

THE POLITICS OF FTAs IN SOUTH ASIA: TOWARDS A NEW BILATERALISM OR NEW REGIONALISM?

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Introduction

The world has been witnessing the global proliferation of bilateral free trade agreements along side deepening regionalism in most parts of the global economic system over the last decade. Both these trends connect closely and give a new dimension to regional integration. When SAARC was established in 1985, there was no provision for trade cooperation among its member states. It took about a decade for the South Asian countries to embark upon a preferential trading arrangement (PTA) with the establishment of the SAARC Preferential Trading Arrangement (SAPTA) in 1993. For the first time, the region witnessed a mechanism to liberalize trade regimes on a preferential basis. Ironically, this did not generate momentum for progress and virtually it was stalled after several rounds of talks. However, since the late 1990s South Asian countries have pursued an aggressive policy of trade cooperation through free trade agreements (FTAs) within the region and outside. So far South Asia has witnessed a dramatic rise of FTA initiatives at three levels - regional, sub-regional and bilateral. Different nations in South Asia have considered FTAs a critical component of their trade policies. Particularly, India and Pakistan are leading and often competing with each other in signing and negotiating bilateral FTAs in the region and beyond. This rise of FTAs is an integral part of understanding new regionalism process in South Asia. In this context, it is worthwhile to deal with some key questions. Why do the South Asian countries become interested about FTAs? How have FTAs been featured in South Asian trade cooperation? To what extent has this region progressed in trade cooperation? What are the consequences of bilateral FTAs for regionalism in South Asia? Is it leading to new economic bilateralism? These are the pertinent questions to be addressed in this paper in order to understand the directions of South Asian regional economic cooperation.

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Benefits and Dangers of PTAs/FTAs

South Asia’s shift towards the market economy since the early 1990s under conditions of globalization has created the necessary environment for trade cooperation in the region. Regional trade liberalization is seen as an important step to generate a significant increase in intra-regional trade and cross-border investment. The importance of an open trade environment in explaining economic growth performance has been demonstrated in a variety of studies covering both developed and developing countries (see the figure 1). One conclusion to emerge from the literature is that openness to trade is associated with higher rates of growth, or, conversely, that a lack of openness to trade is correlated with poor growth performance (Dollar 1992; Krueger 1978; Krugman 1986; Edwards 1993; Harrison 1996). International trade facilitates technology transfers, the exchange of information, and opportunities to realize economies of scale, and trade agreements provide greater certainty for trade policy generally especially in countries which have a history of reversing moves towards high protectionism and subsequently towards unilateral liberalization. As all of this reduces the risks of – or raises the returns to – investment, greater volumes of investment provide one of the reasons for the observed positive relationship between openness to trade and growth.

Undeniably, a more liberal trade policy does not explain everything about a country’s economic growth rate. There are a variety of other important explanatory factors like human capital, the type of investment undertaken, political instability, the presence or absence of market distortions, diversification away from a dependence on primary exports, and location.

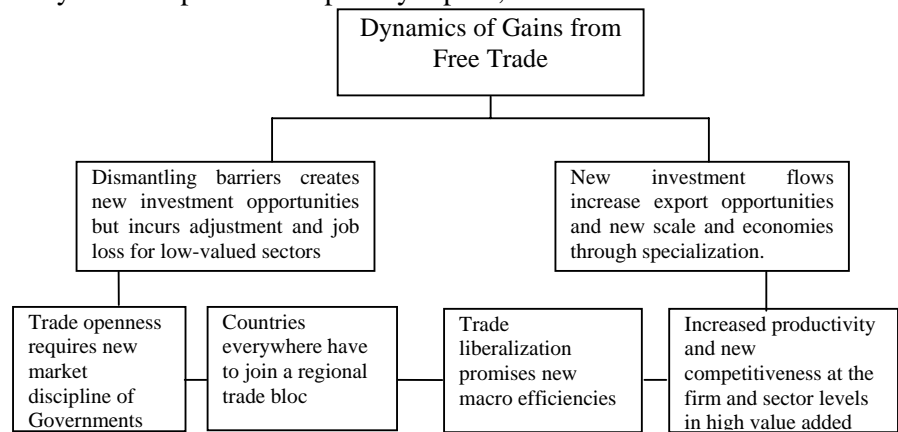


Figure-1: Expected Gains from FTA Initiatives.
Source: Daniel Drache (2000).

In South Asia, inter-state and intrastate conflicts, political and economic instability, and deficient public service provision have also been found to correlate negatively with growth. It is strongly believed that regional trade liberalization through FTAs/PTAs form convergence clubs and thus contributes to regional integration. With such convergence clubs the poorer members can reap some of the gains from trade via larger markets and improved efficiency, without exposure to non-regional competition. In this process, they can catch up with richer ones through the process of trade. It has been argued that all countries which are open and integrated in the world economy are, in fact, members of a convergence club (Sachs and Warner 1995: 41). Since the conclusion of the 12th SAARC Summit in 2004 in Islamabad, South Asia has started envisioning a South Asian Economic Union.

While these potential benefits provide incentives to advance with the idea of FTAs/PTAs, it has also negative implications. According to Panagriya, PTAs can have adverse impact on the outside countries and the multilateral-trading system through five major channels: (i) terms of trade; (ii) increased extra-union protection; (iii) fragmentation of the trading system through what Bhagwati calls the spaghetti-bowl effect; (iv) the stumbling blocks effect on multilateral liberalization; and (v) proliferation of non-trade issues (2005). Bhagwati is particularly concerned about the *spaghetti-bowl* effects with hundreds of different rules, "crisscrossing preferences," and a "maze of discriminations" (Bhagwati 1995). The FTAs are blamed to be an obstacle to global trading regime and a cause to trade diversion. Hence, the rise of free trade does not automatically lead to benefits for the region. It depends on a good mix of policies and how they are pursued in real life situations.

South Asian Free Trade Agreement (SAFTA)

The major initiative for trade cooperation at multilateral level comes through the establishment of the SAFTA. The ultimate aim of SAFTA is to put in place a full-fledged South Asian Economic Union on the lines of EU, however ambitious it might look. The signing of SAFTA was dubbed a 'milestone' or a 'historic' event in the history of regional economic cooperation in this region (*Dawn*, Karachi, 19 January 2004). It becomes operational on July 1, 2006, upon the completion of 12 rounds of negotiations on Sensitive Lists, Rules of Origin, Revenue Loss Compensation Mechanism for LDCs and technical assistance for the