the LDCs

As per Article 10 of SAPTA, all contracting states shall provide, wherever possible special and more favourable treatment exclusively to the LDCs

As per Article 1 of SAPTA, "Least Developed Country" means a country designated as such by the United Nations[124]. As per this definition, Bangladesh, Bhutan, Maldives and Nepal fall under the category of LDCs among the contracting states. As per Article 10 of SAPTA, in addition to other provisions of this Agreement, all contracting states shall provide, wherever possible special and more favourable treatment exclusively to the least developed states. Such treatments as set out in the Agreement are as follows:

(a) Duty free access, exclusive tariff preferences or deeper tariff preferences for the exportable products;

(b) The removal of NTBs;

(c) Removal, where appropriate, of para tariff barriers;

(d) The negotiations of long term contracts with a view to assisting least developed contracting states to achieve reasonable levels of sustainable exports of their products;

(e) Special consideration of exports from LDC Contracting States in the application of Safeguard measures.

(f) Greater flexibility in the introduction and continuance of quantitative or other restrictions provisionally and without discrimination in critical circumstances by the least developed contracting states on imports from other states.

(g) There are some special and additional concessions and favours provided to the LDCs as per Article 6. According to this Article, technical assistance and cooperation arrangements have been designed to assist them (LDCs) in expanding their trade with other contracting states and taking advantage of the potential benefits of SAPTA. This agreement has also listed some of the potential areas, which are mainly industrial, agricultural, export maximisation, export marketing, joint venture, etc.[125]

4.5 The role of Group of Eminent Persons

The Ninth SAARC Summit held in Male in 1997, constituted a Group of Eminent Persons (GEP), which was mandated to undertake a comprehensive appraisal of SAARC and to "identify measures, including mechanisms to further vitalise and enhance the effectiveness

GEP was set up to identify measures to further vitalise and enhance the effectiveness of the association in achieving its objectives

of the association in achieving its objectives."[126] Though a decision was to be taken on the basis of this report – that was submitted just prior to the Tenth Summit in 1998 – it was postponed since member states needed more time to study it. The report, however, did form the basis for the decisions made, especially in the areas of trade and economic cooperation, during the Eleventh SAARC Summit concluded in Kathmandu in early 2002.

A central piece in the Report of the GEP is the proposal for moving from an Association to Community. The GEP proposes the following stages:

- The establishment of SAFTA by the year 2010 by the least developed member states and by 2008 by other member states.
- Establishment of a South Asian Custom's Union (SACU) by 2015[127]
- Commencement from the beginning of 2016 of the process of implementing the remaining measures for moving towards South Asian Economic Union (SAEU) by the year 2020.[128]

At the conclusion of the much-awaited Eleventh SAARC Summit, which was held in Kathmandu from 4 to 6 January 2002, leaders of SAARC countries directed the Council of Ministers to finalise the text of the Draft Treaty Framework by the end of 2002. They also directed that in moving towards the goal of SAFTA, the member states expedite action to remove tariff and NTBs and structural impediments to free trade.[129] These decisions were more or less in line with the recommendations made by the GEP. Indeed, the Summit Declaration paragraph 45 states:

> The Leaders noted with appreciation that the report of the GEP was an important contribution in the on-going introspection into the functioning of the association as well as in setting out the perspective plan of action for that purpose. They endorsed the report of the Council of Ministers on the implementation of recommendations of the GEP report, and directed the Council of Ministers to undertake a review of progress in this regard. [130]

However, based on the political and economic realities of the region, the GEP report has been criticised for being too ambitious. Jayasekera (2001) remarks:

Given the considerable backtracking that has taken place over the years, to expect SAFTA to be in place by 2008 [for developing countries], is not practicable

> "Given the considerable backtracking[131] that has taken place over the years, to expect SAFTA to be in place by 2008 [for developing countries] is not practicable. The GEP recommends an across the board reductions of tariffs by 12.5 percent annually to achieve their objective of eliminating restrictions on substantially all trade. This is a laudable strategy, but given the protracted product-by-product negotiations, which took place under SAPTA, this may not be acceptable to all member states." [132]

While Jayasekera feels that the target of phasing out all the NTBs by the year 2010 is attainable, [133] he is skeptical about the creation of a CU by 2015. There are many skeptics who feel that it is not possible for South Asia to become an EU within such a short period of time, especially when one considers the fact that it took nearly 50 years for the EU to become what they are now. However, the issue is not that South Asia should take as much time as the Europeans given the fact that there are number of lessons available from the European model, but the level of preparedness and the commitment among the South

Asian countries to enter into such an arrangement within a reasonable period of time. Added to that are other socio-political problems (discussed in Chapter V), which must be resolved before an Economic Union is created.

There are reasons to be skeptical about the creation of an Economic Union by 2020. Economic Union would have been a utopia had EU not become a reality. This is the deepest level of economic integration, which does not look feasible in any other RTA at this point in time. Despite the commitments made at the political levels, it will take a while even for the established regional groupings like MERCOSUR or AFTA to be converted into the Economic Unions in a practical sense. The first step towards Economic Union would be a single market, where it is presumed that the transport, telecommunications and energy infrastructure would be substantially integrated.[134] Then come the issues of monetary union (another thorny issue)[135], harmonisation and/or mutual recognition of standards, harmonisation of tariff procedures, free movement of capital and labour, adoption of common competition policy, among others. Given the difficulties that SAARC member countries are likely to encounter in the process, the target seems virtually impossible to attain (discussed further in Chapter V).

Given the difficulties that SAARC member countries are likely to encounter in the process, the target seems virtually impossible to attain

One of the related means to attain greater coherence in the regional policy making in the areas of trade and investment as proposed by the GEP was for SAARC countries to take a common position on emerging global economic issues. In fact, the former Secretary General of SAARC stated: "The analytical capacity of SAARC has been developed and we take collective positions at international negotiations such as the WTO." [136] Accordingly, SAARC Commerce Ministers prepared their common positions in the Bandos Island, Maldives, in 1999 prior to the Seattle Ministerial Conference of the WTO. A second such meeting was organised in New Delhi in August 2001 to form a common position for the WTO Doha Ministerial Conference. However, despite these efforts, the Ministers could not maintain a common position during the Doha Ministerial Conference. While it is clearly stated on the common position that the SAARC countries would oppose any new round (including inclusion of any new issues), unless and until implementation issues were fully addressed, during the Ministerial Conference, Sri Lanka pointed out that it could be flexible on environment and Pakistan mentioned that it could be flexible on investment. Such deviation from the agreed framework weakens the common position and reduces SAARC's credibility. Therefore, it is advisable not to prepare a common position at all, if the Ministers cannot stick to the same.

SAARC commerce ministers, despite having agreed to take common positions in the WTO, have not been able to stick to their commitments

4.6 The way forward: Moving towards SAFTA

Reliance on a preferential trade regime has proven to be of little help for the South Asian trade liberalisation process. Failure of SAPTA to provide meaningful trade liberalisation has led to the largest economy in the region, viz., India, to sign three consecutive bilateral FTAs with its smaller neighbours (Bhutan, Nepal and Sri Lanka) with the possibility of having a similar agreement with Bangladesh. While such initiatives have helped to open up protected markets of the smaller countries, they have created tremendous confusion to the exporters and investors alike. Writes Weerakoon (2001), "Any potential benefits of bilateral agreements have to be weighed against the political fallout in a wider South Asian context. Not only is there the real danger that bilateral agreements may undermine commitment to a greater South Asian Economic Area, but there is a far greater danger of alienating key players even further."[137] SAFTA, however, will be completely different inasmuch as members are required to show greater degree of

commitment towards free trade now, thanks to WTO rules governing RTAs. As argued in Chapter III, non-serious RTAs will have difficulty to pass through WTO scrutiny.[138]

Framework for a SAFTA treaty is supposed to be decided by the end of 2002, and there are a number of challenges drafters are likely to encounter

Framework for a SAFTA treaty is supposed to be decided by the end of 2002, and there are a number of challenges drafters are likely to encounter. The first challenge before the drafters is to ensure that the agreement is going to be compatible with the relevant provisions of the WTO. Secondly, as is the general practice, LDCs should be provided with longer transition period to implement trade liberalisation, with even longer transition period for landlocked LDCs (LLDCs) so that they do not lose out disproportionately compared to relatively better off countries. Reflecting the deep-seated concerns of the LLDCs, the CASAC (1999) has taken an extreme position as described below:

> As experience of other regional organisations have shown that an equitable sharing of benefits of cooperation is the key to success of regionalism, special care must be taken to ensure that the least developed countries can take full advantage of the freeing of trade by other countries. As a means of compensating the cost incurred by them in moving to a free trade regime, it is important to have special elements in their favour. These include: i) a longer time period for freeing trade in general and staggering the process of freeing trade in particular sectors; ii) resort to safeguard measures for a longer period of time; iii) establishment of a special fund for compensating for the loss of revenue suffered as a result of reducing or eliminating tariffs; iv) creation of a reasonably large sized fund for the development of their infrastructure, human resources, export production and diversification of capacity; and v) facilitating freer movement of private capital to the least developed countries from other member states.[139]

It is a good idea to devise some type of 'transitional' mechanism to address the fears of the relatively weaker countries in the region

While CASAC's position may not be acceptable to the relatively more developed countries of the SAARC, it is a good idea to devise some type of 'transitional' mechanism to address the fears of the relatively weaker countries in the region. Here, the emphasis on the word 'transitional' is important because an eternal compensation mechanism is neither sustainable nor desirable.

Thirdly, the dispute settlement process should not only be fair and transparent, but also provide option to the member countries to either resort to the regional dispute settlement mechanism or resort to the WTO dispute settlement mechanism, as in the case of NAFTA. This provision was included in the NAFTA at the insistence of Canada and Mexico, which suspected that NAFTA mechanism could favour the largest country within the RTA. Due to asymmetry in the countries within South Asia and hegemony of one large country, this approach can and should be replicated by SAFTA.

Having discussed the modalities, it is worth sounding a note of caution. As discussed in Chapter I, available evidence suggests that compared to North-North and North-South RTAs, South-South RTAs are worse – they divert trade, place weaker nations at a comparative disadvantage and cause income divergence rather than convergence. However, the only major benefit of a South-South RTA is of a long-term nature and that comes mainly through increased size of the market. When the market size and resultant trade potential increases, it becomes attractive as like Northern FTAs or CUs, to enter into an embrace of the same, as is happening with MERCOSUR now. Both the EU and NAFTA are in an unusual hurry to bring MERCOSUR into their fold. [140] As recently reported in the *Financial Times*, "The EU and MERCOSUR, the

SAARC should, in the long run, strive to join hands with a mega grouping to reap benefits of trade liberalisation

South American customs union are looking to accelerate free trade talks and could adopt a deadline to reach an accord before the planned FTAA in 2005."[141]

Dubey (2000) too substantiates this claim in the following manner:

> The thinking of some experts today on regional grouping is that such groupings among developing countries do not make any sense. You can have such regional grouping for two purposes: one for an interim period when you are negotiating to join a mega grouping so that you are in a stronger position to bargain. And the other is that when a regional grouping has a major country whose economy has displayed dynamism, the economies of the other countries can be pulled up. These are the only two grounds on which experts have said that regional groupings among developing countries are useful.[142]

Issues for comment

- Are series of bilateral trading arrangements between the member countries of SAARC posing serious threat to SAFTA?
- What should be the modalities of concession to be followed under the SAPTA/SAFTA so as to ensure that greatest degree of liberalisation takes place within South Asia?
- Is it possible for SAARC to achieve the targets set by Group of Eminent Persons for the various stages of regional integration, can any other alternative be proposed?
- What are the challenges (economic, legal and institutional) that drafter of the framework for SAFTA face?
- What kind of transitional arrangement should be prepared for relatively weaker countries of the region so as to ensure that they do not share disproportionately higher burden of adjustment?

CHAPTER V

THE POLITICAL ECONOMY OF REGIONAL INTEGRATION IN SOUTH ASIA

5. 1 Introduction

What is the current problem in South Asia? South Asia is at cross roads; the regional cooperation umbrella promoted by respective states, i.e., SAARC, has progressed very little while regional cooperation espoused by the South Asian civil society, although well meaning, has not been effective. There is a shrinking sense of purpose in the SAARC member countries. SAARC has become weak because member states assign a low status to it. The Indo-Pak relationship is a core issue in South Asian cooperation. Underlying this core issue is a core structural problem, i.e., the difficulty in portraying and building of South Asia as a region in a world that is rapidly organizing into regional blocs. It may be useful to look at SAARC from the perspective of some elements of the economic cooperation framework.

5.2 Economic cooperation in South Asia: Some political issues

Frequently, in the SAARC debate the following five issues have been raised: (i) the trade deficit of the smaller members with that of the larger members, (ii) geographical asymmetry of the region that could be more favourable to the largest country, (iii) India's attitude towards SAARC, (iv) Pakistan's attitude towards SAARC, and the most talked about (v) security situation in the region.

Asymmetry may be an issue if it is related to the political economy of regional cooperation in South Asian context

Simple economic arguments show that (i) cannot be considered as an issue in the modern day world and it is not dwelt with here.[143] The asymmetry, however, may be an issue if it is related to the political economy of regional cooperation. Attitude of major players of the region towards the region is equally important, for the small nations alone cannot carry the entire region with themselves. The security issue is important because it cuts across economic, cultural, and social relations and thus can undermine them effectively. In the following subsections we deal with these aspects in somewhat detail.

5.2.1 *Asymmetry in the region*

The size related perception is not confined to SAARC, there is Indonesia in ASEAN, Brazil in MERCOSUR, Germany in EU, Canada in NAFTA, and so on. There is a suspicion in smaller countries about problems that could result from institutionalisation of a region with the hegemony of the larger country. If the geographically large country is not an economic power as in the case of Indonesia, Brazil, and Canada in the above examples, then asymmetry may not be an issue.

When deciding whether to cooperate or not, it is the gain over non-cooperation that counts, not the amount that the partners will obtain

In the SAARC, India is not only the physically largest, but also the economic and military powerhouse unlike in the EU and ASEAN.[144] Thus, the hegemonic suspicions among the other SAARC members run strong. For India, there is the suspicion that the smaller nations will gang up against her at an institutional forum. Moreover, any external power can always cultivate a smaller nation to gain a foothold in the region, and India in particular. These suspicions, whether we like it or not, exist in South Asia and it is the reality.

That asymmetry is an issue can be demonstrated in the area of economic cooperation. Das (2000), for instance, argues that Islamabad suspected that India gained relatively more advantages from SAPTA II. He argues that the "discrepancy should be rectified in future SAPTA deliberations".[145] Clearly this type of thinking defeats the broad concept of "cost of non-cooperation". After all, when deciding whether to cooperate or not, it is the gain over non-cooperation that counts, not the amount that the partners will obtain. But such thinking does not prevail in some nations. Be that as it may, even if the problems related to asymmetry are fully addressed by the proposed SAFTA treaty and other measures, there are issues related to the perception of SAARC by India and Pakistan that act as impediments to regional cooperation.

5.2.2 *India and SAARC*

Bargava (2000) argues that due recognition should be made by all other SAARC members of India's pivotal role in regional cooperation. But does India really have a desire to play this pivotal role?[146] Muni (1999: 122-123), for example, argues[147]: "For India, though SAARC is a preferred channel of integrating South Asia through cooperative interdependence, it does not promise high economic incentives. India's regional trade in South Asia is around 1 per cent of its total foreign trade. Even in a strengthened SAARC when this trade increases substantially, it cannot fulfil the needs of the growing Indian economy. India also feels frustrated in its failure to induce Bangladesh in forging comprehensive economic cooperation ties and to induce Pakistan in establishing normal trade and economic relations at the bilateral level, not to mention the irritations arising out of the communal question in these relations. Therefore, India has to look towards other economically dynamic regions for its investments, technology and trade. Hence, its moves towards ASEAN, APEC and the Indian Ocean Rim".

Even in a strengthened SAARC when this trade increases substantially, it cannot fulfil the needs of the growing Indian economy

ASEAN emerged as the third largest foreign direct investor in India after US and EU. There has been a doubling of trade between India and ASEAN in the 1990s.[148] India already has two channels to ASEAN, viz., (1) Dialogue Partner status with ASEAN since 1993, and (2) membership of BIMSTEC since 1997. India's "Look East" policy is served well by these two arrangements. The IOR-ARC also gives India access to Thailand, Malaysia, Indonesia, and Singapore to discuss economic issues. Why should India bother too much with SAARC when it already has bilateral free trade agreements with two important partners in South Asian nations and can achieve much more from cooperating with ASEAN? So from an economic cooperation point of view SAARC has little meaning for India.

India now considers itself as a global player and the US officials accept this fact. Pakistan has refused to accept the pivotal role of India in South Asia and received encouragement from several external forces for challenging India's role. It is because of these factors that India has been reluctant to give leadership to the SAARC process. The leadership that Suharto gave to ASEAN played a major role in keeping ASEAN together. Regional groupings without political leadership have fallen apart like the Bangkok Agreement.[149] During a limited period, SAARC received the Indian leadership of Prime Minister Gujral with the "Gujral Doctrine" coming into place. But thereafter, SAARC is back to square one with no leadership. For an Association that is still in its early stages of development, lack of political leadership is an issue.

However, Indian leadership not going to be accepted by every country of the region (even if one does not take into account Pakistan's animosity with India). Writes Nayar (2002), "At present, India is acting

the Big Brother towards its neighbours. Its size overawes them. It has to introspect its policies. Foreign Minister Yashwant Sinha did well to start his stint with visits to countries like Nepal and Bangladesh. But then there was no follow-up. There have been such spurts in the past with no long-term strategy. Something is lacking somewhere because 'we are ugly Indian' practically throughout South Asia."[150]

5.2.3 *Pakistan and SAARC*

For Pakistan integration of South Asian economies that has India as the dominant partner can threaten its political and strategic identity and thus may not be fully acceptable.[151] Pakistan's attitude to SAARC is summarised in following terms by an Indian author: "Pakistan is a split personality; she has not been able to completely identify herself with West Asia; in South Asia she feels odd."[152] The author goes on to argue that while geography, common history and socio-cultural traditions pull Pakistan towards South Asia – factors like ideology, economy, and serious differences on a number of regional and international issues with India push Pakistan outside South Asia and accordingly help it to determine its policy and attitude towards South Asia.[153] We would like to reserve our comments on this viewpoint, however, from the last 17 years of SAARC it could be stated that Pakistan views SAARC as a harmless organisation and is not terribly excited by it. However, Pakistani Delegation (2000) argues, "The imperatives of economic survival must persuade Pakistan, like other South Asian states, to increase its faith in regional cooperation, especially in view of the shifts in the priorities of the traditional aid-givers."[154]

The imperatives of economic survival must persuade Pakistan to increase its faith in regional cooperation, especially in view of the shifts in the priorities of the traditional aid-givers

There is a new dimension that shapes Pakistan's attitude towards SAARC. Following the September 11, 2001 event, Pakistan has become key player in Washington-determined politics. Consequently, USA has dropped sanctions related to Pakistan's nuclear test in 1998. Moreover, penalties imposed on Pakistan discarding democracy are also no longer applicable. Pakistan wanted more open market from the West and is now getting it.[155] In fact, Pakistan has been rewarded by the West with aid, loans from the IMF, and possibility of obtaining trading arrangements, similar to those granted to Sub-Saharan Africa, Central America, the Caribbean, Israel, and Jordan by the USA. In this scenario, given its current global trading patterns, SAARC is of limited importance to Pakistan.[156]

After the decision of Pakistan to postpone Twelfth SAARC Summit to be held in Islamabad, there has been cross firing of opinions from Indian and Pakistani media alike blaming each other for the scuttling of the Summit. Writes Bhatty, "With all pointers reflecting reservations, and lacking a response from India with just a month to go, Pakistan decided to postpone the SAARC summit."[157] The author feels that reinvigoration of regional cooperation is very much in the interest of a region, but falls short of explaining how a successful Summit would have helped Pakistan.

5.2.4 *Security issue*

Despite all the rhetoric on economic cooperation, as long as Pakistan and India remain locked up in adversarial relationship, security issues will dominate over all other issues

Despite all the rhetoric on economic cooperation, as long as Pakistan and India remain locked up in adversarial relationship, security issues will dominate over all other issues. This is the reality in South Asia.

South Asia is more vulnerable to instability from within than from outside. The development of security issues has not received as much attention as it deserves, probably because it is embedded in a nation state. The Kashmir issue with enormous security implications for

regional peace and stability has never featured on the SAARC agenda, since the SAARC Charter excludes bilateral and contentious issues from the deliberations of the Association. Can bilateral issues that cut across all cooperation efforts be left out of the SAARC agenda any longer? Some commentators have argued that it would be appropriate to define a new concept of security, which encompasses not only military security but also broader issues such as poverty reduction, environment conservation, energy and food security.[158] It is argued that such an approach will: (a) contribute to a shift from state-centric security perception to individual security, and (b) will encourage countries to jointly address the issue of "Common Enemy".

However, while such theorising remains good sounding, the experience of SAARC so far shows that this approach is not practical. Recall that the Independent South Asian Commission for Poverty Alleviation (ISACPA) came up with a report titled "Meeting the Challenge" in 1992 and up to this date there has hardly been any follow up on the recommendations. Instead, at the Eleventh SAARC Summit in Kathmandu, SAARC decided to have a reconstituted Commission to once again look at the poverty situation in South Asia. Furthermore, as the GEP Report stated the SAARC Food Security Reserve has never been utilised despite the need for urgent food imports by member states. From these examples it is clear that until the main state-centric security problem is solved no other alternative conceptualisation of security issues is going to be of much use. Security cooperation in the region is inconceivable in the absence of mutual trust between the two old South Asian adversaries – India and Pakistan.

A US delegation (15 senators and 46 members of the House of Representatives) called Kashmir the "most dangerous nuclear flash-point in the world today". The cold war nuclear confrontation was between two stable superpowers that were secure, not given to volatility, with back channels for communications. They also shared a great degree of rationality because deep down their philosophical paradigms and world outlook had common roots.[159] The two cold war rivalries did not have an ancient history, no civilisation burden of partition, and no old scores to settle. They never shared the same landmass or the same borders and never fought a land war. Indo-Pak antagonism has an atavistic dimension due to its historical and civilisation roots. Thus, the relations between the two are far more 'envenomed' than that of the two super powers.

The relations between India and Pakistan are far more 'envenomed' than that of the two super powers

The event of September 11th has added a new dimension for Indo-Pak relations. Pakistan has been forced to the forefront of the war against the Taliban regime in Afghanistan, and the Al Quaeda movement. As the Afghan war radicalise Islamic communities worldwide how will the hard-line Hindus react to the rise of Islamic fundamentalism? The small countries in the SAARC are living under this sub- continental volcano. Can they be further burdened with this problem?

The small countries in the SAARC are living under this sub- continental volcano

Optimists such as Das (2000) have argued that enormous scope exists for mutually beneficial cooperation between India and Pakistan.[160] The question here is not the scope and good intentions of the civil society in both countries but deeply embedded political divisions, which ultimately decide on cooperation.

Given the problems of military and economic asymmetry, perceptions of the SAARC by the two major countries in South Asia, and the dangerous security situation, regional cooperation in the SAARC is faced with a major political problem. In such an environment economic cooperation becomes difficult, as it cannot stand on its own. But as the

ensuing section shows, even if economic cooperation stands on its own, it has its own problems.

5.3 Economic cooperation in the SAARC: Some technical issues

Many studies have looked at regional integration in South Asia to determine potential economic gains.[161] Srinivasan (1994) using a gravity model concluded that, at the time, most of the pre-conditions needed to enhance the probability of a successful FTA were not present in South Asia.[162] As mentioned in Chapter II, these are: high pre-arrangement tariffs, high level of trade before any arrangement, the existence of complementary rather than competitive trade, and differences in economic structure based on competitiveness. It concluded that South Asia would be better off liberalizing unilaterally and trying to tie up with an established group such as NAFTA or the European Union.[163] One may have some reservations about the first conclusion in regard to the degree of unilateral liberalisation, but at least the second conclusion is strongly supported by the existing trading patterns of the region.[164]

Theoretical foundation of the gravity model appears to be weak because the model does not capture the major determinants of inter-and intra-industry trade

Srinivasan *et al* (1994) also found that removing all tariffs in South Asia will lead to a 3 per cent of GDP increase of trade for India, 59 percent of GDP increase for Nepal and in-between for other countries.[165] A 50 per cent reduction in tariffs would increase trade by about 1 per cent of GDP for India and 9 per cent of GDP for Nepal. However, these estimates have been challenged by Karmacharya (1999) where he argues that the theoretical foundation of the gravity model estimated by Srinivasan appears to be weak because the model does not capture the major determinants of inter-and intra-industry trade.[166] RIS (2002) also states that from preferential trading in the region it will be the small countries that would gain more.[167] Weerakoon and Wijayasiri (2001: 8) after making a comprehensive survey of the existing studies conclude: "…the empirical results appear to be mixed and offer different interpretations of the cost and benefits (of both trade and welfare) that South Asia may experience at deeper level of economic integration. While some studies appear to suggest that the smaller countries will benefit (in trade and welfare terms), this is found not to be the case in other studies".[168] The point made here is that there is no consensus that small countries would gain more from preferential trading than the larger nations. It is in fact contrary to the example of Kenya that we mentioned in the earlier Chapters.

As stated earlier, the perceived gain is an issue that needs to be addressed in the context of economic cooperation. And this can be done using an appropriate regulatory framework. It was argued elsewhere that the issue of asymmetry in South Asia could be to some extent accommodated by a clearly defined negative (or reserved) list, differentiated ROO, and the implementation of the Gujral doctrine in India.[169] But work in the area of a regulatory framework for the functioning of an FTA – SAFTA Treaty – is still on-going and is expected by end 2002.

The other argument that is put forward in favour of moving to a FTA is the cost of non-cooperation (Box 5.1). RIS (1999), for instance, has estimated that the cost of non-cooperation amounts to US $ 266 million for Sri Lanka on account of Sri Lanka's imports from outside the region despite the fact that those items were available in the South Asian region, in particular, India.[170] In fact, it is this realisation that led Sri Lanka to go into the Indo-Lanka Bilateral Free Trade Agreement (ILBFTA).

Box: 5.1

Cost of non-cooperation in South Asia

A few years back *The Economist* carried out an interesting article on how for a single country, Pakistan, the growth in intra-regional trade would make such a dramatic difference if only cross border trade between countries were legalised. For instance, in 1994 while Pakistan's import from the other six South Asian countries amounted to US $138 million, about 1 billion intermediate and capital goods from India alone reached Pakistan via countries outside the region. It was estimated that smuggling across the 1,000 km border along the two countries accounted for another US $1 billion trade every year, while an official Indian study estimated that, if trade were liberalised, Indian exports to Pakistan would be about US $2.5 billion a year.

A study conducted by Consumer Unity and Trust Society (CUTS) in 1995-1996 to ascertain the level of costs imposed on the home consumers due to the country not importing from another country within the region found the following results:

Consumers in Pakistan paid extra costs of US $ 36.3 mn., US $ 48.9 mn. and US $ 33.7 mn. over the calendar years 1992, 1993 and 1994 respectively for their governments importing 82 to 83 per cent of their tea import requirements from countries outside the region (such as Kenya or the UK).

Despite India being self sufficient in sugar, it suffered an underproduction during the years 1992 and 1993 and had to import sugar. Though Pakistan had exportable surplus during that year, India chose to import sugar from outside the region, thus incurring additional costs to the tune of US $ 151 mn. in 1992 and US $ 215 mn. in the year 1993. Likewise, Pakistan is known to import steel from China at a price, which is twice that of Indian exports.

There are gains to be had from higher level of trade and economic cooperation in the region and consumers can gain a lot. However, as political economy suggests that consumers are widely dispersed and cannot organise themselves, they cannot exert sufficient pressures on the politicians to resort to market opening at the regional level.

Sources:

Bhargava, Kant K. and Sridhar Kharti (1999)

Waqif, Arif (1998)

SAPTA dialogues have been completely unproductive due to various differences among countries that emerge from time to time

In this context, it is vital to ask whether we need SAARC to address the cost of non-cooperation. So far, there have been only limited gains from the three rounds of SAPTA and Weerakoon and Wijayasiri (2001) show that the gains for Sri Lanka have been insignificant.[171] SAPTA dialogues have been completely unproductive due to various differences among countries that emerge from time to time. Should so much of finance and time of the officials be spent for meetings/negotiations when the gains are limited? It took more than one year for Sri Lanka and India to agree on the negative list after the ILBFTA was signed. In multiplying this process to include all seven SAARC countries, the task for agreeing on a negative list is going to be an extremely cumbersome exercise.[172] Then there are questions such as will the negative list come before or after the SAFTA agreement is signed? These are crucial questions that cannot be brushed aside in

any dialogue on the cost of non-cooperation in the region under the SAARC umbrella.

The cost of non-cooperation is not a significant issue because the tariff and non-tariff barriers of South Asian nations are gradually coming down

The cost of non-cooperation is in any case not a significant issue because the tariff and non-tariff barriers of South Asian nations are gradually coming down under WTO regulations and IMF/World bank led liberalisation programmes.[173] So the gains of liberal trading are in any case on the way. Some have even argued that there is a large amount of illegal trade between South Asian countries and the intra-regional trade will be boosted by the illegal trade coming into the formal net via SAFTA. There are doubts whether all the illegal trade will come into the formal net with SAFTA coming into operation.[174] Leaving this fact aside, by a PTA what we expect is new trade or trade creation, not intra-regional trade getting a boost from an existing component of trade coming into the formal net. So the crucial question is trade creation via SAFTA. There are a number of doubts on this area too.[175]

Despite the evidence received from the Latin American experience[176], why SAARC followed the slow product-by-product approach in all three Rounds of SAPTA negotiations remains very much questionable. Was it deliberately done for the purpose of confidence building? This is unlikely. Kelegama (1996) argued that for preferential tariffs to be effective three pre-conditions should be satisfied, viz., (1) trade coverage should be wide, (2) actively traded goods should be covered, and (3) tariff cuts should be deep and should be accompanied by the removal of non-tariff barriers.[177] Countries can appear very generous simply on the basis of the number of concessions offered with hardly any trade coverage. This precisely happens to be the case with all three SAPTA Rounds. Weerakoon and Wijayasiri (20001) show the irrelevance of much of the goods for which concessions have been offered to stimulate trading, and goes on to show that the percentage of imports into Sri Lanka falling into SAPTA concessions has declined marginally over the 1997-1999 period.[178]

Why are bilateral agreements and other arrangements spreading in South Asia? Pakistan has so far not extended MFN status to India. A SAFTA cannot become a realistic proposition until bilateral issues are addressed. "The non-existence of MFN status to India means that Pakistan is in effect constrained from granting tariff concessions to other member countries of SAARC due to the fact that those same concessions have to be offered to India as well…. Pakistan, for example, was reluctant to grant concessions on tea to Sri Lanka under SAPTA negotiations since the same concessions would have to be extended to India. As a result, Sri Lanka and Pakistan are in the process of negotiating their own bilateral free trade agreement."[179]

Proponents of tariff-based subregional groupings in South Asia argue that they will eventually be building blocs for the SAFTA, but this argument does not hold much water

Clearly the key explanatory factor is the slow progress of SAPTA and the political problems. Diagram 1 below shows the current pattern of regional cooperation. There have hardly been similar trends in other regional groupings. Subregional cooperation in ASEAN was based on the concepts of "natural economic territories/zones", "transnational economic zones", "transborder economic neighbourhood", and "geo-economic development zones" which are nothing but sectoral cooperation arrangements with limited objectives to achieve and did not involve preferential tariffs.[180] Proponents of such tariff-based subregional groupings in South Asia argue that they will eventually be building blocks for the SAFTA, but this argument does not hold much water.

First, a country like Sri Lanka enthusiastically supported SAFTA to gain access to the large Indian market and perhaps to gain access to the Pakistan market for particular products. Now the former has been achieved and the latter is almost about to become a reality. Given this

If bilateral FTAs among SAARC member countries are to be integrated within SAARC framework, then they will have to be the starting points for negotiations

fact, Sri Lanka's enthusiasm for SAFTA has tapered away. It is likely to be the case with other South Asian nations that sign bilateral free trade agreements (FTA) with India and Pakistan. Second, how are bilateral agreements going to be integrated to SAFTA negotiations? If they are to be integrated then they will have to be the starting points for negotiations. If not they will exist as parallel trade agreements, generating a "spaghetti bowl" phenomenon (Chapter I) and lead to confusion among traders and investors.[181]

5.4 Speed of economic integration in South Asia

Regionalism (especially economic cooperation) was seen as a means of facing the challenges of globalisation in the early 1990s and the argument was that South Asia was lagging far behind other regions and that the region has to leap frog. It was on this thinking that, in the Male Summit of SAARC in 1997, the SAFTA timetable was expedited for 2001.

The EPG Report, however, stated that this accelerated timetable was unrealistic in the background of the nuclear explosions in the subcontinent in 1998 and the problems of the SAARC least developed countries, and extended it to 2008. Taking stock of the overall situation the EPG went on to state: "that the next phase of evolution of SAARC should be one of consolidation and concentration on the one hand, and 'new major thrusts' on the other. Instead of further expanding SAARC cooperation horizontally, activities already undertaken should be consolidated and there should be a concentration of effort in areas that have greater potential of making a visible impact on the life of the common man in the region" (37-38)[182].

Time and again it has been said that the SAARC institutional framework is inadequate for promoting rapid regional economic cooperation

Time and again it has been said that the SAARC institutional framework is inadequate for promoting rapid regional economic cooperation. Here again, the point needs to be made that there are already a number of institutions that contributes to enhance cooperation in the region. For economic cooperation too, a number of institutions are in place or either emerging (for example, SAARC Arbitration Council).[183] But the existing institutions have failed to deliver. The GEP suggests the streamlining of existing institutional structures and rationalising Technical Committees under the Integrated Programme of Action (IPA). The question is would these steps be adequate to speed up economic cooperation under the existing framework?

As the EPG suggests steps that are taken should make a visible impact on the common people, if not the demand for institutions suggested by the EPG [(a) Common Investment Area, (b) South Asia Development Bank, and so on] will emerge only when economic cooperation is at a higher level and the civil society in SAARC has tasted the benefits of economic cooperation under the SAARC umbrella, not before that.

The problem with SAARC is that there is a tendency to push aside the major problem and go in for ambitious projects

The problem with SAARC is that there is a tendency to push aside the major problem and go in for ambitious projects. Leap frogging is not going to be easy for SAARC. Wickremasinghe (2000), for instance, has shown that in the area of services, SAARC lags behind considerably and it would not be possible for the service sector to be a new economic frontier in the region.[184] Given these problems, SAARC need not take a complacent view by stating that Europe took 50 years to achieve an EU and ASEAN was bogged–down on a PTA since 1977 and it is only now they are talking about an FTA in 2008, but rather look for a more realistic path in the current problematic environment.

In this context, it is worth examining how some other regional groupings achieved more tangible economic cooperation by being less ambitious but having a fast track time table for deliverables. Here the example of

the Greater Mekong Subregional Economic Cooperation Programme (GMSP) will be useful. The ADB initiated an inter-country consultation in the early 1990s and acted as a facilitator providing technical and financial assistance. The GEP identifying the existing constraints focused on a more step-by-step, results-oriented approach. Priority projects were endorsed and donor assistance mobilised. ADB's technical assistance in aid coordination and its role as a catalyst in mobilising core financing have been useful in pushing through the GMS programme. To date, 10 subregional infrastructure projects are under implementation or have been completed with overall investment amounting to US $ 2 billion. The aim is to have an East-West Corridor linking Thailand, Lao PDR, Vietnam, and Myanmar to exploit the economic potential in the corridor.

In ASEAN, the role of Japan in stimulating economic cooperation is well known.[185] There are a number of external agencies and countries that are interested in supporting cooperation in South Asia such as Japan, EU, Germany (Friedrich Ebert Stiftung), etc. But they too have taken a cautious approach realizing the limitation of the role that they can play given the current major problem of the SAARC, i.e., Indo-Pakistan relations.

If economic cooperation takes off quickly in SAARC, the political issues could be sidelined and could lay the foundation for solving them

It has been argued by some commentators that if economic cooperation takes off quickly in SAARC, the political issues could be sidelined and could lay the foundation for solving them. This argument is not really valid in South Asia although it was to some extent valid for ASEAN.[186]

5.5 Political/Economic Cooperation Efforts: Track II and III and Civil Society in SAARC

Critics have pointed out that SARRC is very much 'summit centred', that the nitty gritties need to await the approval of the highest body in the absence of which, every pre-determined agenda comes to an untimely halt. For example, the 4th Round of SAPTA negotiations and the drafting of the SAFTA Treaty have been stalled for more than three years now. Muni, for instance, has argued that SAARC "cannot therefore remain as an Association of governments and needs to be pulled-out from the hallways of foreign office". But is this realistic? Which regional association worked outside the state framework and achieved results?

There are more than 40 dialogue channels in South Asia and about 12 outside South Asia

There are number of channels outside the state where regional cooperation in South Asia is discussed. A study was conducted on the existing non-governmental dialogues in South Asia and what contribution they are making to promote regional cooperation. The study found that there are more than 40 dialogue channels in South Asia and about 12 outside South Asia.[187] Regular interactions among groups of scholars, experts, retired diplomats and military officials have been going on between India and Pakistan for the last 10 years (since the Neemrana initiative in 1991).

The report argues that most non-official dialogues are at an early stage of development, and points out the obstacles for these dialogues producing concrete results. These include: (1) the prevailing atmosphere of mistrust in the region, especially between India and Pakistan, not only between government officials but also among civil society organisations, (2) geopolitical asymmetry of the region, (3) political fragility in South Asia which makes it difficult for governments to take the initiative on issues where opposition parties can exploit, (4) dialogue organisers often not conducting sufficient preparatory research and consultation or post-dialogue follow-up activities. Rarely have they

found ways to communicate their results effectively to the broader public.

Even high profile Track II activities dealing with regional cooperation in South Asia have floundered and given little recognition to within the official process of SAARC

The challenge in South Asia is to overcome these and find new ways to cooperate. But what is this new way? Behera *et al* (1997) broadly categorise seven methods of conducting dialogue, which include "track two", 'track three' and so on.[188] But what can the outcome of these be? This is particularly pertinent in the context of the outcome of a prominent Track II activity, i.e., the Citizens Commission of South Asia that was headed by the former Prime Minister of India, Inder Kumar Gujral. The high-standing Commission met in Kathmandu in December 2000 and prepared a statement for reviving the SAARC process to all Heads of States. The outcome of it was far from satisfactory. If this was the fate of a high profile Track II activity what could we expect from other tracks?

The South Asian People's Summit which could be categorised as a Track III activity commenced in December 2000 in Colombo and had its second summit in Kathmandu in early January 2002. What was the outcome of this summit – nothing but high sounding statements and declarations to the effect that people's rights have to be safeguarded and so on.[189] It is pertinent to pose the question whether statements and declarations of the SAARC official process (Track I) have had any impact. The Convention on Suppression of Terrorism, Narcotic Drugs and Psychotropic Substances has had no impact on controlling terrorism or drug trafficking through regional cooperation in South Asia. Some of the countries have still not even enacted enabling legislation to give effect to these conventions.[190] When high sounding declarations of the SAARC official process have had no impact how could Track III have an impact?

SAARC civil society has not found a device to insulate itself from the unending political problems of the region

SAARC's Confidence Building Measures (CBMs) at whatever level – Nuclear CBMs, Non-Nuclear Military CBMs or Economic CBMs – are all very vulnerable to Indo-Pakistani relations, and this has been the experience so far in SAARC. Track II and Track III have hardly been significant in making a major impact at the official level. SAARC civil society has not found a device to insulate itself from the unending political problems of the region.

5.6 Concluding remarks

The major problem in SAARC is a political problem that seems to cut across all other areas. The political problem has its roots in the South Asia nation state. The assertions that South Asia had a common civilisation or a common past have little relevance for contemporary cooperation among nations. South Asia does not have religious harmony, ethnic and economic homogeneity. Some South Asian nations being recent creations, a strong rhetoric has been built around the states and they are aided by the powers of state institutions. The mapping of the cartography of the colonial regime has eroded the foundation of regional linking. The division into nation states is strong. Since the nation-states are themselves in the process of being formed in the region, the concept of a supra-national region seems novel and contradictory to the immediate task of nation building. Nation states are absolutely central and crucial for any project in South Asia. SAARC fails because most nation states themselves are major failures.

In this milieu, achieving any tangible results from the official process of cooperation appears very slim given the frequent postponement of the Summits. It is unlikely to come about through a mechanism of regional economic agenda. The important question is can SAARC insulate its economic agenda from regional politics? If so, can it commit to a clearly defined agenda with a specific timetable and each country given

specific commitments? Irrespective of SAARC summits been postponed to accommodate political developments, can the economic agenda have a momentum/life of its own? The answers to all these questions are a clear no. Thus, economic cooperation within a framework of regional arrangement in South Asia does not have a bright future. Moreover, deeper economic cooperation as suggested by the EPG report may not be desired by all members in a regional organisation without any leadership.

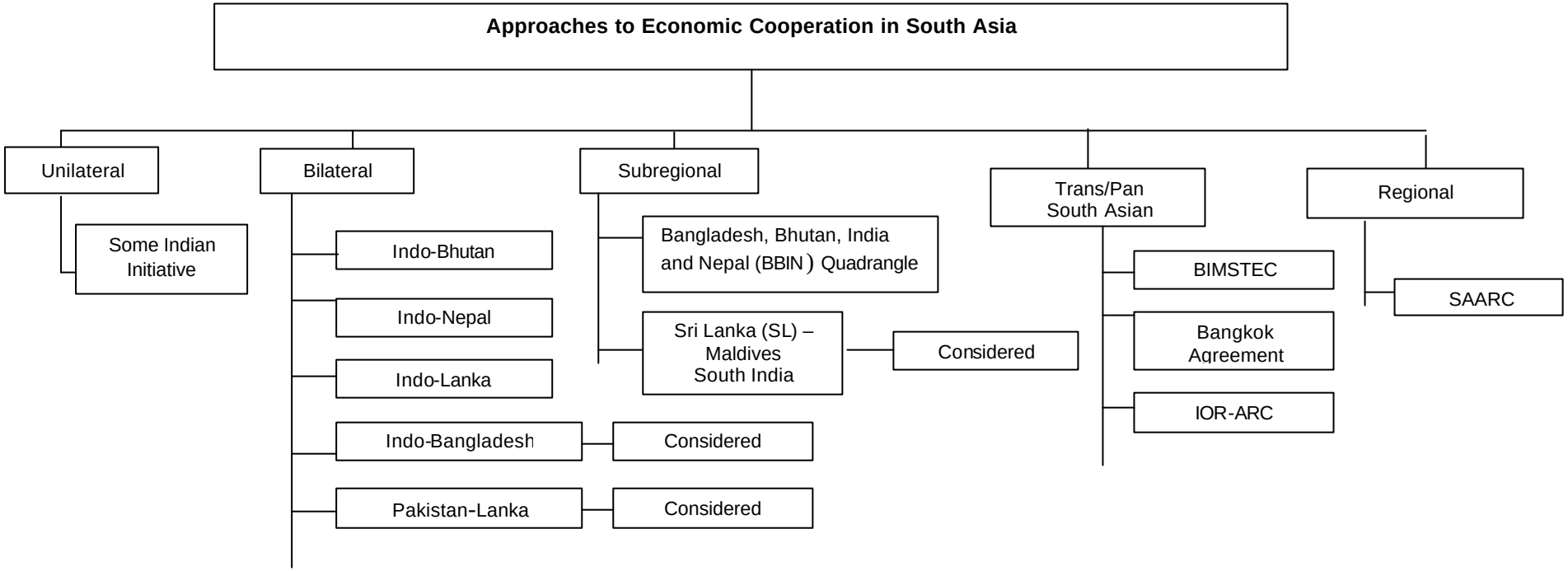
Despite all these problems the SAARC process should continue. Moreover, given the fact that substantial groundwork has been done on the SAARC during the past 17 years it would not be prudent to disband SAARC. South Asian countries could continue pursuing sub-regional sectoral projects, bilateral free trade agreements, growth triangles and quadrangles, etc., that have already been started. Also, Pan South Asian and Trans South Asian regional grouping efforts like BIMSTEC, Bangkok Agreement, IOR-ARC etc., can continue giving new opportunities for trade and investment in South Asia. Meanwhile, measures should be taken to streamline confidence-building measures in South Asia – which are scattered and ad hoc in nature at present. The role that the ASEAN Regional Forum (ARF) played in ASEAN, Commission for Security and Cooperation in Europe (CSCE) and Organisation for Security and Cooperation in Europe (OSCE) played in Europe, Agency for Prohibition of Nuclear Weapons in Latin America and the Caribbean (OPANAL) played in Latin America, etc., in security and confidence building is well known. An existing institution in South Asia could play a similar role, for this would go a long way in strengthening regional integration.

In a milieu of complex political economy factors, there is no doubt that the Committee on drafting the SAFTA Treaty is going to face challenges not only in meeting WTO requirements and addressing concerns of smaller countries of the SAARC, but also in addressing other challenges unique to the region. The best that the Committee could do is to accommodate the concerns highlighted in this Discussion Paper as far as possible and hope for some positive outcome. Projects such as the SAFTA Treaty can be kept alive by promoting parallel confidence building measures. At least this will ensure that the cost of cooperation will have some dividend in the long run.

Issues for comment

- Besides asymmetry in economic size and security issues, what are other political economy factors that hinder progress in regional economic cooperation in South Asia?
- How significant is the issue of cost of non-cooperation in South Asia especially in the context of MFN-based trade liberalisation and autonomous trade liberalisation measures being undertaken by South Asian countries?
- What are the systemic problems within SAARC which inhibits participation of civil society in the official process?
- What kind of regulatory framework is required in South Asia to ensure that trade liberalisation results in overall sustainable development of the member countries?
- What are the major challenges to be encountered/addressed by the drafters of SAFTA Treaty framework?

Diagram 1



Source: RIS (2002) with some additions.

Annex 1

Regional Trade Agreements Notified to the GATT/WTO and in Force
By status in the examination process
As of 30 June 2002

		GATT/WTO notification				Examination process	
Agreement	**Date of entry into force**	**Date**	**Related provisions**	**Type of agreement**	**WT/ document series**	**Status**	**Ref.**
CEFTA accession of Bulgaria	1-Jan-99	24-Mar-99	GATT Art. XXIV	Accession to free trade agreement	REG11	Consultations on draft report	...
CEFTA accession of Romania	1-Jul-97	8-Jan-98	GATT Art. XXIV	Accession to free trade agreement	REG11	Consultations on draft report	...
CEFTA accession of Slovenia	1-Jan-96	8-Jan-98	GATT Art. XXIV	Accession to free trade agreement	REG11	Consultations on draft report	...
EC — Hungary	1-Feb-94	27-Aug-96	GATS Art. V	Services agreement	REG50	Consultations on draft report	...
CER	1-Jan-89	22-Nov-95	GATS Art. V	Services agreement	REG40	Consultations on draft report	...
NAFTA	1-Apr-94	1-Mar-95	GATS Art. V	Services agreement	REG4	Consultations on draft report	...
EC accession of Austria, Finland and Sweden	1-Jan-95	20-Jan-95	GATT Art. XXIV	Accession to customs union	REG3	Consultations on draft report	...
EC accession of Austria, Finland and Sweden	1-Jan-95	20-Jan-95	GATS Art. V	Accession to services agreement	REG3	Consultations on draft report	...
CEFTA	1-Mar-93	30-Jun-94	GATT Art. XXIV	Free trade agreement	REG11	Consultations on draft report	...
EFTA — Hungary	1-Oct-93	23-Dec-93	GATT Art. XXIV	Free trade agreement	REG13	Consultations on draft report	...
NAFTA	1-Jan-94	1-Feb-93	GATT Art. XXIV	Free trade agreement	REG4	Consultations on draft report	...
EC — Hungary	1-Mar-92	3-Apr-92	GATT Art. XXIV	Free trade agreement	REG18	Consultations on draft report	...
India — Sri Lanka	15-Dec-01	26-Jun-02	Enabling Clause	Free trade agreement	...	Examination not requested	...
EC — Mexico	1-Mar-01	21-Jun-02	GATS Art. V	Services agreement	...	Examination not requested	...
EAC	7-Jul-00	11-Oct-00	Enabling Clause	Other	...	Examination not requested	...
CEMAC	24-Jun-99	28-Sep-00	Enabling Clause	Other	...	Examination not requested	...
WAEMU/UEMOA	1-Jan-00	3-Feb-00	Enabling Clause	Other	...	Examination not requested	...
MSG	22-Jul-93	7-Oct-99	Enabling Clause	Other	...	Examination not requested	...

COMESA	8-Dec-94	29-Jun-95	Enabling Clause	Other	...	Examination not requested	...
SAPTA	7-Dec-95	22-Sep-93	Enabling Clause	Other	...	Examination not requested	...
AFTA	28-Jan-92	30-Oct-92	Enabling Clause	Other	...	Examination not requested	...
CAN	25-May-88	12-Oct-92	Enabling Clause	Other	...	Examination not requested	...
ECO	not available	22-Jul-92	Enabling Clause	Other	...	Examination not requested	...
Laos — Thailand	20-Jun-91	29-Nov-91	Enabling Clause	Other	...	Examination not requested	
GCC	not available	11-Oct-84	Enabling Clause	Other	...	Examination not requested	...
LAIA	18-Mar-81	1-Jul-82	Enabling Clause	Other	...	Examination not requested	...
SPARTECA	1-Jan-81	20-Feb-81	Enabling Clause	Other	...	Examination not requested	...
GSTP	19-Apr-89	25-Sep-89	Enabling Clause	Other	...	Examination not requested	...
PTN	11-Feb-73	9-Nov-71	Enabling Clause	Other	...	Examination not requested	...
EFTA—Former Yugoslav Republic of Macedonia	1-Jan-01	31-Jan-01	GATT Art. XXIV	Free trade agreement	REG117	Factual examination concluded	...
Latvia — Turkey	1-Jul-00	22-Jan-01	GATT Art. XXIV	Free trade agreement	REG116	Factual examination concluded	...
Turkey—Former Yugoslav Republic of Macedonia	1-Sep-00	22-Jan-01	GATT Art. XXIV	Free trade agreement	REG115	Factual examination concluded	...
EC — Israel	1-Jun-00	7-Nov-00	GATT Art. XXIV	Free trade agreement	REG110	Factual examination concluded	...
Estonia — Ukraine	14-Mar-96	25-Jul-00	GATT Art. XXIV	Free trade agreement	REG108	Factual examination concluded	...
Poland — Turkey	1-May-00	14-May-00	GATT Art. XXIV	Free trade agreement	REG107	Factual examination concluded	...
EFTA — Morocco	1-Dec-99	20-Feb-00	GATT Art. XXIV	Free trade agreement	REG91	Factual examination concluded	...
Bulgaria—Former Yugoslav Republic of Macedonia	1-Jan-00	21-Jan-00	GATT Art. XXIV	Free trade agreement	REG90	Factual examination concluded	...
Hungary — Latvia	1-Jan-00	20-Dec-99	GATT Art. XXIV	Free trade agreement	REG84	Factual examination concluded	...
Hungary — Lithuania	1-Mar-00	20-Dec-99	GATT Art. XXIV	Free trade agreement	REG83	Factual examination concluded	...
Poland — Latvia	1-Jun-99	29-Sep-99	GATT Art. XXIV	Free trade agreement	REG80	Factual examination concluded	...

BAFTA	1-Apr-94	15-Jun-99	GATT Art. XXIV	Free trade agreement	REG77	Factual examination concluded	...
Kyrgyz Republic — Moldova	21-Nov-96	15-Jun-99	GATT Art. XXIV	Free trade agreement	REG76	Factual examination concluded	...
Bulgaria — Turkey	1-Jan-99	4-May-99	GATT Art. XXIV	Free trade agreement	REG72	Factual examination concluded	...
Czech Republic— Turkey	1-Sep-98	24-Apr-99	GATT Art. XXIV	Free trade agreement	REG67	Factual examination concluded	...
Slovak Republic— Turkey	1-Sep-98	24-Mar-99	GATT Art. XXIV	Free trade agreement	REG68	Factual examination concluded	...
EC — Tunisia	1-Mar-98	23-Mar-99	GATT Art. XXIV	Free trade agreement	REG69	Factual examination concluded	...
Estonia — Turkey	1-Jun-98	23-Mar-99	GATT Art. XXIV	Free trade agreement	REG70	Factual examination concluded	...
Slovenia — Israel	1-Sep-98	8-Mar-99	GATT Art. XXIV	Free trade agreement	REG66	Factual examination concluded	...
Poland — Israel	1-Mar-98	25-Feb-99	GATT Art. XXIV	Free trade agreement	REG65	Factual examination concluded	...
Czech Republic — Estonia	12-Feb-98	3-Aug-98	GATT Art. XXIV	Free trade agreement	REG62	Factual examination concluded	...
Slovak Republic — Estonia	12-Feb-98	3-Aug-98	GATT Art. XXIV	Free trade agreement	REG63	Factual examination concluded	...
Lithuania — Turkey	1-Mar-98	8-Jun-98	GATT Art. XXIV	Free trade agreement	REG61	Factual examination concluded	...
Israel — Turkey	1-May-97	18-May-98	GATT Art. XXIV	Free trade agreement	REG60	Factual examination concluded	...
Romania — Turkey	1-Feb-98	18-May-98	GATT Art. XXIV	Free trade agreement	REG59	Factual examination concluded	...
Hungary — Turkey	1-Apr-98	12-May-98	GATT Art. XXIV	Free trade agreement	REG58	Factual examination concluded	...
Czech Republic — Israel	1-Dec-97	30-Mar-98	GATT Art. XXIV	Free trade agreement	REG56	Factual examination concluded	...
Slovak Republic — Israel	1-Jan-97	30-Mar-98	GATT Art. XXIV	Free trade agreement	REG57	Factual examination concluded	...
Slovenia — Croatia	1-Jan-98	25-Mar-98	GATT Art. XXIV	Free trade agreement	REG55	Factual examination concluded	...
Hungary — Israel	1-Feb-98	24-Mar-98	GATT Art. XXIV	Free trade agreement	REG54	Factual examination concluded	...
EC — Andorra	1-Jul-91	25-Feb-98	GATT Art. XXIV	Customs union	REG53	Factual examination concluded	...

Poland — Lithuania	1-Jan-97	30-Dec-97	GATT Art. XXIV	Free trade agreement	REG49	Factual examination concluded	...
Slovak Republic— Latvia	1-Jul-97	14-Nov-97	GATT Art. XXIV	Free trade agreement	REG47	Factual examination concluded	...
Slovak Republic— Lithuania	1-Jul-97	14-Nov-97	GATT Art. XXIV	Free trade agreement	REG48	Factual examination concluded	...
Czech Republic— Latvia	1-Jul-97	13-Nov-97	GATT Art. XXIV	Free trade agreement	REG45	Factual examination concluded	...
Czech Republic— Lithuania	1-Sep-97	13-Nov-97	GATT Art. XXIV	Free trade agreement	REG46	Factual examination concluded	...
Romania — Moldova	1-Jan-95	24-Sep-97	GATT Art. XXIV	Free trade agreement	REG44	Factual examination concluded	...
Canada — Chile	5-Jul-97	26-Aug-97	GATT Art. XXIV	Free trade agreement	REG38	Factual examination concluded	...
Slovenia — Estonia	1-Jan-97	20-Feb-97	GATT Art. XXIV	Free trade agreement	REG37	Factual examination concluded	...
Slovenia—Former Yugoslav Republic of Macedonia	1-Sep-96	20-Feb-97	GATT Art. XXIV	Free trade agreement	REG36	Factual examination concluded	...
Slovenia — Latvia	1-Aug-96	20-Feb-97	GATT Art. XXIV	Free trade agreement	REG34	Factual examination concluded	...
Slovenia — Lithuania	1-Mar-97	20-Feb-97	GATT Art. XXIV	Free trade agreement	REG35	Factual examination concluded	...
Canada — Israel	1-Jan-97	23-Jan-97	GATT Art. XXIV	Free trade agreement	REG31	Factual examination concluded	...
EC — Slovenia	1-Jan-97	11-Nov-96	GATT Art. XXIV	Free trade agreement	REG32	Factual examination concluded	...
EC — Poland	1-Feb-94	27-Aug-96	GATS Art. V	Services agreement	REG51	Factual examination concluded	...
EC — Slovak Republic	1-Feb-95	27-Aug-96	GATS Art. V	Services agreement	REG52	Factual examination concluded	...
EFTA — Estonia	1-Jun-96	25-Jul-96	GATT Art. XXIV	Free trade agreement	REG28	Factual examination concluded	...
EFTA — Latvia	1-Jun-96	25-Jul-96	GATT Art. XXIV	Free trade agreement	REG29	Factual examination concluded	...
EFTA — Lithuania	1-Aug-96	25-Jul-96	GATT Art. XXIV	Free trade agreement	REG30	Factual examination concluded	...
EC — Czech Republic	1-Mar-92	13-May-96	GATT Art. XXIV	Free trade agreement	REG18	Factual examination concluded	...
EC — Slovak Republic	1-Mar-92	13-May-96	GATT Art. XXIV	Free trade agreement	REG18	Factual examination concluded	...

Faroe Islands — Norway	1-Jul-93	13-Mar-96	GATT Art. XXIV	Free trade agreement	REG25	Factual examination concluded	...
Faroe Islands — Switzerland	1-Mar-95	8-Mar-96	GATT Art. XXIV	Free trade agreement	REG24	Factual examination concluded	...
Faroe Islands — Iceland	1-Jul-93	23-Jan-96	GATT Art. XXIV	Free trade agreement	REG23	Factual examination concluded	...
EFTA — Slovenia	1-Jul-95	18-Oct-95	GATT Art. XXIV	Free trade agreement	REG20	Factual examination concluded	...
EC — Lithuania	1-Jan-95	26-Sep-95	GATT Art. XXIV	Free trade agreement	REG9	Factual examination concluded	...
EC — Estonia	1-Jan-95	30-Jun-95	GATT Art. XXIV	Free trade agreement	REG8	Factual examination concluded	...
EC — Latvia	1-Jan-95	30-Jun-95	GATT Art. XXIV	Free trade agreement	REG7	Factual examination concluded	...
EC — Bulgaria	31-Dec-93	23-Dec-94	GATT Art. XXIV	Free trade agreement	REG1	Factual examination concluded	...
EC — Romania	1-May-93	23-Dec-94	GATT Art. XXIV	Free trade agreement	REG2	Factual examination concluded	...
EFTA — Poland	15-Nov-93	20-Oct-93	GATT Art. XXIV	Free trade agreement	REG15	Factual examination concluded	...
EFTA — Bulgaria	1-Jul-93	30-Jun-93	GATT Art. XXIV	Free trade agreement	REG12	Factual examination concluded	...
EFTA — Romania	1-May-93	24-May-93	GATT Art. XXIV	Free trade agreement	REG16	Factual examination concluded	...
EFTA — Israel	1-Jan-93	1-Dec-92	GATT Art. XXIV	Free trade agreement	REG14	Factual examination concluded	...
EC — Poland	1-Mar-92	3-Apr-92	GATT Art. XXIV	Free trade agreement	REG18	Factual examination concluded	...
Chile — Costa Rica	15-Feb-02	24-May-02	GATS Art. V	Services agreement	...	Factual examination not started	...
Chile — Costa Rica	15-Feb-02	14-May-02	GATT Art. XXIV	Free trade agreement	REG136	Factual examination not started	...
Turkey — Slovenia	1-Jun-00	6-Mar-02	GATT Art. XXIV	Free trade agreement	REG135	Factual examination not started	...
United States — Jordan	17-Dec-01	5-Mar-02	GATT Art. XXIV	Free trade agreement	REG134	Factual examination not started	...
EC — Slovenia	1-Feb-99	11-Feb-02	GATS Art. V	Services agreement	...	Factual examination not started	...
EC — Lithuania	1-Feb-98	11-Feb-02	GATS Art. V	Services agreement	...	Factual examination not started	...

EC — Estonia	1-Feb-98	11-Feb-02	GATS Art. V	Services agreement	...	Factual examination not started	...
EC — Latvia	1-Feb-99	11-Feb-02	GATS Art. V	Services agreement	...	Factual examination not started	...
EFTA — Jordan	1-Jan-02	22-Jan-02	GATT Art. XXIV	Free trade agreement	REG133	Factual examination not started	...
EFTA — Croatia	1-Jan-02	22-Jan-02	GATT Art. XXIV	Free trade agreement	REG132	Factual examination not started	...
Slovenia — Bosnia and Herzegovina	1-Jan-02	21-Jan-02	GATT Art. XXIV	Free trade agreement	REG131	Factual examination not started	...
EC — FYROM	1-Jun-01	21-Nov-01	GATT Art. XXIV	Free trade agreement	REG129	Factual examination not started	...
Hungary — Estonia	1-Mar-01	4-Oct-01	GATT Art. XXIV	Free trade agreement	REG128	Factual examination not started	...
New Zealand - Singapore	1-Jan-01	4-Sep-01	GATT Art. XXIV	Free trade agreement	REG127	Factual examination not started	...
New Zealand - Singapore	1-Jan-01	4-Sep-01	GATS Art. V	Services agreement	REG127	Factual examination not started	...
EFTA - Mexico	1-Jul-01	25-Jul-01	GATT Art. XXIV	Free trade agreement	REG126	Factual examination not started	...
EFTA - Mexico	1-Jul-01	25-Jul-01	GATS Art. V	Services agreement	REG126	Factual examination not started	...
Chile — Mexico	1-Aug-99	14-Mar-01	GATS Art. V	Services agreement	REG125	Factual examination not started	...
Chile — Mexico	1-Aug-99	27-Feb-01	GATT Art. XXIV	Free trade agreement	REG125	Factual examination not started	...
Mexico — Israel	1-Jul-00	27-Feb-01	GATT Art. XXIV	Free trade agreement	REG124	Factual examination not started	...
EC — South Africa	1-Jan-00	14-Nov-00	GATT Art. XXIV	Free trade agreement	REG113	Factual examination not started	...
EFTA — Palestinian Authority	1-Jul-99	21-Sep-99	GATT Art. XXIV	Free trade agreement	REG79	Factual examination not started	...
EC — Palestinian Authority	1-Jul-97	30-Jun-97	GATT Art. XXIV	Free trade agreement	REG43	Factual examination not started	...
EC — Bulgaria	1-Feb-95	25-Apr-97	GATS Art. V	Services agreement	...	Factual examination not started	...
EEA	1-Jan-94	10-Oct-96	GATS Art. V	Services agreement	...	Factual examination not started	...
EC — Czech Republic	1-Feb-95	9-Oct-96	GATS Art. V	Services agreement	...	Factual examination not started	...

EC — Romania	1-Feb-95	9-Oct-96	GATS Art. V	Services agreement	...	Factual examination not started	...
Czech Republic — Slovak Republic	1-Jan-93	30-Apr-93	GATT Art. XXIV	Customs union	REG89	Report adopted	41S/112 04.10.94
EFTA — Czech Republic	1-Jul-92	3-Jul-92	GATT Art. XXIV	Free trade agreement	REG87	Report adopted	41S/116 08.12.94
EFTA — Slovak Republic	1-Jul-92	3-Jul-92	GATT Art. XXIV	Free trade agreement	REG88	Report adopted	41S/116 08.12.94
EFTA — Turkey	1-Apr-92	6-Mar-92	GATT Art. XXIV	Free trade agreement	REG86	Report adopted	40S/48 17.12.93
EC accession of Portugal and Spain	1-Jan-86	11-Dec-85	GATT Art. XXIV	Accession to customs union	...	Report adopted	35S/293 19.10.88
United States — Israel	19-Aug-85	13-Sep-85	GATT Art. XXIV	Free trade agreement	...	Report adopted	34S/58 14.05.87
CER	1-Jan-83	14-Apr-83	GATT Art. XXIV	Free trade agreement	REG111	Report adopted	31S/170 02.10.84
EC accession of Greece	1-Jan-81	24-Oct-79	GATT Art. XXIV	Accession to customs union	...	Report adopted	30S/168 09.03.83
ASEAN	31-Aug-77	1-Nov-77	Enabling Clause	Other	...	Report adopted	26S/321 29.01.79
EC — Egypt	1-Jul-77	15-Jul-77	GATT Art. XXIV	Free trade agreement	REG98	Report adopted	25S/114 17.05.78
EC — Jordan	1-Jul-77	15-Jul-77	GATT Art. XXIV	Free trade agreement	REG100	Report adopted	25S/133 17.05.78
EC — Lebanon	1-Jul-77	15-Jul-77	GATT Art. XXIV	Free trade agreement	REG100	Report adopted	25S/142 17.05.78
EC — Syria	1-Jul-77	15-Jul-77	GATT Art. XXIV	Free trade agreement	REG104	Report adopted	25S/123 17.05.78
PATCRA	1-Feb-77	20-Dec-76	GATT Art. XXIV	Free trade agreement	...	Report adopted	24S/63 11.11.77
Bangkok Agreement	17-Jun-76	2-Nov-76	Enabling Clause	Other	...	Report adopted	25S/109 14.03.78
EC — Algeria	1-Jul-76	28-Jul-76	GATT Art. XXIV	Free trade agreement	REG105	Report adopted	24S/80 11.11.77
CARICOM	1-Aug-73	14-Oct-74	GATT Art. XXIV	Customs union	REG92	Report adopted	24S/68 02.03.77
EC — Norway	1-Jul-73	13-Jul-73	GATT Art. XXIV	Free trade agreement	...	Report adopted	21S/83 28.03.74
EC — Cyprus	1-Jun-73	13-Jun-73	GATT Art. XXIV	Customs union	REG97	Report adopted	21S/94 21.06.74
EC — Iceland	1-Apr-73	24-Nov-72	GATT Art. XXIV	Free trade agreement	REG95	Report adopted	20S/158 19.10.73
EC — Switzerland and Liechtenstein	1-Jan-73	27-Oct-72	GATT Art. XXIV	Free trade agreement	REG94	Report adopted	20S/196 19.10.73
EC accession of Denmark, Ireland and United Kingdom	1-Jan-73	7-Mar-72	GATT Art. XXIV	Accession to customs union	...	Report adopted	C/M/107 11.07.75
EC — Malta	1-Apr-71	24-Mar-71	GATT Art. XXIV	Customs union	REG102	Report adopted	19S/90 29.05.72

EC — OCTs	1-Jan-71	14-Dec-70	GATT Art. XXIV	Free trade agreement	REG106	Report adopted	18S/143 09.11.71
EFTA accession of Iceland	1-Mar-70	30-Jan-70	GATT Art. XXIV	Accession to free trade agreement	...	Report adopted	18S/174 29.09.70
TRIPARTITE	1-Apr-68	23-Feb-68	Enabling Clause	Other	...	Report adopted	16S/83 14.11.68
CACM	12-Oct-61	24-Feb-61	GATT Art. XXIV	Customs union	REG93	Report adopted	10S/98 23.11.61
EFTA (Stockholm Convention)	3-May-60	14-Nov-59	GATT Art. XXIV	Free trade agreement	REG85	Report adopted	9S/70 04.06.60
EC (Treaty of Rome)	1-Jan-58	24-Apr-57	GATT Art. XXIV	Customs union	...	Report adopted	6S/70 & 109 29.11.57
Georgia — Armenia	11-Nov-98	21-Feb-01	GATT Art. XXIV	Free trade agreement	REG119	Under factual examination	...
Georgia — Azerbaijan	10-Jul-96	21-Feb-01	GATT Art. XXIV	Free trade agreement	REG120	Under factual examination	...
Georgia — Kazakhstan	16-Jul-99	21-Feb-01	GATT Art. XXIV	Free trade agreement	REG123	Under factual examination	...
Georgia — Russian Federation	10-May-94	21-Feb-01	GATT Art. XXIV	Free trade agreement	REG118	Under factual examination	...
Georgia — Turkmenistan	1-Jan-00	21-Feb-01	GATT Art. XXIV	Free trade agreement	REG122	Under factual examination	...
Georgia — Ukraine	4-Jun-96	21-Feb-01	GATT Art. XXIV	Free trade agreement	REG121	Under factual examination	...
Kyrgyz Republic — Armenia	27-Oct-95	4-Jan-01	GATT Art. XXIV	Free trade agreement	REG114	Under factual examination	...
EC — Morocco	1-Mar-00	8-Nov-00	GATT Art. XXIV	Free trade agreement	REG112	Under factual examination	...
EC — Mexico	1-Jul-00	1-Aug-00	GATT Art. XXIV	Free trade agreement	REG109	Under factual examination	...
CIS	30-Dec-94	1-Oct-99	GATT Art. XXIV	Free trade agreement	REG82	Under factual examination	...
Kyrgyz Republic — Kazakhstan	11-Nov-95	29-Sep-99	GATT Art. XXIV	Free trade agreement	REG81	Under factual examination	...
Poland — Faroe Islands	1-Jun-99	18-Aug-99	GATT Art. XXIV	Free trade agreement	REG78	Under factual examination	...
Kyrgyz Republic — Russian Federation	24-Apr-93	15-Jun-99	GATT Art. XXIV	Free trade agreement	REG73	Under factual examination	...
Kyrgyz Republic — Ukraine	19-Jan-98	15-Jun-99	GATT Art. XXIV	Free trade agreement	REG74	Under factual examination	...
Kyrgyz Republic — Uzbekistan	20-Mar-98	15-Jun-99	GATT Art. XXIV	Free trade agreement	REG75	Under factual examination	...
EAEC	8-Oct-97	6-Apr-99	GATT Art. XXIV	Customs union	REG71	Under factual examination	...
Estonia — Faroe Islands	1-Dec-98	26-Jan-99	GATT Art. XXIV	Free trade agreement	REG64	Under factual examination	...
Canada — Chile	5-Jul-97	13-Nov-97	GATS Art. V	Services agreement	REG38	Under factual examination	...
EC — Faroe Islands	1-Jan-97	19-Feb-97	GATT Art. XXIV	Free trade agreement	REG21	Under factual examination	...

EC — Turkey	1-Jan-96	22-Dec-95	GATT Art. XXIV	Customs union	REG22	Under factual examination	...
EC (Treaty of Rome)	1-Jan-58	10-Nov-95	GATS Art. V	Services agreement	REG39	Under factual examination	...
MERCOSUR	29-Nov-91	5-Mar-92	Enabling Clause	Customs union	COMTD/1	Under factual examination	...

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ENDNOTES

[1] We feel that a clarification as to the Preferential Trading Arrangement (PTA), Free Trade Area (FTA) and Regional Trading Agreement (RTA) should be made at the outset. Most literatures on this issue use these words interchangeably and we too have followed the same conventional approach. Some others have used PTA to denote every form of regional economic grouping inasmuch as they are largely 'preferential' and 'exclusionary' in nature. However, one has to take cognizance of the fact that RTA is a much broader term, which encompasses not only PTA and FTA but also deeper economic integration efforts such as customs union and economic union. RTAs can also be referred to as Regional Integration Agreement (RIA).

[2] A Group of Eminent Persons (GEP) was constituted during the Ninth Summit (held in Male) of SAARC.

[3] Bergsten, Fred (2000a): 8.

[4] World Bank (2000): 12.

[5] Bergsten, Fred (2000), *above*, note 3: 8.

[6] World Bank (2000), *above*, note 4: 13.

[7] World Bank (2000), *above*, note 4: 15.

[8] It is also said that when the Americans were defeated Vietnam war, the threat of communist insurgency confronting all ASEAN countries galvanised the group [ASEAN] into action. See Mattli, Walter (2000): 164

[9] World Bank (2000), *above*, note 4: 16.

[10] World Bank (2000), *above*, note 4: 20.

[11] World Bank (2000), *above*, note 4: 7-8.

[12] Dunkley, Graham (2000): 82.

[13] See World bank (2000), *above*, note 4: 64.

[14] Baldwin, Richards E. (1997): 872.

[15] Bulk of their revenue comes from income tax and VAT.

[16] World Bank (2000), *above*, note 4: 44.

[17] World Bank (2000), *above*, note 4: 52.

[18] India and Sri Lanka are not only members of the SAARC, but also of the Bangladesh, India, Myanmar, Sri Lanka, and Thailand – Economic Cooperation (BIMST-EC), Indian Ocean Rim – Association for Regional Cooperation (IOR-ARC), Bangkok Agreement, and the Indo-Sri Lanka Bilateral Free Trade Agreement. See a diagram on Approaches to Regional Cooperation in South Asia on Chapter V.

[19] 'Spaghetti bowl' is a phrase coined by Prof. Jagdish Bhagwati to describe (numerous) overlapping RTAs.

[20] Das, Dilip K (2001): 9.

[21] Viner, Jacob (1950): 41-56.

[22] Dam, Kenneth (1970): 283-4.

[23] Srirnivasan, T.N. (1995).

[24] Bhattacharya, Debapriya and Mustafizur Rahman (1999): 30.

[25] Ibid

[26] Das, Dilip K. (2001), *above*, note 20: 4.

[27] A country which is the epicenter of industrial/trading activities; is the common denominator for majority of the RTAs; and has bilateral or regional trade agreements with all (or most) other countries is the hub and other countries which may not have any agreements within themselves but have a bilateral or RTA relation with the hub are called 'spokes.' Of late, the US and EU have emerged as major hubs, while other countries have remained spokes. To further illustrate this point one can consider trade Association Agreement of the EU (hub) with several Eastern European countries and free trade agreements with South Africa, Turkey, and Mexico etc (spokes). These smaller countries have agreement with the EU, but not necessarily within themselves. See Stevens, Christopher and Mathew McQueen (1999), Regional Trade Agreements, Background Briefing No.2, Institute of Development Studies, Brighton.

[28] Dunkley, Graham (2000), *above*, note 12: 82.

[29] Winters Alan L. (1996).

[30] Bergsten, Fred (1997): 2-3.

[31] Winters Alan L. (1996), *above*, note 29: 57.

[32] Bergsten, Fred (1997), *above*, note 3: 3.

[33] *Cf.* Das, Dilip K (2001), above, note 23.

[34] Das, Dilip K (2001), *above*, note 20: 11.

[35] Das, Dilip K (2001), *above*, note 20: 22.

[36] See Baldwin, Richards E (1997), *above*, note 14: 877-8.

[37] Based on personal conversation with Prof. Baldwin on 22 January 2002 at the World Trade Institute, Bern.

[38] Sapir, Andre (2001): 386.

[39] Bergsten, Fred (1997), *above, note* 3:4.

[40] Bergsten, Fred (1997), *above*, note 3: 12.

[41] Srinivasan, T.N. (1997)

[38] Kelegama, S. (2000a); Kelegama, S. (2000b) ; and Kelegama, S. (2002)

[43] Bhagwati, Jagdish (1999): 7.

[44] Bhagwati, Jagdish (1988): 169.

[45] See Panagariya, Arvind (1998): 22-23

[46] Ibid.

[47] Bhagwati, Jagdish, Pravin Krishna and Arvind Panagariya (1999): xvii.

[48] Ibid at 22-25.

[49] World Bank (2000), *above,* note 4: 104.

[50] Das, Dilip K. (2001), *above*, note 20: 4-5.

[51] It has taken the EU more than 40 years to grow from 6 members 15. Canada-US free trade agreement has included only one member by converting itself into NAFTA over a period of one decade. Attempts by even a tiny country such as Chile have faced serious resistance. See, Panagariya, Arvind (1998), *above*, note 41: 35.

[52] Ben Zissimos and David Vines (2000).

[53] Kelegama, S. (2000a), *above*, note 42.

[54] See Dunkley, Graham (2000), *above*, note 12: 97.

[55] Winters, L. Alan (1996): 2.

[56] World Bank (2000), *above*, note 4. As per the study MERCOSUR could not only develop itself as a 'commitment mechanism' by locking in its Members on a predictable mode of liberalisation, but could also achieve huge competition and scale effect, which has not been possible in other South-South RTAs. Therefore, the report argues: "If developing countries want to use trade blocs to improve their terms of trade, the most pertinent model is …MERCOSUR", (p 126).

[57] Large scale foreign direct investment from Japan played a key role in stimulating intra-ASEAN trade via the investment-trade nexus. Further details are given in Kelegama, S. (1996).

[58] Ethier, W. (1998): 1149-1161.

[59] *Cf.* Laird, Sam (1999): 1187.

[60] Baldwin, Richards E. (1997), *above*, note 14: 888.

[61] *Cf*. Jakson, John (1997): 171.

[62] Bergsten, Fred (2000b): 21.

[63] De Jonquieres, Guy (1994): 14

[64] Differential and More Favourable Treatment, Reciprocity and Fuller Participation of the Developing Countries, Decision of the GATT contracting parties of 28 November 1979.

[65] Because WTO operates through a consensus based system, there is a serious paralysis in the decision making process of the Committee on Regional Trading Agreement (CRTA), which has given stamp of approval to only two agreement so far, namely, the FTA between Chez and Slovak Republic and CARICOM. For further details, refer Chapter III.

[66] See Kindleberger, Charles P (1989).

[67] Dunkley, Graham (2000), *above,* note 12: 80-81. See also Hoekman, Bernard (1995).

[68] This section draws heavily on the lecture of Dr. Edwini Kessie delivered on 23-24 January 2002 to Master of International Law and Economics (MILE) Programme (2001-2002) at the World Trade Institute (WTI), Bern.

[69] Formed for the discussion on EEC's compliance with Article XXIV of the GATT.

[70] See WTO (1999a), *Turkey - Restrictions on Imports of Textile and Clothing Products*, Appellate Body Report, WT/DS34/AB/R, 22 October 1999 (AB-1999-5), World Trade Organisation, Geneva.

[71] The Agreement Establishing European Economic Community, which has now been converted to European Union.

[72] WTO (1999b).

[73] WTO (1999a), *above*, note 70.

[74] Dam, Kenneth (1970), *above,* note 22: 277.

[75] New Zealand and Australia did not bother to set out a plan and schedule in their free trade agreement of the 1965. See Dam, Kenneth (1970), *above*, note 22: 283.

[76] According to paragraph 3 of the Understanding on the Interpretation of Article XXIV of the GATT 19994, "The 'reasonable length of time' should exceed 10 years only in exceptional cases. In cases where members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explantation to the Council for Trade in Goods of the need for a longer period."

[77] Some members have stressed that the lack of precision in the text reflects the "pragmatism" necessary to address complex negotiations for the formation of an RTA, a particularly relevant matter in the case of large agreements in which the bulk of concessions are made at the last minute. They argue that, if the relevant WT O rules were made too strict, their effectiveness and legitimacy would be called into question. See WTO (2000a): 8.

[78] Sovereign governments have to make substantial trade off at their respective domestic levels before agreeing to an RTA. If the WTO were to ask them to make changes, howsoever minor they may be, to make the Agreement compatible with the WTO, it would be embarrassing for them. In all probability, it will be extremely difficult for them to go back to their respective constituencies to amend the agreement before it has actually become functional.

[79] Canada and Norway indeed pointed out the political difficulty of notifying agreements before ratification. See WTO (2000a), *above*, note 77: 8.

[80] As per Viner trade creation was likely to occur if parties to RTAs substantially liberalised their economies. Abolition of tariffs and other barriers to intra-trade would ensure would enhance the position of the most efficient producer, who will be able to produce for the entire FTA or CU, thereby enhancing consumer welfare and promoting efficiency gains.

[81] WTO (1995a).

[82] Ibid

[83] See WTO (2001).

[84] WTO (2000a), *above*, note 77:21.

[85] WTO (1995a), above, note 81.

[86] Wilcox, Clair (1949) :70-71.

[87] WTO (2000b).

[88] WTO (2001).

[89] Lome Agreement, for example, between the European Union and the less-developed former colonies of the European imperial powers (the UK, France, the Netherlands, Spain and Portugal) is the single largest waiver in the history of GATT/WTO. Now known as Cotonou Agreement, the waiver has been extended till 2006 by the fourth Ministerial Conference of the WTO held in Doha.

[90] http://www.wto.org/english/tratop_e/region_e/type_250901_e.xls

[91] Four modes of service supply include: cross border supply, consumption abroad, business presence and movement of natural person.

[92] Agreement entered into in pursuance to the Enabling Clause were notified to the Committee on Trade and Development.

[93] Laird, Sam (1999), *above*, note 59: 1191-2.

[94] Kessie E. (2001).

[95] This practice followed by the DSB has proven to be extremely effective.

[96] They include those notified under Article XXIV of the GATT, Article V of the GATS and the Enabling Clause. See WTO website www.wto.org

[97] They include the Southern Rhodesia-South Africa CU Agreement; the El Salvador-Nicaragua FTA and participation of Nicaragua in the Central American FTA; The Caribbean Free Trade Agreement and later the Caribbean Community and Common Market (CARICOM); and the Czech Republic-Slovak Republic CU. Since four of these six agreements are presumed no longer operative, there are only two active agreements notified under Article XXIV – namely CARICOM and the CU between Czech Republic and Slovak Republic. See WTO (1995b): 16-17.

[98] Dam, K (1970): 276.

[99] www.tehelka.com/channels/currentaffairs/2002/jan/4/ca010402saarc.htm

[100] Dubey, Muchkund (1999).

[101] Waqif, Arif A (2000).

[102] www.saarc-sec.org/economic/economic.htm

[103] www.csis.org/saprog/sam9.html

[104] See Bhattacharya, Swapan K (2001): 282

[105] www.saarc-sec.org/economic/economic.htm

[106] Mukherji, I.N (1996).

[107] Udagedera, Saman (2001): 19.

[108] Ibid at 21

[109] Weerakoon, Dushni (2001): 2-3.

[110] Kelegama, S. (1996), *above*, note 57.

[111] Weerakoon, Dushni (2001), *above*, note 109: 3-4.

[112] SAARC (2002).

[113] Jayasekera, Douglas (2001): 74.

[114] That was on a complaint brought forward by the US. America had argued that there was no justification for India to continue maintaining QRs on imports of agricultural, textile and industrial products from the US in the absence of any imminent balance of payment difficulties. The panel accepted this argument. An appeal was preferred against this Decision to the Appellate Body, on questions of law. The Appellate Body rejected the Indian position and upheld the decision of the Panel.

[115] Azeez, A.L.A (2001). However, on the flip side, this has diluted the offer India had made unilaterally for more than 2,000 products. See, *above*, note 15.

[116] See Panchamukhi, V.R and Ram Upendra Das (2001).

[117] Jayasekera, Douglas (2001), above, note 113: 76

[118] Azeez, A.L.A (2001), *above*, note 115: 14.

[119] SAARC Secretariat (nd).

[120] Ibid.

[121] Azeez, A.L.A (2001), *above*, note 115: 14.

[122] Azeez, A.L.A (2001), *above*, note 115: 14.

[123] Committee means Committee of Participants established pursuant to Article 9 of SAPTA for overseeing the implementation of commitments and settlement of disputes.

[124] Altogether 49 countries fall into this category. In South Asia there are four LDCs, namely, Bangladesh, Bhutan, Maldives and Nepal.

[125] SAARC Secretariat (nd).

[126] Joyasekera, Douglas (2001), *above*, note 107: 71.

[127] This would set up a single South Asian Tariff regime in respects of imports from outside the region and agreement on common non-tariff barriers and other trade regulation measures.

[128] CASAC (1999a).

[129] The Rising Nepal (2002).

[130] SAARC (2002), *above*, note 112.

[131] Mukherji (2001: 317) remarks, "The Colombo Summit held in 1998, which considered the Group's report, set the time frame for drafting the treaty as the end of 2001. This is indeed considerable backtracking, considering that the very same date had earlier been set for attaining a free trade areas for the region". See Mukherji (2001).

[132] Jayasekera, Douglas (2001), *above*, note 113: 75.

[133] This is in part due to the phasing out of the NTBs as per the WTO commitments.

[134] Jayasekera, Douglas (2001), *above*, note 113: 76.

[135] Maskay (2001: 217) argues that since SAARC does not have the making of an optimal currency area (OCA), moving towards monetary integration without some level of economic convergence will likely spell disaster for the region. See Maskay, Nephil Matangi (2001).

[136] Rodrigo, Nihal (2002).

[137] Weerakoon, Dushni (2001), *above*, note 111: 11.

[138] As mentioned in Chapter III, SAARC member countries should follow Article XXIV of GATT and Article V of GATS route rather than relying on Enabling Clause, which has a fragile foundation.

[139] CASAC (1999), *above*, note 126.

[140] Adhikari, Ratnakar (2002).

[141] Financial Times (2002).

[142] Dubey, Muchkund (2000).

[143] For a discussion, see RIS (2002).

[144] For a detailed discussion, see De Silva, K.M. (1999), "The European Community and ASEAN: Lessons for SAARC", *South Asian Survey*, Vol. 6, No. 2.

[145] Das, S. (2000): 4352.

[146] Bargava, K.K. (2000).

[147] Muni, S.D. (1999)

[148] Baru, S. (2001).

[149] Kelegama, S. (2001a).

[150] Nayar, Kuldip (2002).

[151] Maass, C.D. (1999).

[152] Upadhyaya, S (2000): 76

[153] Describing Pakistan's proximity with Middle-East, Pakistani Delegation (2000) argues, "Pakistan has always considered itself more as an extension of the Muslim Middle-East than a South Asian entity. Its links with Muslim states, especially its role in the Organisation of Islamic Countries, have often led to misunderstandings, even estrangement, iwht the South Asian neighbour." See Pakistani Delegation (2000): 217.

[154] Ibid at 218.

[155] *The Economist* (2001): 77.

[156] Main export markets of Pakistan are the USA and the EU.

[157] Bhatty, Maqbool Ahmad (2002).

[158] See, for instance, Fuwa, Y. (2001).

[159] Judeo-Christianity, Ancient Greece and Rome, the Renaissance, the Age of Enlightenment, the French Revolution, the Industrial Revolution - all these were common signposts and constituted a shared, but debated, intellectual lineage and heritage that of the Western civilisation and modernity. Great stability to the cold war was introduced by the concept of Mutually Agreed Destruction, which was recognised and acknowledged.

[160] Das, S. (2000), *above*, note 145.

[161] Sirinivasan, T.N. (1994); Karmacharya, B.K. (1999); RIS (1999).

[162] Srinivasan (1994), ibid.

[163] Also see, Pigato, M. *et al* (1997): 35.

[164] Kelegama, S. (1996), *above*, note 57; Kelegama, S. (2001b); RIS (1999), *above*, note 160, and others.

[165] Srinivasan (1994), *above*, note 161.

[166] Karmacharya, B.K. (1999), *above*, note 161.

[167] RIS (2002), *above*, note 143.

[168] Weerakoon, D. and J. Wijayasiri (2001).

[169] Kelegama, S. (1999).

[170] RIS (1999), *above*, note 161.

[171] Weerakoon, D. and J. Wijayasiri (2001), *above*, note 168.

[172] Weerakoon, D. and J. Wijayasiri (2001), *above*, note 168.

[173] Kelegama, S. (1996), *above*, note 57.

[174] Kelegama, S. (1996), above, note 57.

[175] Panagariya, A. (1999).

[176] See, for instance, Rajapatirana, S. (1997).

[177] Kelegama, S. (1996), *above*, note 57.

[178] Weerakoon, D. and J. Wijayasiri (2001), 168.

[179] Weerakoon, D. and J. Wijayasiri (2001), *above*, note 168: 37.

[180] Kalam, A. (2001).

[181] Weerakoon, D. and J. Wijayasiri (2001), *above*, note 168.

[182] GEP (1998).

[183] SAARC (2000).

[184] Wickremasinghe, U. (2000).

[185] Kelegama, S. (1996), *above*, note 57.

[186] Kelegama, S. (2001b), *above*, note 57.

[187] Behera, N.C., P.M. Evans, and G. Rizvi (1997).

[188] Ibid.

[189] *The Observer* (2002): 07.

[190] Mukerji, I.N. (2001).