

## Chapter 2

### SAPTA Negotiations: Constraints and Challenges

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#### 1. Introduction

The activities of the SAARC, which was established in 1985, were limited to soft areas such as health, population, meteorology, telecommunication, sports, culture etc. at the initial stage. The Fourth SAARC Summit held in Islamabad in December 1988, emphasized the need for concrete and result-oriented activities within the SAARC framework to include trade, manufacture and services as new areas of co-operation. As a result, a consultant was commissioned to carry out a *Study on Trade, Manufacture and Services (TMS)* in the SAARC region. *The Study on Trade, Manufacture and Services*, which was completed in 1991, considered economic co-operation among the members of SAARC as an inevitable imperative for economic development in the region.

The idea of liberalizing trade among SAARC countries was first mooted by Sri Lanka at the Sixth Summit of the South Asian Association for Regional Co-operation (SAARC) held in Colombo in December 1991. Heads of State at the Sixth SAARC Summit declared their commitment to the liberalization of trade in the region through a step by step approach in such a manner that countries in the region share benefits of trade expansion equitably. The Inter-Governmental Group (IGG) on Trade Liberalization was established under the SAARC Committee on Economic Co-operation to formulate and reach agreement on an institutional framework under which specific measures for trade liberalization among SAARC member states could be furthered. The IGG also was mandated by the Sixth SAARC Summit to examine the Sri Lankan proposal to establish a SAARC Preferential Trading Arrangement (SAPTA) by 1997. The IGG met on several occasions in different capitals and prepared the Draft Agreement on SAARC Preferential Arrangement (SAPTA), which is a framework of rules for liberalization of trade in the region.

#### 2. SAARC Preferential Trading Arrangement (SAPTA)

The Agreement on SAARC Preferential Trading Arrangement (SAPTA), which envisages the creation of a Preferential Trading Area among the seven Member States

of the SAARC, was signed in Dhaka in April 1993, providing a legal framework for liberalization. It was agreed that SAPTA is a stepping-stone to higher levels of trade liberalization and economic co-operation among SAARC member countries. SAPTA therefore is the first step towards higher levels of trade and economic co-operation in the region.

The aim of the SAPTA is to promote and sustain mutual trade and economic co-operation among the Contracting States, through exchange of concessions'. The Agreement is based on the principles of overall reciprocity and mutuality of advantages.

SAPTA has four main components, namely,

- a. Tariff
- b. Para tariff
- c. Non-tariff and
- d. Direct trade measures

SAPTA specified four negotiating approaches, namely: (a) product-by-product basis, (b) across the board tariff reduction, (c) sectoral basis, and (d) direct trade measures. However, it was agreed that tariff concessions would initially be negotiated on a product-by-product basis. The Agreement also provides for negotiation of tariff concessions to be an ongoing process.

SAPTA envisages that concessions on tariff, para-tariff and non-tariff measures will be negotiated step-by-step, improved and extended in successive stages. Tariff, para-tariff and non-tariff concessions negotiated and exchanged amongst the Contracting States will be incorporated in the National Schedules of Concessions, which will be attached to the Agreement as Annex II. Furthermore, the concessions negotiated and agreed to under the SAPTA, except those made exclusively for Least Developed Contracting States should be multilateralized among all Contracting States of the SAPTA. In addition to the other provisions of the Agreement, Article 10 of the Agreement provides for special and more favourable treatment exclusively to the Least Developed Contracting States.

The products covered by the SAPTA must satisfy the rules of origin set out in Annex III of the Agreement to be eligible for preferential treatment. The purpose of the rules of origin is to ensure that the benefits of tariff concessions exchanged under SAPTA are given only to products originating in Contracting States. In addition to products wholly produced or obtained within the exporting contracting state, products with imported raw material and components will also be eligible for concessions, provided that the total value of imported raw material, parts and components does not exceed 50 per cent of the value of the finished product. Furthermore, products originating in Least Developed Contracting States are allowed a favourable 10 percentage points, thus making the permitted maximum percentage of the value of imported raw material and parts 60 per cent. In 1999, domestic value addition requirement was revised downwardly to 40 per cent to enable the smaller and Least Developed Countries to benefit from the trade liberalization. Accordingly, domestic value addition requirement was reduced to 30 per cent for products originating from LDCs giving them a favourable 10 percentage point reduction.

The Agreement provides for suspension of concessions by any Contracting State facing economic problems including balance of payments difficulties. However, the concessions extended by member countries could be modified or withdrawn from the national Schedule of Concessions only after a period of three years from the implementation of such concessions. A Contracting State, intending to modify or withdraw concessions must enter into consultations and negotiations with other Contracting States. Also safeguard measures and corrective action are incorporated in the Agreement, if a sudden surge in imports were to cause, or threaten to cause serious injury in the importing Contracting State.

The Agreement also provides for the adoption of additional trade facilitation measures to support and complement SAPTA for mutual benefit. It also has provisions for extending special consideration to Least Developed Contracting States in the form of technical assistance and provisions for co-operation arrangements. Under the Agreement, Contracting States have agreed to undertake measures for developing and improving communication systems, transport infrastructure and transit facilities for accelerating the growth of trade within the region.

Finally, the Agreement has provisions to set up a Committee of Participants consisting of representatives of Contracting States. This Committee monitors the implementation of the Agreement and looks into the settlement of disputes.

### 3. First Round of Negotiations

The process of negotiation of Schedules of Concessions, which form an integral part of the Agreement commenced in 1993. The negotiations, were carried out through the Inter-Governmental Group on Trade Liberalization (IGG). The First Round of Negotiations was carried out on a product-by-product basis as agreed. At the 6th meeting of the IGG, held in Kathmandu on 20 and 21 April 1995, the delegations held intensive rounds of bilateral and multilateral negotiations and agreed on the National Schedules of Concessions to be granted by individual Contracting States to other member states under the SAPTA Agreement. The Consolidated National Schedules of Concessions agreed at the 6th IGG meeting cover 226 tariff lines as follows:

**Table 1**  
**Consolidated National Schedules of Concessions**

Country	For All Countries	Only for LDCs	Total Lines
Bangladesh	11 (10 reduction)	1 (10% reduction)	12
Bhutan	4 (15% reduction)	7 (10%, 13% & 15%)	11
India	44 (10% % 50%)	62 (50% & 100%)	106
Maldives	17 (7.5% reduction)	--	17
Nepal	10 (7.5%, 10%)	4 (10% reduction)	14
Pakistan	19 (10% reduction)	16 (15% reduction)	35
Sri Lanka	20 (10%, 20% & 35%)	11 (10% & 15%)	31
Total	125	101	226

As could be observed from the above Table, the concessions granted under the First Round of Negotiations are no more than a symbolic gesture. During the first round of negotiations, after six meetings of the IGG and two years of negotiations, the seven SAARC countries could agree only on 226 items for exchange of tariff concessions. Out of the 226 items on which tariff concessions were agreed, 101 items were limited to LDCs. The depth of tariff cuts varied from 7.5 per cent to 50 per cent except for few

items. Tariff concessions exchanged so far have not resulted in any meaningful trade expansion among member countries of the SAPTA.

It has been estimated that the value of intra-regional import coverage in respect of the 226 tariff lines, which were subjected to tariff concessions, amounted to a mere 6 per cent of the intra-regional imports.

#### 4. Second Round of Negotiations

The 6<sup>th</sup> meeting of the SAARC Committee on Economic Co-operation held in New Delhi on 16 and 17 November 1995, recommended that the Inter-governmental Group on Trade Liberalization (IGG) should be reconvened to initiate and carry out the Second Round of Negotiations for widening the product coverage, deepening the tariff cuts and removal of para-tariff and non-tariff measures. The first SAARC Commerce Ministers meeting held on 8 and 9 January 1996 in New Delhi provided further political impetus and direction to conduct the First IGG meeting under the Second Round of Negotiations.

The First Meeting of the Inter-Governmental Group on Trade Liberalization (IGG) under the Second Round of Negotiations was held in Colombo on 14 and 15 March 1996. The IGG meeting decided that full information on para-tariff, non-tariff and other trade control barriers, which were currently applicable, should be exchanged among member states to enable them consider further measures in this area.

**Table 2**  
**Consolidated National Schedules of Concessions Second Round of**  
**Negotiations Number of HS Lines Agreed**

Country	For All Countries	Only for LDCs	Total Lines
Bangladesh	115 (10% reduction)	11 (10% reduction)	226
Bhutan	37 (10% reduction)	10 (15% reduction)	47
India	390 (10%, 5%, 25%, 40% reduction)	512 (25% & 50% reduction)	902
Maldives	3 (15% reduction)	3 (15% reduction)	5
Nepal	166 (10% reduction)	67 (15% reduction)	233
Pakistan	232 (10% reduction) 57 items are not importable from India	131 (15% reduction)	363

Sri Lanka	72 (10% reduction)	23 (10%, 50%, 60% reduction)	95
Total	1114	757	1871

The Inter-governmental Group decided to conduct trade negotiations by adopting a combination of approaches without precluding the product-by-product approach. The Group also agreed on the need for a fast-track approach for negotiations in view of the mandate to conclude the Second Round of negotiations by 31 July 1996. It further agreed that all attempts should be made to realize SAFTA by the year 2000. The Second Round of Trade Negotiations, which concluded in December 1996, resulted in the exchange of tariff concessions on 1871 tariff lines as given in the Table 2.

Although member countries agreed on adopting a combination of approaches, the Second Round of Negotiations was also held on a product-by-product basis.

### **5. Third Round of Trade Negotiations**

The Ninth Summit of SAARC held in Male in May 1997, mandated the member countries of SAPTA to hold the Third Round of Trade Negotiations under SAPTA using a combination of different approaches, viz., product-by-product, sectoral and across-the-board and directed to cover products which are being actively traded among the member countries and to conclude the Third Round by January 1998. The Summit also decided to advance the implementation of the South Asian Free Trade Area (SAFTA) by the year 2001. The Tenth Summit, held in July 1998 in Colombo, reassessed the progress made in the First two Rounds of SAPTA trade negotiations and directed that, in addition to deeper tariff concessions to be granted to member countries during the Third Round, discriminatory practices and non-tariff barriers should be simultaneously removed on items in respect of which tariff concessions were being granted or had been granted earlier. The Summit also directed that measures to remove structural impediments should also be taken in order to move speedily towards the goal of SAFTA. The Third Round of Negotiations was concluded in 1998 and tariff concessions were offered on 3456 tariff lines.

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.

**Table 3**  
**Consolidated National Schedules of Concessions Third Round of**  
**Negotiations Number of HS Lines Agreed**

Country	B'desh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
B'desh	X	10 items (10-15%)	260 items 11 chapters	113 items chapter 3 & 16	20 items (10-15%)	71 items chapter 16 & 51	7 items
Bhutan	34 items (10%)	X	X	26 items (18%)	41 items (10-20%)	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	X	all	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%)	--

Number of products and tariff concessions exchanged by member countries during the Third Round of Negotiations under SAPTA is given in the Table 3 above.

## 6. Negotiations on SAFTA (South Asian Free Trade Area)

The SAARC Council of Ministers that met in new Delhi in December 1995 emphasized that expression of political will by member states was imperative for the realization of South Asian Free Trade Area (SAFTA) and agreed that member states should strive for the realization of SAFTA preferably by year 2000 but not later than 2005.

Following the mandate given by the Heads of State at the Ninth SAARC Summit held in Male in May 1997, towards creating a SAFTA Treaty, the first meeting of Inter-Governmental Expert Group (IGEG) on transition from SAPTA to SAFTA was held in Kathmandu in June 1997. The IGEG decided that the following areas should be included when launching the SAFTA Treaty.

- a. Tariff elimination without any import restrictions,
- b. Removal of structural impediments,
- c. Harmonization of customs procedures and documentation,
- d. Banking facilitation,
- e. Port and transportation facilities,
- f. Facilitation of trade related services, and
- g. Establishment of a reviewing and monitoring mechanism.

The IGEG held its Second meeting in Kathmandu in October 1997 to consider Terms of Reference for drafting the Treaty for SAFTA.

The Tenth Summit reiterated the importance of achieving SAFTA as mandated by the Ninth SAARC Summit. To this end, they decided that a Committee of Experts, in consultation with Member States, be constituted with specific Terms of Reference (TOR) to work on drafting a comprehensive treaty regime for creating a free trade area. The Heads of State expressed the view that such a Treaty must incorporate, among other things, binding time-frames for freeing trade, measures to facilitate trade, and provisions to ensure an equitable distribution of benefits of trade to all states especially, for smaller and least developed countries including mechanisms to compensate revenue losses. They emphasized the importance of finalizing the text of the regulatory framework by the year 2001.

In terms of the mandate given by the Heads of State at the Tenth Summit meeting held in July 1998 in Colombo to Constitute a Committee of Experts (COE) to draft a comprehensive Treaty Regime to create a South Asian Free Trade Area, and endorsed by the Meeting of the Council of Ministers in Nuwara Eliya in March 1999, the IGEG stood wound up and the Terms of Reference of the IGEG were subsumed under those of the Committee of Experts (COE).



The First Meeting of the Committee of Experts was held in Kathmandu in July 1999 and the TOR, based on the proposals by Sri Lanka, India, Bangladesh and the former IGEG was finalized at this meeting with a work programme designed to commence work towards drafting a Comprehensive Treaty Regime to create SAFTA. The draft Treaty was to be in place by end of 2001. However, further meetings of the Committee of Experts could not be held due to subsequent political developments in the region.

## **7. Constraints**

Even though three Rounds of Negotiations have been concluded and tariff concessions agreed have been given effect to and value addition criteria has been downwardly revised, intra-regional trade has not expanded as expected due to a number of reasons. Although tariff concessions have been exchanged on a large number of products, the value of items, which have been subject to tariff concessions, has been too small to make an impact on intra-regional trade. Most of the items on which tariff concessions have been granted are not produced or actively traded by the member countries. In other words, preferences have not been exchanged on items, which are being traded on a large scale. Some of the tariff preferences are not of practical value as they duplicate preferences granted under other preferential arrangements such as the Bangkok Agreement. Secondly, trade negotiations were confined to reduction of tariffs. The reduction of para-tariffs and non-tariff measures was not addressed. The positive effect of tariff concessions can be effectively negated by non-tariff measures such as licensing, state trading, canalization etc. Furthermore, the depth of tariff cuts offered under the SAPTA has not been deep enough to stimulate trade flows among member states. India has offered a 100 (on 13 items offered to LDCs) to 50 per cent reductions on its basic duty while most of the other countries have offered a preferential margin of ten to twenty per cent reductions in their national list of concessions. The experience of preferential trading arrangements shows that the tariff cuts below threshold level do not have a substantial impact on trade flows.

Trade liberalization among SAARC countries has not progressed at the desired pace due to a number of constraints which have hampered the SAPTA process. These constraints include political distrust, economic asymmetries among member countries and the nature of the framework agreement which does not make compulsory the reduction of tariff and elimination of NTBs within a stipulated time frame etc.



## **8. Political Distrust**

The political will and a common perception of economic interests form a major driving force behind the success of a regional trading arrangement. Franco-German political rapprochement has been the anchor for the successful economic co-operation in the European community. Mutual suspicion and political distrust among SAARC members-which of course are not singular to the SAARC region-has been the major obstacle, which impeded economic and trade co-operation among SAARC countries. The regional conflicts and tension among major partners in the region notably India and Pakistan, has had a dampening effect on the trade liberalization process.

The trade potential between SAARC countries, in particular between India and Pakistan is immense, but political distance between the two countries has become a constraint for any meaningful economic co-operation between these two major players and in turn among the rest of the SAARC countries. Partition of India and Pakistan had fragmented an integrated economic structure built over a long period of time. The political division has been matched by an equal economic division. The logic of economics has been tampered by political prejudices.

In 1989/90 India extended MFN status to Pakistan. However, Pakistan did not extend full MFN status to India but reciprocated by allowing just 270 items only to be imported from India, which was later increased to 700 items. It is to be seen how Pakistan while not extending MFN status to India would be an active partner of a Free Trade Area in the region opening its borders to SAARC countries including India. Since Pakistan has limited imports from India to a list of approved items, tariff concessions on items excluded in the approved list cannot be extended to India. Non-extension of MFN status to India by Pakistan could prevent it from granting tariff concessions to other member countries of SAPTA due to the fact that those concessions have to be extended to India as well through multilateralization of concessions. Even though Pakistan is a net importer of tea and imports considerable volume of its requirement of teas from outside the region, it was reluctant to grant tariff concessions to Sri Lanka teas probably due to the fact that such concessions would get automatically extended to India as well. The MFN issue between Pakistan and India will be a constraint to the process of eventual transformation of SAPTA into SAFTA as Pakistan maintains that it will not grant MFN status to India without a lasting

solution to the Kashmir question. This position may have been the reason for India under I. K. Gujral to propose that India should enter into sub-regional co-operation under SAARC with Bangladesh, Nepal and Bhutan and deal with Pakistan separately ignoring the fabric of SAARC.

Indo-Pakistan relations went from bad to worse since the escalation of clashes on the Kargil heights in July 1999. Following the change of leadership in Pakistan in November 1999, India did not agree to convene the SAARC Summit in Katmandu bringing most of the SAARC activities to a halt. The Fourth Round of Negotiations did not take off the ground as member countries could not agree on dates to hold the first meeting of the IGG so far. The activities of the Committee of Experts to Draft A Comprehensive Treaty Regime also had a similar fate.

The Indo-Pakistan conflict is not the only political issue that acts as an impediment to trade negotiations. Political conflicts other member countries have with India also act as impediments. " It would not be unfair to say that several SAARC countries (for example, Pakistan, Bangladesh and Nepal) for political reasons and non-economic reasons of reducing their pattern of heavy dependence on imports from India (e.g. Nepal) had in the past deliberately diverted their imports away from India to other countries even if it meant importing competitive Indian goods at higher cost through third countries (for example, Dubai and Singapore) or through so-called unofficial or informal trade (including extra-normal border trade called smuggling)".<sup>1</sup>

In the post Cold War era, geo-economics have acquired priority over geo-politics. South Asia, however has not still come to terms with this reality. Regional economic groupings have become an integral part of the international trading system and continue to grow in importance. All member countries have to realize this fact if any tangible results are to be achieved through trade liberalization in the region.

## **9. Economic Asymmetries**

The level of economic development of the seven member states of SAARC is not uniform. Table 4 shows the basic economic indicators for the seven SAARC member

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<sup>1</sup> Wadhva, Charan D., 1999, *Assessing the SAARC Preferential Trading Arrangement*.

states. Bangladesh, Nepal, Bhutan and Maldives belong to the category of Least Developed Countries (LDCs), while India, Pakistan and Sri Lanka are categorized as developing countries. Among these three countries India and Pakistan are far ahead in the industrialization process compared to Sri Lanka. On the other hand, Sri Lanka and Bangladesh were well on the way to trade liberalization at the time SAPTA was negotiated, while many of the other SAARC countries had restrictive trade regimes, which emphasized import substitution and self-sufficiency.

**Table 4**  
**Basic Economic Indicators of SAARC Member Countries 1998**

Indicator	B'desh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Population (Million))	124.7	2.00	982,22	0.27	22.84	148.16	18.45
Area sq. km.	147,570	46,500	3287,253	248	147,181	796,095	65,610
GNP \$mn.	44,000	315	421,310	323	4,800	63,200	15,200
GDP Growth Rate 1995-98	4.3	4.6	5.6	6.0	4.5	5.3	5.0
GNP per Capita (US \$)	350	158	430	1230	210	480	810
Exports (Million US\$)	5141.1	108.8	34,076	92.5	485.5	8360	4734.9
Imports Mn. (US\$)	6862.1	165.2	44,828	307.5	1238.3	10,762	5302.4

Trade negotiations among SAARC countries have been constrained by the vast economic asymmetries in terms of geographical size, population, industrial and technological development, levels of economic development and natural resource endowment that exist in the SAARC countries because of the fear of small countries that they would have to bear the burden of adjustments to a greater extent than the larger economies. Due to different levels of economic development, industrialization, resource endowment and economic policies followed by the member countries there are differences in the perceptions among the member countries of SAPTA about the

product coverage and depth of tariff cuts. This has become an impediment for expanding the product coverage and deepening tariff cuts.

Due to the geographical location and the levels of industrialization, trade relations in the SAARC countries, with the exception of Pakistan, are like the hub and spokes of a wheel; with India as the hub and the remaining countries, the spokes. There is a link between the hub and spokes but not much among the spokes. While India's exports to SAARC countries continue to increase in absolute terms and as a percentage of her global exports, her imports from the member countries remain abysmally low. Many SAARC countries have an increasing adverse balance of trade with India, which is not very conducive for expansion of regional trade and economic co-operation.

India represents 73.6 per cent of the population, 76 per cent of the GNP and 64 per cent of the export trade in the SAARC region. The sheer size of the Indian economy has created fear and apprehension in smaller and less developed member economies that Indian goods will swamp their markets and cause injury to their domestic industries. Due to different levels of economic development and size of their economies, small and less developed countries tend to think that it is premature to open their economies to competition from Indian goods. Countries such as India and Pakistan with diversified industrial structures and export capacities stand to gain more from trade liberalization. On the other hand, small economies that have rising adverse trade balances with India will not be able to take full advantage of the trade liberalization. Thus, differences in geographical, economic and demographic sizes of member countries have posed constraints in the process of trade liberalization under the SAPTA.

#### **10. Degree of Complementarities and Competitiveness**

Limited complementarities of intra-regional trade-the extent to which a country's exports match the trading partners import needs- is another constraint to the trade liberalization process among SAARC countries. All member countries of SAPTA produce similar export products, both agricultural and industrial. "Trade complementarities in the SAARC are limited partly because most of the countries have structures of production, producing commodities which compete with one another. Most of them are basically agricultural economies with a small industrial base and a narrow range of products. The trade complementarities in other regions have grown on

the basis of manufactured goods but this has not taken place in the SAARC member countries owing to the smallness of the manufacturing sector and the restricted range of products."<sup>2</sup>

*SAARC Study on Trade, Manufacture and Services* states, "The Picture in regard to degree of overlapping or competitiveness is of mixed character. While some Member States of SAARC are competing in the export of the same commodity, others are importing it. There are also significant complementarities, which exist amongst the SAARC countries. For example, while Sri Lanka, Bangladesh and India compete in exporting tea, Pakistan is a net importer of tea. Similarly, while India competes with Bangladesh in the export of jute, the other countries are importers of jute and jute products. Furthermore, Pakistan and India are exporting cotton while all other countries of the region are net importers of cotton. In the manufacturing sector, while India and to some extent Pakistan, are exporters of engineering goods, the rest of the countries of the region are net importers."

Except India, most of the other countries have a limited export base due to the low level of industrialization. Most of these countries still remain as agricultural economies exporting a narrow range of products. They are therefore, not in a position to offer products that are in demand in other countries at competitive prices and in required quality and quantity. This is a constraint faced by the negotiators in requesting tariff concessions for products of export interest to these countries.

The direction in which SAARC countries are moving under free market policies is likely to further reduce trade complementarities in the region (i.e.) all SAARC countries are pursuing export oriented policies and are inviting foreign investment mainly from TNCs, that generally invest in import substitution industries. These new export oriented industries have helped SAARC countries to increase trade complementarities with countries outside the region, but not those within the SAARC region. These industries include garments, cut and polished diamonds, electronic components etc., which are destined to countries outside the South Asian region.

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<sup>2</sup> Kelegama, S., 1999, 'SAPTA and its Future' in E. Gonsalves and N. Jetley (eds.), *The Dynamics of South Asia: Regional Cooperation and SAARC*, Sage Publications, New Delhi, p. 175.

## **11. Lack of Commitment**

SAARC Preferential Trading Arrangement does not specify a definite and binding timeframe for reduction or elimination of tariff, para-tariff and non-tariff measures. It is therefore, not compulsory for member countries to open their markets to other member countries within a specific timeframe. This rather negative and non-binding nature of the agreement though not a constraint has contributed to the slow pace at which trade liberalization takes place under SAPTA. This shows that even at the time of drafting the Agreement, member countries had adopted a cautious approach, intentionally or otherwise.

The Agreement also specifies four components of SAPTA namely tariff, para-tariff, non-tariff measures and direct trade measures. As there is no compulsion for members to adopt these components in trade policy regimes, only tariffs have been subject to negotiation during the three rounds negotiated so far. Although tariff concessions have been granted on a large number of items during trade negotiations, most of these items have not been of export interest to other member countries demonstrating lack of genuine commitment for expansion of trade in the region.

## **12. Lack of Information**

Lack of information on trade policy measures in particular tariff, para-tariff and non-tariff measures has acted as a constraint to some extent in SAPTA negotiations. There are several instances where tariff concessions offered during the negotiations have been effectively negated by imposition of para-tariff and non-tariff barriers such as canalization and import restrictions. Although member countries are expected to exchange information on tariff, para-tariff and non-tariff measures at the beginning of each round of negotiations, exchange of information has not taken place in any comprehensive manner.

## **13. Negotiation Approaches**

SAPTA envisages four negotiating approaches, namely product-by-product approach, sectoral basis, across the board tariff cuts and direct trade measures. It was agreed that the First Round of Negotiations will be conducted on a product-by-product basis.



Experience however, shows that product-by-product negotiations are not only time consuming and tedious, but often proved to be also frustrating. Even the GATT round of trade negotiations, which are mostly being carried out on a sectoral basis, have taken many years to be finalized. Similarly, the inter-regional preferential trading arrangements under the GSTP among developing countries have also proved to be difficult for implementation because of its product-by-product approach. The major constraint posed by the product-by-product approach is that vested interests in individual member countries would exert pressure on the concerned government and prevent the inclusion of certain products for trade concessions."<sup>3</sup>

Trade negotiates under the First and Second Rounds of Negotiations were conducted on a product-by-product basis, which by its very nature, is a cautious approach. As a result, progress of trade liberalization has been limited.

#### **14. Existence of Preferential/Free Trade Arrangements Among Member Countries**

A few member countries of the SAPTA have entered into bilateral free trade agreements with India. Nepal, Bhutan and recently Sri Lanka concluded free trade agreements with India. Since these countries have liberalized trade among themselves, there is no necessity for them to exchange tariff concessions under the SAPTA. For example, Bhutan and Nepal did not exchange tariff concessions with India during the Third Round of Negotiations, as there was no necessity for them to exchange tariff concessions under the SAPTA framework. Similarly, Sri Lanka may also not negotiate with India during the next round of negotiations as the two countries have concluded a free trade agreement for removal of tariffs.

#### **15. Challenges**

Promotion of co-operation among SAARC countries in the core economic areas occupies a place of central importance in the activities of the Organization. The relevance of SAPTA to member countries depends on its ability to promote intra-regional trade. A number urgent steps are needed to attain the objectives of SAPTA.

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<sup>3</sup> Raghavan, S.N., 1995, *Regional Economic Cooperation Among SAARC Countries*, Allied Publishers, New Delhi, p. 110.

## **16. Widening Product Coverage and Deepening Tariff Cuts**

It was considered that the SAPTA was a stepping-stone for a high level of trade liberalization and that SAPTA would eventually transform itself into SAFTA. In order to achieve this goal, member countries need to take a number of positive steps and adopt a broad based approach to accelerate the trade liberalization process. It is necessary that all member countries endeavour to offer deeper tariff cuts on the existing concessions if any meaningful trade exchanges are to take place among member countries. It is also important that all member countries adopt a sectoral approach, if across the board tariff cuts are not feasible. Furthermore, tariff concessions should be granted on actually traded items and those items which offer potential for trade expansion. A most disconcerting development has been that the Fourth Round of Negotiations did not take off the ground, as one member country did not confirm its participation. After the Senior Officials meeting in Colombo last year, many attempts were made to hold the IGG meeting for intimating the Fourth Round of Negotiations, but without success. The early convening of the IGG to launch the Fourth Round of Negotiations has thus become a matter of high priority for maintaining the momentum of co-operation among member countries in the area of trade liberalization.

The SAPTA process, which has come to a standstill, has to be jump-started again. The Fourth Round of Negotiations could not be launched as scheduled and the Second meeting of the Committee of Experts could not be held for two years. Pakistan maintains the position that the only way to restart the SAARC activities is to convene the "Charter Body" meetings (i.e.) the SAARC Standing Committee, Council of Ministers and the Summit. In this regard, it is expected that the proposed SAARC Foreign Secretaries' meeting will provide member countries with a good opportunity to review SAARC activities and to re-activate the SAPTA process.

## **17. Ensuring Equitable Distribution of Benefits**

As mentioned earlier, the trade liberalization process carried out so far has a number of shortcomings. The benefits of the trade liberalization remain confined to a few

countries. Secondly, exchange of tariff concessions has been focused on a narrow range of products. Also, the extent of tariff concessions offered during the various round of negotiations is inadequate and unequal. Therefore, there is a necessity to "guard against polarization of benefits from trade liberalization measures to a small number of Member States, tendency to keep such liberalization focused on a narrow range of products with very limited trade turnover, and inadequate and unequal extent of tariff concessions offered during the negotiations."

### **18. Removal of structural impediments to trade**

Removal of impediments to trade induced by the trade policy regime such as tariff, para-tariff and NTBs alone will not result in expansion of trade among developing countries. Removal of structural impediments to trade such as non-diversity of export base, inferior transport links, high cost of insurance and financing etc. is equally important. Although the IGG has identified the necessity to address structural impediments, so far no action plan has been designed for this purpose.

### **19. Transformation from SAPTA to SAFTA**

Paving the way for SAFTA is the main challenge. There is considerable work involved in sorting out several contentious issues. Drafting a comprehensive treaty regime for SAFTA is a major task.

To transform SAPTA into SAFTA within an agreed timeframe, member countries need to target the elimination of a certain number of tariff lines every year. Establishment of a free trade area in the SAARC region involves elimination of tariff, para-tariff and non-tariff measures. Abolition of restrictions on trade such as high tariffs, para-tariffs and non-tariff measures built over long years of protectionism and economic nationalism, is indeed a real challenge. This cannot be achieved overnight and without causing shocks that need careful cushioning if they are to be absorbed without unduly upsetting the balance. Long and painful adjustments will have to take place involving shifts of investment, transfer of resources, modernization of plant and methods of production, changes in patterns of marketing and conditions for trade. Thus there is the need for an adequate transition period for transformation from SAPTA to SAFTA.

## Discussion

Discussant: Ravi Yatawara

- Dr. Yatawara said that both papers were interesting and the arguments sound. Free Trade Agreements would result from large trade flows and not the other way around. He thought that Table 2 of Dr. Weerakoon's paper was pertinent. It brought into focus the nature of tariff cuts under SAPTA, the low level of tariff cuts, and cuts on goods not extensively traded. He however thought that the Table should have reflected the period 1996-99 in order to capture the 2<sup>nd</sup> and 3<sup>rd</sup> Rounds of Negotiations. There was an underlying assumption in Dr. Weerakoon's paper that bilateralism is bad, since it undermines the formation of SAFTA. However, bilateral agreements could act as a stimulus to regionalism and multilateralism. There was the example of the United States negotiating NAFTA (North American Free Trade Agreement) in order to activate the GATT Uruguay Round negotiations. There are problems in incorporating bilateral agreements into the SAFTA process. Countries may feel that they do not need SAPTA/SAFTA if they have Free Trade Agreements with their main trading partners in the region. This could lead to a 'spaghetti bowl' of overlapping trade agreements, where manufacturers would have to wade through a lot of information to obtain the most favourable tariff rate for their product. He stressed the need for research, prior to signing agreements, in order to minimise unanticipated effects. Regarding Mr. Udagedera's paper it revealed the clear lack of political will to pursue trade liberalization in the region. Up to now Pakistan has not extended MFN (Most Favoured Nation) treatment to India. MFN status results in a country enjoying non-discriminatory treatment.
- Both papers however, do not address the importance of domestic policies. India's liberalization process which began in 1991 gave a momentum to the SAPTA process, leading to the first round of negotiations. India's dismantling of non-tariff barriers recently could also be an opportunity for further progress for the SAARC member countries. Both papers however, drew attention to the Indo-centric nature of SAARC – the hub being India and the spokes, the other countries. In view of the dominant position of India, there was the need for safeguard measures in the form of anti-dumping legislation and countervailing

duties, to prevent unfair trading practices. However, this should not be a protectionist device.

- Finally, there was the need to guard against insidious regionalism, where countries may be tempted to concentrate on the regional market and move away from the multilateral markets. India for instance, is not looking only at South Asian markets for trade growth. Other SAARC countries should do likewise.

### **Open Discussion**

- South Asia was one of the last areas to move towards regional cooperation. There was a need for a strong political will to hasten the process of economic cooperation. In the SAARC region, economic cooperation was taken up, more than six years after its establishment.
- The Indo-Lanka Free Trade Agreement was different from the Indo – Nepal Agreement, which was a Trade and Transit Agreement, rooted in history. In view of the asymmetry of SAARC, there was the need for the larger countries to be generous to the smaller ones. For example, in the European Community concessions, aid and subsidies were given to the smaller member countries like Spain, Italy and Greece. SAARC had not assisted the smaller countries like Sri Lanka. The only assistance was to the Least Developed Countries in the region.
- There is a need to identify and rectify the inherent structural impediments in the treaties. There is also a role of civil society in this process. Civil society refers not only to the N.G.O's but also to Universities, Research Institutions, and the Business Community etc. to persuade the leaders to move the process forward. Should we confine ourselves to the South Asian region? No, since our main export, garments, is mainly to the U.S.A.; tourism is mainly from Western Europe; and labour is mainly to West Asia.
- The multiplicity of agreements – SAPTA, Free Trade Agreements, Bangkok Agreement – are confusing to exporters. It was revealed in Dr. Weerakoon's paper, that some items are eligible for concessions under SAPTA, but these same items are in the Indian Negative list under the Indo-Lanka Free Trade Agreement.

- There is need to settle disputes immediately by invoking the dispute settlement mechanism under Indo-Lanka Free Trade Agreement.
- Bilateral agreements in themselves are not necessarily bad, but we should decide where our priorities be – bilateral in bilateral or regional trade.
- Stimulate cooperation in Science and Technology, Human Resource Development, Services etc. Cooperation should also be extended to the Mineral resources sector. There should be a bottom up approach rather than a top-down one.
- Are trade concessions on bilateral basis only?
- What is India's position on non-tariff barriers?
- Relationship with India should be more than a Free Trade Agreement.

#### **Response to above remarks**

- All trade concessions are multilateralised other than those granted to Least Developed Countries.
- India has unilaterally removed all non tariff barriers in favour of SAARC countries in August 1998.
- The SAARC Charter provides for cooperation in non-trade related areas – customs and standards harmonization, industrial cooperation, science and technology, SAARC Chamber of Commerce and Industry etc.
- There is need for a linear approval to tariff concessions – higher tariffs should attract higher cuts.

## **Part II**

## Chapter 3

### Towards Knowledge Based Economies in South Asia: Prospects and Challenges

Janaka Wijayasiri & Tilani Dias Desinghe

#### 1. Introduction

Today, knowledge is becoming an increasingly important stimulant to economic growth all over the world. In the industrial age of the 20<sup>th</sup> century, factors of production were tangibles like capital, labour and natural resources. But in the new millennium, it is increasingly intangible factors such as knowledge that matter most as sources of growth. In an era of knowledge-based competition, the progress of economies will depend on how best countries can make use of their intellectual capital. In a knowledge economy, “...success depends increasingly on brains, not brawn” (Economist, 1999).

Although the importance of knowledge acquisition has long been recognized, it has acquired a new urgency in an increasingly integrated global economy. This growing interest is a result of two developments. First, investment in knowledge-based activities and resources has become critical to competitiveness (Department of Industry, Science and Resources, 2000) due to:

- The phenomenal growth in information and communication technologies (ICTs)
- Increased speed of scientific and technological advances and their diffusion
- Increased global competition due to reduced transportation and communication costs, enlarged markets, and liberalization of investment and trade and capital markets
- Growing awareness of the value of specialized knowledge in organizational processes.

Second, developments in economic theories have incorporated knowledge into the framework of analysis, thus allowing the importance of knowledge to be quantified (Department of Industry, Science and Resources, 2000). For the last two hundred years the neo-classical economics has recognized only two factors of production: labour and capital. Knowledge, productivity, education and intellectual capital were all regarded as



exogenous factors - that is, falling outside the system. New growth theory based on work by Paul Romer and others have attempted to deal with the causes of long run growth; something that traditional economic models have had difficulty with. Following the work of economists such as Joseph Schumpeter, Robert Solow and others, Romer proposed a change to the neo-classical model by factoring technology (and the knowledge on which it is based) as an intrinsic part of the economic system. Knowledge has become the third factor of production in today's economies.

The world is increasingly making a transition from an industrial to a knowledge-based economy and developed countries are already taking the lead in the race. OECD has documented mounting evidence of a strong correlation between knowledge and economic development and the ever-increasing contribution of knowledge to economic and national welfare. According to recent estimates more than half of the GDP in the major OECD countries is based in the production and distribution of knowledge. Countries like Canada, Denmark, Finland, UK and US have recognized the growing importance of knowledge and this is reflected in their economic policies. The increasing importance of knowledge intensive trade is also evident. The share of high-technology goods in international trade has doubled over the past two decades. It now represents about one-fifth of the total value of international trade (Oxfam, 2001). Over the same period, the share of non-mineral primary commodities has halved to 13 per cent.

Many multilateral institutions such as the World Bank too have recognized that long run objectives of poverty alleviation cannot be met by tangible evidence of development like factories and infrastructure projects alone. Instead, they now focus on intangibles of knowledge, institutions and culture in the development process. According to the 1998/99 World Development Report, entitled "Knowledge for Development":

*For countries in the vanguard of the world economy, the balance between the knowledge and resources has shifted so far towards the former that knowledge has become perhaps the most important factor determining the standard of living - more than land, than tools, than labour. Today's most technologically advanced economies are truly knowledge based. (World Bank, 1989/99).*

Having missed the first two industrial revolutions, developing countries are eager not to miss the third one, which would enable countries to leap frog whole stages of

industrial development. A few developing countries are closing the gap at breathtaking speed. South Asia too has joined in the race but lags behind other countries in the developing world, especially compared to its counterparts in East Asia. The purpose of this paper is to examine the extent to which South Asian countries have progressed as KBEs (vis-à-vis the rest of the world), and the likely policy challenges facing them and prospects for regional cooperation in promoting KBEs in SAARC countries. The rest of the paper is organised as follows. Section 2 defines what a KBE is and how it is measured; section 3 identifies the characteristics of a knowledge-based economy (KBE) using a framework developed by McKeon and Weirs (2000); section 4 examines how Asian countries measure up as KBEs relative to sample of countries with respect to a range of KBE characteristics identified; section 5 discusses challenges facing SAARC countries in their move to KBEs and prospects for cooperation in the region in promoting KBEs. The section also discusses KBE related activities undertaken by SAARC so far.

## **2. What is a KBE and How is it Measured?**

Knowledge is mainly personal – the totality of what a person knows – and consists of many forms, including “knowledge of”, “knowledge about”, “knowledge how to”, “knowledge in words” and “knowledge without words” (McKeon and Weir, 2000). Knowledge can be organisational too. An organisation’s knowledge includes its capability of integrating information with experience and expertise to take action. The different categories of knowledge are often distinguished as explicit knowledge, which is codified and stored, and as tacit knowledge, which is implied and informed and gained through experience rather than instilled by education and/or training. In knowledge based economy, both types of knowledge are considered equally important.

A knowledge-based economy (KBE) has been defined as “one in which production, distribution and use of knowledge is the main driver of growth, wealth creation and employment across all industries” (McKeon and Weir, 2000). Being a knowledge-based economy means more than simply having a thriving “new economy” or “information economy”, separate from a stagnant “old economy”. In a truly knowledge-based economy, all sectors are knowledge-intensive, and not just those usually called “high technology”. The growing importance of knowledge in production is all-pervasive and is already transforming products and industries. For example, branding and design accounts

for an ever-higher proportion of the value of goods and services consumed around the world. About 70 per cent of the production cost of a new car is attributed to knowledge-based elements of production such as styling, design and software.

Measuring performance of a KBE is a challenge as is the issue of how one defines a knowledge-based economy. Traditional economic indicators such as national accounts do not provide an adequate tool for measuring performance of such an economy. A wide range of indicators is being used by OECD countries to define and measure how knowledge intensive an economy is. A revealing indicator that would measure whether a particular country is operating as a KBE, is the proportion of current economic activity in an economy that is in some sense "knowledge intensive". This proportion has been measured either by:

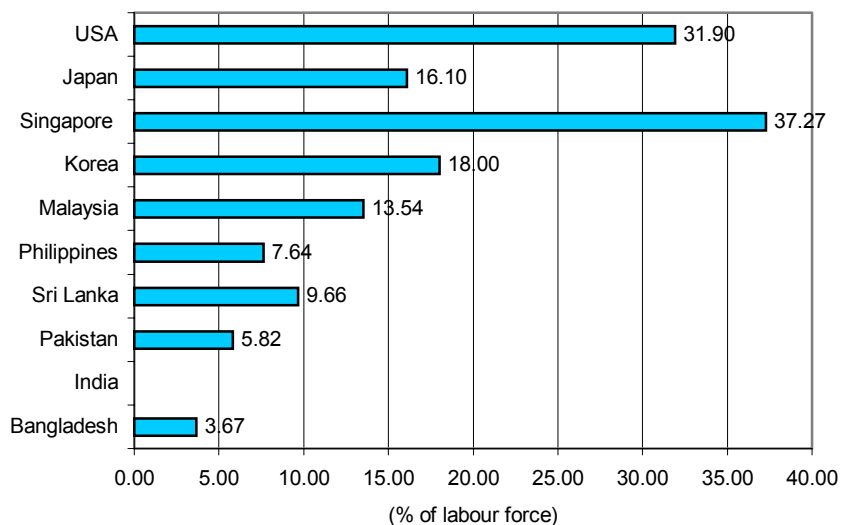
- amount of money involved (per cent of GDP contributed by "knowledge based industries").
- by the number of people involved (per cent of labour force that are "knowledge workers").

OECD's definition of the knowledge economy is broad and it has grouped high-tech and medium-high-tech manufactures, together with community, social and personal services, financial and other business services, and communications services as 'knowledge-based industries' (KBIs). Using this definition, the contribution of KBIs to GDP was found to be over 40 per cent for the OECD in mid 1990s. Interestingly, Germany, not the US tops the OECD's knowledge-economy table (Economist, 1999). Knowledge-based industries accounted for 58.6 per cent of Germany's GDP in 1996 compared to 55.3 per cent in the US. Japan came in third, with the UK and France close behind. However, such data is not yet available for other countries, including South Asia.

An alternative indicator of knowledge intensity in an economy is the proportion of the labour force that are "knowledge workers". A "knowledge worker" is defined as one whose work lies primarily in the manipulation of symbols, and with a strong requirement for specialized knowledge. A "knowledge worker" has been classified as anyone whose occupation is reported to the International Labour Organization (ILO) as falling into any of the following categories: managers and senior government officials, professional workers, or "associate professionals". Since ILO classification is based on what a

particular worker (occupation) actually does, and not on what industry they work in, it gives an independent perspective from that based on classifying particular industries as "knowledge-based". A major advantage of this indicator is that the ILO statistical yearbooks yield a data set, which gives reasonably comparable and readily available information for most countries, including for South Asian countries. As shown in Figure 1, the proportion of "knowledge workers" in the labour force, calculated in this way is over 30 per cent for most of the developed countries and high performing Asian countries.<sup>4</sup> For East Asian Fast Followers, the proportion of "knowledge workers" lies between 10 per cent and 20 per cent of the labour force. The percentage for South Asia is much less (3-10 per cent). Amongst the South Asian countries, Sri Lanka has the largest number of knowledge workers as a proportion of the labour force (9.66 per cent), followed by Pakistan (5.82 per cent) and Bangladesh (3.67 per cent). Data for India and the rest of South Asia were not available.

**Figure 1**  
**Knowledge Workers (1996)**



<sup>4</sup> Knowledge workers in the labour force in Japan and Korea are quite low compared to other most developed countries and high performing Asian countries. This may be largely due to the way in which each country's occupational data have been compiled (APEC, 2000). It is likely that both Japan and Korea have classified as production/clerical workers many highly skilled workers who would in other countries have been classified as technical/administrative.

Source: ILO Statistical Year Book.

**Table 1**  
**Summary of Characteristics Examined with Indication**  
**of their State in a Fully Developed KBE**

<b>Characteristic</b>	<b>In a Fully Developed KBE</b>
1. Business Environment	
<i>International Orientation</i>	
- Growth of FDI	Indicates confidence in economy
- Growth in trade	Strong performance and global orientation
- Knowledge networks	Strong international links of knowledge
- Openness	Ready entry of new ideas and products
- Immigration	Skilled immigrants embody new ideas
Knowledge based industries	Knowledge intensity high in all industries
Role of the government	As market facilitator, rather than dominant participant
<i>Regulatory environment for business</i>	
- Financial system	Transparent, efficient and open
- Capital formation	Available venture capital
- Intellectual property rights	Protected but open knowledge
- Competition policy	Encourage innovation
- Sound macroeconomic foundations	Conducive to prosperity
- Transparency in corporate	Avoidance of cronyism
<i>Social values</i>	Reflected policy
<i>Information needed for democracy</i>	Readily available and used
2. Innovation Systems	
Promotion of Innovation	Supportive culture within firms, society and government
Capacity to assimilate knowledge from	Strong, helped by skill base and internal creativity
Relationship between firms and research institutions	Close relationship between firms with complementary skills and between firms and research institutes, assisted by formal and informal mechanisms
Technology diffusion	Actively facilitated
Role of SMEs	Numerous new technology based firms
Role of knowledge management	Knowledge actively acquired and well shared among firms
3. Human Resource Development	
Investment in intellectual assets	Including human capital, widespread
Education and training system	Near universal base education to at least upper secondary
Policies that encourage lifelong	In industry, government and education institutions
Preservation of intellectual capital	Good knowledge/information management systems
Other knowledge	Also needed and valued, e.g. management, cultural
Knowledge workers	Employment dominated by knowledge / information work
4. ICT Infrastructure	
Telecommunications	Advanced telecommunications widespread and affordable
Role of ICT	ICT important as enabling technology

**Source:** Rob McKeon and Tony Weir (2000).

### **3. Characteristics of a Knowledge-based Economy (KBE)**

McKeon and Weir (2000) characterised an idealised KBE as consisting of four dimensions – innovation system, human resource development, ICT infrastructure, and business environment. They are as follows:

- **Business environment:** The business environment is supportive of enterprise and innovation. Business environment includes economic and legal policies of government etc.
- **ICT infrastructure:** An efficient infrastructure operates, particularly in information and communications technology (ICT), which allows citizens and businesses to readily and affordably access relevant information from around the world.
- **Innovation system:** Innovation and technological change are pervasive and supported by an effective national innovation system – that is, a network of institutions in the public and private sector whose activities and interactions initiate, import, modify and diffuse new technologies and practices.
- **Human resource development:** Human resource development is pervasive: education and training are of high standard, widespread and continue throughout a person's working life and beyond.

Available empirical evidence suggests that among the more developed countries of the world, economic growth is more sustainable in countries that are strong in all four dimensions (McKeon and Weir, 2000). In fact the strong performance of the Asian tiger economies over the past two decades has been said to be based on strengths in all of the dimensions. Although accumulation of physical capital was important, it was the investments in human capital and technology in these countries that reduced the gap between them and the developed countries. These were enhanced by local institutions and a culture that was generally accepting change and appreciative of knowledge and education in general and science and technology in particular. It is becoming ever more the case that the most successful economies are those that are closest to being KBEs. Thus, a KBE is characterized by important features such as openness to trade, new ideas and new enterprises, sound macroeconomic policies, the importance attached to education and lifelong learning, and the enabling role of information and

telecommunications infrastructure. The desirable characteristics of a KBE discussed are summarized in Table 1. An economy should be concerned with all of the four dimensions if it is to transform itself into a KBE.

#### **4. Country Comparisons**

Using the McKeon and Weirs (2000) framework the characteristics of South Asian countries (Sri Lanka, Pakistan, India and Bangladesh) relating to their performance as KBEs are summarised in Table 2. The indicators are divided into groups corresponding to the four key dimensions of a KBE listed and discussed above (business environment, ICT infrastructure, innovation system and human resource development). For all the indicators used (except government, finance, competition policy, intellectual property), the bigger values are better – as they display characteristics of a KBE. While each indicator gives only a partial impression of a dimension, the group of indicators gives an overall impression of a dimension.

Most of the indicators for the US and Japan are relatively higher compared to others and this is not surprising given that they are the most developed economies in terms of most economic and social indicators. The US is by far the largest economy in the world and one of the most thriving “new economies” drawing particular dynamism from its ICT sector. The indicators for both Korea and Singapore – the so-called high performing Asian economies - are similar to those of US and Japan, which suggest that these countries are comparable to the most developed economies in their movement towards a KBE. This is largely due to the explicit and well-resourced strategies adopted by both Singapore and Korea to become KBEs. Both Korea and Singapore have committed substantial resources to building their ICT infrastructure, innovative systems and human resource development and this shows up in their respective indicators. Governments in both countries have recently articulated a clear vision of the countries’ future as knowledge-based economies and they have set in train resources and guidance to help the private sector take the economies down this path. FDI is particularly high in Singapore, reflecting a conscious policy decision in acquiring new technology from this source whereas the number of patent applications and private spending in R&D is relatively higher in Korea reflecting different approaches to acquisition of new technology in the latter.

**Table 2**  
**KBE Indicators for a Selected Group of Countries**

	Most	High Performing				Asian		South Asian			
	Developed	Asian countries				Fast		Countries			
	Countries										
	US	JP	SI	KO	MA	PH	SL	PK	IN	BA	
1. Business Environment											
Services exports (% of GDP)	2.99	1.62	31.5	5.75	20.3	18.2	5.62	2.27	2.41	0.08	
High-tech exports (% of mnf. exports) 1996	44	38	71	39	67	56	3	4	11	na	
FDI (% of GDP) 1997	1.21	0.08	8.96	0.64	5.24	1.47	2.84	1.11	0.93	0.41	
Government (country rank 1-60)	14	37	1	5	3	20	35	Na	30	na	
Finance (country rank 1-60)	5	9	4	18	21	36	39	Na	40	na	
Competition policy (country rank 1-60)	8	19	14	24	49	47	43	Na	35	na	
Intellectual property (country rank 1-60)	2	17	13	45	35	47	46	Na	49	Na	
Openness (trade as % of GDP) 1996	24	17	356	69	183	94	79	37	27	38	
2. ICT Infrastructure											
Mobile phones (per 1000 people) 1996	206	304	273	150	113	18	6	1	1	na	
Phone lines (per 1000 people) 1996	644	479	543	444	195	29	17	18.5	18.6	2.6	
Computers (per 1000 people) 1996	406.7	202.4	400	150.7	46	13.6	4.09	4.48	2.09	na	
Internet (per 10000 people) 1997	442.1	75.8	196	28.78	21	0.59	0.33	0.07	0.05	na	
3. Innovation Systems											
Scientists & engineers in R&D (per mn people) 1981-95	3732	5677	2512	2636	87	90	173	54	181	na	
R&D expenditure (% of GDP) 1996	2.5	2.3	1.13	2.82	0.24	0.22	0.19	Na	0.73	0.03	
Private sector expenditure on R&D (as a % of total R&D expenditure)	59.4	81.7	62.5	84.0	8.3	1.9	..	..	24.0	na	
No. of patent applications filed (of which is residents) 1995	2354440 (127476)	388957 (33506 1)	1188 (10)	96557 (5924 9)	4052 (141 )	2779 (163)	1602 (76)	699 (21)	8292 (1660)	226 (70)	
Research collaboration (rank 1-60)	13	29	18	42	37	56	60	Na	33	na	
4. Human Resource Development											
Secondary enrollment (% of gross enrollment) 1996	97.4	103	na	102	na	77	75	Na	49	na	
Natural Science & engineering Graduates 1996	1014.79	720.13	1583. 4	na	na	828.2 4	137.4 6	Na	na	159. 5	
Knowledge workers (% of labour force) 1996	31.9	16.1	37.3	10.23	18	7.64	9.66	5.82	na	3.67	
Public expenditure on education (% of GNP) 1996	5.4	3.6	3.0	3.7	5.2	2.2	3.4	3.0	3.4	2.9	
Newspaper (per 1000 people) 1994	212	580	324	394	163	82	29	21	na	9	
Human Development Index (HDI)	0.927	0.924	0.888	0.852	0.77	0.74	0.721	0.508	0.545	0.44	

**Notes:** USA (US), Japan (JP), Singapore (SI), South Korea (KO), Malaysia (MA), Philippines (PH), Sri Lanka (SL), Pakistan (PK), India (IN), Bangladesh (BA); <sup>a</sup> Measures the role of the state in the economy. This includes the overall burden of government expenditures, fiscal deficits, rates of public saving, marginal tax rates and the overall competence of the civil service; <sup>b</sup> Measures how efficiently the financial intermediaries channel savings into productive investment, the level of competition in financial markets, the perceived stability and solvency of key financial institutions, levels of national saving and investment, and credit ratings given by outside observers;



<sup>c</sup> Measures protection of intellectual property (1=is adequately protected); <sup>d</sup> Measures anti-monopoly policy (1=effectively promotes competition); <sup>e</sup> Measures research collaboration between companies and local universities (1=Yes)

**Source:** World Bank (1998/99), J.E. Austin Associates Inc. (2000), UNESCO, UNDP (1999), ILO

The indicators for Asian fast followers and South Asian economies are broadly similar to each other but markedly different from the most developed economies and the high performing Asian economies. Of the Asian fast economies, Malaysia's performance in terms of the four dimensions is relatively better than the Philippines. This is not surprising given that Malaysia is one of the many developing countries attempting to shift towards a knowledge-based economy. Although Malaysia has not explicitly formulated a plan for a KBE it has been implementing the second *Industrial Master Plan (1996-2005)*, which aims at transforming the industrial sector into one of high value-added. The ambitious long-term plan, *Vision 2020*, and the strategy of the Multimedia Super Corridor (MSC) are also related to KBE promotion. The Multimedia Super Corridor (MSC), is a 15km wide corridor that stretches from the centre of Kuala Lumpur to Cyberjaya, a newly established city designed to incubate high technology companies. The shift to the K-economy, as known in Malaysia, is part of a wider plan to achieve fully developed status by year 2020.

While Asian fast followers and South Asian economies lag behind the most developed economies and the high performing Asian economies significantly in all of the four dimensions, the Asian fast followers do relatively better than South Asians in terms of business environment, ICT infrastructure, and human resource development. Amongst South Asian countries, Sri Lanka performs relatively better in business environment, ICT infrastructure, and human resource development, except for innovation systems, in which India out-performs not only Sri Lanka but Malaysia and the Philippines as well.

### **5. Challenges and Prospects in Promoting KBEs in South Asia**

The overall poor performance of South Asia as a KBE is due to the weaknesses in all four dimensions, and these could be thought of as impediments to promoting knowledge based economies in the region. Given that firms and workers will be the key actors in a KBE, this section examines what actions governments can take to help firms and workers more effectively develop, acquire and use knowledge and thereby promote KBEs in their respective countries. The impediments to promotion of KBEs in the South Asian countries are largely domestic and as such needs to be addressed domestically by national

governments. Nevertheless, regional cooperation could facilitate the promotion of KBEs by way of improving the business environment, innovative systems, ICT infrastructure, and human resource development in the member countries. A regional organisation such as SAARC therefore has a role to play. SAARC has been involved in promoting KBE related activities, directly and indirectly, since its establishment through various technical committees and programmes.

In fact, one can say that the operation of a regional organisation *per se* can contribute to the development of KBEs. Through SAARC and its activities, knowledge and information are generated, disseminated and utilised. Thus, the development of SAARC as a regional organisation already contributes to the promotion of KBEs in South Asia. However, it is equally important that specific programmes and activities of SAARC are used directly and more effectively to promote KBEs in the region. South Asia should start to explore a consolidated and better-focused approach to promotion of KBE. As of now the region, let alone the countries, does not have an explicitly formulated plan for KBE, while other countries and even regional organisations have accepted the promotion of knowledge-based economies and some have pursued ways to promote KBEs in their respective countries and regions. APEC for example, has been actively promoting KBEs in the region since its inception through its various activities. In recognizing the importance of KBEs, its leaders accepted a proposal for its promotion in 1998, and the 2000 APEC Leaders' Declaration includes an important action agenda for facilitating the New Economy in the region (APEC, 2000). A KBE Task Force was also established in 2000 to facilitate the discussion and implementation of KBE promotion. Thus, it is imperative that governments in South Asia and SAARC as a regional organisation recognise the importance of knowledge and its development, acquisition and utilisation in the economies and formulate a national and a regional KBE policy, respectively.

Thus, in this section, we also identify potential areas of cooperation in each of the four dimensions, current KBE related activities undertaken by SAARC and impediments to such cooperation, if any. Unlike other regional organisations such as APEC, the prospects for cooperation in South Asia in promoting KBE is greater given that countries are at similar stages of development and face similar problems in their transition from an 'old' economy to a 'new' economy.

## **5.1 Business Environment**

A knowledge friendly environment is important to promoting KBE where the key players are entrepreneurs. In order to enhance the private sector's initiatives, it is important to have open trade and investment regimes in the region. Openness to trade and foreign investment is an important precondition to a KBE since they act as channels for the transmission of knowledge.

An open trade environment is a prerequisite for a KBE in that it helps create an incentive for innovation and allows for the implementation of technologies. Openness to trade often implies openness to new ideas, which is required by a KBE. There is clear evidence that outward, international orientation is linked to the process of economic growth and development. In a KBE, this international exposure is a means of communication and knowledge transfers. Since the 1990s the region as a whole has undertaken very substantial trade liberalization, but substantial differences exist across countries in their openness. While Sri Lanka remains one of the most open economies in the region, India is the least open among the region's economies. This is reflected in the ratio of trade to GDP, which yields a simple measure of "openness" of an economy. South Asian countries are relatively less open than their counterparts in East Asia (Table 2). In this context, further trade liberalization is crucial in setting a favourable environment for a KBE.

At the regional level, SAARC has already undertaken measures to liberalize trade amongst member countries under the South Asian Preferential Trade Arrangement (SAPTA) which came into operation in 1995. Under SAPTA tariff and non-tariff barriers are reduced on reciprocal basis with special consideration given to the least developed countries. The eventual objective is for SAPTA to become a South Asian Free Trade Area (SAFTA), based on multilateral tariff reductions. So far three rounds of tariff concessions have been concluded with around 5200 tariff concessions exchanged amongst the member countries. A fourth round is yet to get underway. 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 (South Asia Monitor, 1999). Trade within the South Asian Region has been limited by a host of economic and political factors. On the political side, the main obstacle to greater trade integration has been the tension between India and Pakistan, and to a lesser degree,

distrust of India by her smaller neighbours. On the economic side, perhaps the main inhibiting factor has been a lack of complementarity in the countries' exports. The four major South Asian nations export a similar basket of commodities, and often compete directly in third markets, especially for textiles. Furthermore, India's economic preponderance and comparative advantage in a range of products has resulted in asymmetric trade relations with her neighbours, hindering regional integration. Last, low growth and demand within the region itself, and historical trade links with the developed countries, have resulted in extra-regional patterns of trade.

Along with open trade, foreign direct investment can also be an important source of acquiring technology and knowledge. Valuable technological spillover can occur through training of local staff, and through contacts with domestic suppliers, subcontractors and buyers. Policies to attract foreign investment can contribute to local innovative activity and are important.

Until recently, most countries in South Asia did not welcome FDI and thus the region was not seen as an attractive destination for investments by international investors. Until the 1990s, FDI flows were quite minimal. Policies and attitudes towards FDI in the region have changed sharply since 1990s and reforms to the FDI policies have accompanied trade liberalization in the region. All South Asian countries now actively encourage and seek FDI and a range of measures have been implemented to enhance their attractiveness to potential foreign investors. These include provision of various tax, duty and other incentives, removal of restrictions on repatriation of profits, establishing current account convertibility, reduction of the number of prohibited or restricted sectors, relaxation of ownership restrictions, non-discrimination in favour of domestic investors, fast-tracking of FDI approvals, guarantees against nationalization and expropriation and the setting in place of internationally accepted dispute resolution mechanisms.

As a result, FDI flows to South Asia started to pick up in the mid 1990s and the region has improved its share in terms of total FDI inflows from the world. Nevertheless, the magnitude of inflows attracted by the region remains relatively meagre. In 1998, it attracted a mere 0.5 per cent of global inflows whereas China alone received more than 10 per cent of global flows in that year. Much of the increase in inflows to the region has been accounted for by India. Despite this growth, FDI as a proportion of the GDP in South Asia is comparatively very low. For example, the share of FDI in GDP for India

and Bangladesh was less than 1 per cent while the corresponding figure for Sri Lanka and Pakistan was higher but less than for Malaysia or Singapore.

FDI to South Asia is predominantly from outside the region. While FDI from outside is far more important than intra-regional investments in most countries (except in the case of Nepal where India is the single largest investor in the country), there are signs that intra-regional investments are increasing. Indian companies are the major players of intra-regional investments in South Asia. With the liberalization of the Indian investment policy in the early 1990s, investments made by the Indian companies within the SAARC region (Bangladesh, Maldives, Nepal and Sri Lanka) and outside the region have expanded. The potential for intra-regional investment within the region appears to be enormous given the disparities between the economies of the region in terms of technological capabilities and enterprise development. In this context, policy initiatives such as the formation of a SAARC Investment Area, similar to the ASEAN Investment Area or the MERCOSUR investment promotion schemes, would go a long way in facilitating freer flow of investment in the SAARC region (RIS, 1999). A SAARC Investment Area could help in generating intra-regional investment flows and at the same time help in attracting more foreign direct investment from outside the region.

An open investment environment cannot be attained without a solid regulatory/legal framework to facilitate knowledge flows. Appropriate legal systems have to be in place to administer such an environment. As such, active competition policy that discourages collusive and anti-competitive behaviour is important in facilitating the flow of knowledge in an economy. At a more basic level, intellectual property rights laws must balance the need for good ideas to be actually used against ensuring a fair return for inventors. At the national level, both Sri Lanka and India could do more to protect intellectual property and promote competition in the economies (Table 2). At the regional level, harmonisation of KBE-related legal systems is important to foster an environment for knowledge to flourish and flow within the region but different legal systems within the region pose a challenge to cooperation. In this regard, SAARCLAW has a role to play. SAARCLAW was founded in 1991 and is a regional organization of lawyers, judges, law teachers, legal academicians and legal researchers of SAARC countries. Its objectives are to bring together the legal communities within the region for closer cooperation, developing understanding, promoting exchange of ideas and dissemination of information; to use and develop law as a source and an instrument towards social

change for development as well as for building cooperation among the peoples of the region.

The key role of government in a KBE is being the provider of an environment that promotes less regulated markets, freer trade and investment and a more effective incentive system. That is, government in general needs to take a neutral approach to the development of KBIs. Despite the importance of individual governments in setting the right direction and framework for a KBE, such efforts would be incomplete if economies in the region lack such initiatives. KBE in its truest sense can only be complete with the participation of all economies. In this context, coordination of policy among governments is an essential aspect in realising the potentials for a KBE. But the lack of policy relating to KBE in South Asia poses problems to the overall cooperation efforts.

South Asia does not have highly developed knowledge-based industries (those which are defined as relatively intensive in their inputs of technology or high quality human capital) except in the case of few industries, most notably the IT and pharmaceuticals sector in India, which are inherently knowledge based. India has a higher proportion of high tech exports in its manufactured exports compared to other South Asian countries. But the share is still low compared to other countries. Similarly, service exports which tend to be knowledge-intensive are comparatively low in South Asia.

## **5.2 ICT Infrastructure**

Information and communications technology infrastructure is also an important precondition for the development of a KBE. Advanced technological systems bring down the cost of information and facilitate the access to wider pools of information and thereby promote the spread of ideas. But telephone, PC and internet penetration in South Asia is considerably low compared to other countries (Table 2). Even though the telecom sector in the region has shown signs of improvement with deregulation, it is not yet on par with the rest of the world. The state of a country's ICT critically affects the creation, diffusion and application of knowledge and the competitive edge of a nation. The poor state of ICT infrastructure in the region impedes the promotion of KBEs in the region. South Asia needs to promote greater ICT use if it is to progress more rapidly as a KBE. Continued substantial investment in information and communications technology infrastructure is needed and thus the sector needs to be opened up for further competition.

At the regional level, the SAARC Technical Committee on Communications has a role to play. The TC on Communications was formed in 1993 after the TC on Telecommunications and TC on Postal Services, both established in 1983, were merged. In view of the recent information revolution various steps taken by this technical committee are of considerable importance. Within the overall objective of providing telecommunication services to the majority of the rural population by the year 2000, the Committee has focused on efforts to promote technological and human resource development and management.

There has been substantial progress in implementing the recommendations for the establishment of ISD, automatic telex, and bureaufax facilities, improvement of inter-country links, operation and maintenance of communications links, etc. Efforts are being made to further promote cooperation in improving transit facilities. An initiative has been taken to establish an Information Network among the member countries. Short-term activities in Telecommunications include Seminars/ Workshops on Data Transmission, Digital Switching, Network Management and Operations, Software maintenance, Adoption of new technologies in rural telecommunication systems, IDR satellite technology and improvement of rural telecommunications. While recognizing the need for better and cheaper telecom links between SAARC countries, several possibilities including a SAARC satellite, updating, expansion and harmonization of telecom hardware in the region have been discussed.

A high-level Expert Group on Telecommunications has been set up to address these issues, as well as to examine the possibility of bringing telecommunications tariffs between SAARC countries as close to domestic rates as possible. There has also been recommendations to set up an ICT council within the SAARC region to forge economic integration in South Asia. The group also recommended the setting up of a South Asian ICT Council and it will initiate collaboration towards improved connectivity through high bandwidth; training opportunities on ICT; the empowerment of the underprivileged by providing access to information through setting up tele-centres; use of ICT for cultural interaction among people; and the promotion of the South Asian region as a major source of software development and ICT enabled services for the global market.

### 5.3 Innovative Systems

Innovation has become an increasingly important determinant of competitiveness in KBE. While the importance of science and technology for national development prospects has been recognised in most of South Asia as is evident from the emphasis placed in their development plans and policies, the capacity to innovate remains weak in the region. This is indicative of the scale of S&T activity, measured in terms of proportion of national income spent on R&D activity, which is marginal if at all significant, with the notable exception of India. Available data suggest that the proportion of S&T activity has gone down over the decade or so. In the current era of globalization, where innovation has become key to national as well as international competitiveness, such a trend appears to be odd. For example, SAARC countries, except for India spent under 0.5 per cent of national resources. In Bangladesh, the 1995 allocation for R&D was about 0.2 per cent of GNP. In the case of Pakistan also R&D expenditure was low at 0.4 per cent. In Sri Lanka, the share of R&D expenditure in GNP in 1985 was 0.2 per cent, which remained at that level in 1995. In India R&D allocations as a proportion of GNP fell from 0.91 per cent in 1985 to 0.86 per cent by 1995 but remain relatively higher in comparison with the rest of South Asia.

Various other indicators such as patents and proportion of scientists and engineers in population reflect the low innovative capability in the region, as confirmed in Table 2. The SAARC region has been lagging behind the rest of the world in terms of innovation. This is a major shortcoming of the overall development process of the SAARC countries, which is an impediment to promoting knowledge-based economies in the region. Therefore, building national capabilities with the help of individual country level efforts as well as regional cooperation would be essential.

SAARC has recognised the importance of developing a regional self-reliant capability for South Asia in scientific research and development. Towards this end, the SAARC Technical Committee on Science and Technology was established in 1983 right at the beginning of the cooperation process. The Technical Committee on Science and Technology has undertaken a wide variety of programmes, which include short-term activities such as Seminars/Workshops/ Meetings of Experts, Training Programmes, Joint Research Projects, preparation of State-of-the-Art Reports and compilation of Directories. In the field of bio-technology, the need to institutionalize SAARC



cooperation has been well recognized by the member countries. The establishment of network arrangements in the field of bio-technology and genetic engineering are being pursued. Follow-up actions are being considered on the following aspects: training needs, exchange of scientists, specific infrastructure, directory of scientists and institutions in bio-technology, newsletter, collaborative R&D programmes and bio-informatics. Also the SAARC technical committee on science and technology has agreed to the concept of the proposal on “SAARC Bio-Technology Council”.

In an era of a knowledge-based economy, innovation depends not only on how enterprise, research institutes and universities perform but also on how they interact with one another in innovation systems at national as well as international levels. Much of the little R&D that does take place in South Asia is publicly funded and there is little or no research collaboration between the research institutes and industries. This is a common feature among all the SAARC countries and as a result, research institutions are unable to generate innovations that are found to be commercially viable by the industry. Government’s role is to address failures which block the functioning of the innovation system, hinder the flow of knowledge and technology and thereby reduce the overall efficiency of national R&D efforts. In this context, the TC on Science and Technology may also provide a forum for interaction amongst the local industry and national R&D institutions to explore the possibilities for cooperation at the regional level.

#### **5.4 Human Resource Development**

In a fully developed KBE, high quality education services are both widely available and used, and are a major priority for the economy and society. The education system should be aimed at building a knowledge society – one where the application of thought is the primary means to competitive advantage. The future is said to belong to countries which evolve into knowledge societies and basic education is important to establish a knowledge society. It is a long run investment without which a KBE is unsustainable. Without this background, it is virtually impossible to build other elements of the national knowledge base (such as R&D) to the level needed by a KBE. The experience of the high performing Asian economies suggests that wider and deeper education is a precondition before other aspects can take off. Thus, a major responsibility of the governments in South Asia is to ensure that such education services are in place. Secondary education in

most of the South Asian countries falls short of the preconditions of a KBE (Table 2), though some of these economies are making serious efforts to improve this. South Asia must continue to invest in their people through education to improve educational performance as well as give greater attention to promoting life long learning through training in order to provide a solid foundation for a knowledge based economy.

SAARC's cooperative action in human resource development should be substantially increased through the Technical Committee on Education, Culture and Sports (previously TC on Education and TC on Sports, Arts and Culture). Currently, the priority themes identified for cooperation in the field of Education are: Women and Education; Universal Primary Education; Literacy, Post Literacy and Continuing Education; Educational Research; Science and Technical Education, Education for the Underserved Areas and Distance Education. A SAARC Human Resources Development Centre (SHRDC) has also been set up and the centre aims at developing human resources in Member States, inter-alia, in social, economic, educational and environmental fields. It has recommended a programme of activities which includes: collection and compilation of basic data on HRD issues, meeting of nodal points, preparation of Directory for research institutes in the region in the area of HRD, networking of institutions and information to handle coordination work, and development of training modules and seminars. The first meeting of the Governing Board of the SAARC Human Resource Development Centre (SHRDC) was held in 1999.

## **6. Conclusion**

Increasingly the traditional factors of production – land, labour, capital – on which a country's comparative/competitive advantage was based has become less important when compared to knowledge. Countries all over the world are increasingly focusing on the role that knowledge plays in developing their economies. The term “knowledge-based economy” recognises the crucial role that knowledge plays in the economic process. Although factors of production will continue to be important to a country's comparative/competitive advantage, the emergence of new competitors from other regions, demanding consumers and a freer trading system will make it necessary for countries to adopt strategies to enhance, let alone maintain their competitive positions in the world market. The fastest expansion in the coming years will be in knowledge-based industries and the trade in their products. South Asia lags behind others in its transition to

a knowledge based economy. The region is weak with respect to the four key dimensions of a KBE, namely, business environment, innovation systems, human resource development and ICT infrastructure, which is likely to hinder the movement of the region towards a KBE. At the national level, the market and the private sector should be the main initiators of KBEs, and the government should take the role of facilitator in the process towards a knowledge-based economy. Since the private sector is the forerunner in KBEs, SAARC should encourage and facilitate alliances, joint R&D, investment and trade, etc. among enterprises in the region through the SAARC Chambers of Commerce. Given that the countries in the region are at similar stages of development and thus face similar challenges, there is also potential for cooperation and help for member countries to progress towards a knowledge-based economy. A regional organisation such as SAARC can play a role in promoting KBE in the region. Although some SAARC activities are directly and indirectly related to the promotion of KBEs, it is imperative that SAARC establishes a body such as the APEC KBE Task Force to facilitate the discussion and implementation of KBE promotion in the region. This is due to the importance of the subject and the relevance of the subject since SAARC aims to accelerate the process of economic and social development in Member States.

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## **Chapter 4**

### **Group of Eminent Persons (GEP) Report: Critical Evaluation of Economic Aspects**

Douglas Jayasekera

#### **1. Introduction**

The Ninth SAARC Summit in Malé in 1997, constituted a Group of Eminent Persons (GEP) who were mandated to undertake a comprehensive appraisal of SAARC, and “to identify measures, including mechanisms to further vitalize and enhance the effectiveness of the association in achieving its objectives”.

The GEP’s report contained a set of recommendations for consideration by the Tenth SAARC Summit in Colombo in July 1998. During the Colombo Summit, the GEP report was considered, but only a preliminary discussion was held, and the Council of Ministers, were asked to review the report. A few months later, the Standing Committee of Foreign Secretaries of SAARC discussed the report on the basis of an outline paper prepared by the SAARC Secretary General, and suggested points for review by the Council of Ministers. The Ministers considered the recommendations of the Standing Committee too cautious, and postponed discussion on the subject until the meeting of the Ministers, on the sidelines of the U.N. General Assembly Sessions in New York later in the year. The GEP report however, still awaits adoption by the Ministers, and with the postponement of the Eleventh SAARC Summit in Kathmandu in November 1999, due to Indo-Pakistan differences over bilateral issues, the GEP report remains in limbo.

The GEP report covered three main areas viz., Economic Cooperation, Social Sector Cooperation and the SAARC Institutional structures. This presentation however, will be confined to the economic aspects of the report.

#### **2. Appraisal**

In its appraisal of SAARC, the GEP report refers to its achievements, since SAARC was established in 1985. The Integrated Programme of Action, which was the core programme for regional cooperation, succeeded in fostering personal contacts between

experts of the region, facilitated sharing of experiences, exchange of data and information through seminars, workshops, training programmes etc. This period saw the gradual development of an agenda on the most pressing social concerns of the region, relating to poverty alleviation, women, children and other disadvantaged groups. Four regional centres were set up to supplement the work of the Technical Committees. The GEP was of the view that despite these 'achievements', the progress made was modest. They stated that the SAARC is still far from maturing as a regional economic group. It took several years for SAARC to move to 'hardcore' economic areas. The SAARC Preferential Trading Arrangement (SAPTA) was launched in 1993, and was implemented from 1995. Even in the areas where SAARC has been active, several of the decisions taken at the highest political level remain unimplemented. This is a typical South Asian malaise, where many fine speeches are followed by decisions, which remain only on paper. A classic illustration is the SAARC Food Security reserve, which was established to provide for a reserve of food grains to meet emergency food shortages in member states. These facilities have never been utilized, even though member countries have suffered from food shortages from time to time.

None of the four Regional Centres have emerged as recognized centres of excellence. The appraisal of SAARC undertaken by the GEP clearly indicated its limitations, and the considerable ground which must be covered to realize its full potential. There are several economic areas like manufacturing, services, money and finance, energy, which were outside the pale of SAARC Cooperation. The GEP concluded, "that the next phase of the evolution of SAARC should be one of consolidation on the one hand, and new major thrusts on the other". There should be a concentration of efforts in areas that have greater potential of making a visible impact on the life of people in the region.

In envisioning the future, GEP stated that serious cognizance be taken of the fact, often proclaimed, but rarely used as a basis for developmental policy and action, that South Asia is one of the world's distinctive cultural macro – regions, manifesting great variety, complexity and historical and philosophical depth. The GEP quite rightly felt that the SAARC process must identify the crucial role of culture in the contemporary economic and social scenario in the region. Culture forms a vital and sensitive component of a society's regeneration process, influencing and enhancing creative energies in all fields.

As the GEP report pointed out, South Asian countries have certain inherent advantages in regional cooperation. They have the advantage of geographical contiguity and shared economic, social and cultural characteristics. They also have an inherited development infrastructure, even if it has not been upgraded over the years. With a combined population of 1.3 billion, South Asia commands a huge potential market.

### **3. Vision**

It is, in this context, that the GEP propounded their vision beyond the year 2000. The GEP states that it is imperative to significantly accelerate cooperation in the core economic areas. For the first eight years of its existence, hardcore economic issues such as trade, industry, money and finance were outside the scope of cooperation under SAARC.

The situation was somewhat redressed with the adoption in 1993 of the agreement on SAPTA, and its operationalisation in 1995. Until now three rounds of trade negotiations have been concluded under SAPTA and implemented. The progress has been modest. The tariff cuts have not been deep enough, and some concessions were on items not actively traded. Until now only tariff concessions have been made. In addition, negotiations held so far, have been on a product by product basis, which is highly time consuming. A silver lining in this bleak scenario was India's decision to unilaterally remove all Non Tariff Barriers (NTBs) in favour of SAARC countries in August 1998. This amounted to over 2000 items. However, within the framework of WTO commitments, India also removed globally NTBs on 714 items in fiscal year 2000-01, and the remaining 715 items on April 1, 2001, thus diluting, to some extent the earlier SAARC offer.

The transition from a Preferential Trading Area (SAPTA) to a South Asian Free Trade Area (SAFTA) appears somewhat ambitious. The GEP envisages the establishment of a SAFTA by the year 2010 by the Least Developed Countries (4 member states) and by 2008 by the other three member states. I feel that this is an overly ambitious target, given the previous track record of the SAARC countries. The fourth round of negotiations under SAPTA, have been stalled since 1999. The SAARC Summit in Malé in May 1997 brought forward the date of achieving SAFTA to 2001. This proved to be not practicable, and the Colombo Summit in July 1998, set the timeframe for drafting a treaty to create SAFTA by the end of 2001. The Committee of Experts, mandated to



draft the Treaty by end 2001, met in July 1999, to draw up their Terms of Reference, but have not met since. This is the disappointing record of SAARC economic cooperation. In this situation, given the considerable backtracking that has taken place over the years, to expect SAFTA to be in place by 2008 is not practicable. The GEP recommends an across the board reduction of tariffs by 12.5 per cent 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. The GEP also felt that all NTBs should be phased out by 2008 or 2010. This is one area where the target may be reached. India has done away with NTBs under WTO pressure by 2001. The same pressure may be applied to Pakistan. Sri Lanka has a relatively open trading system where 90 per cent of trade is free of NTBs. The balance four countries, all Least Developed Countries, may be able to reach this objective, to some extent.

The GEP visualizes that at the second stage, the South Asian countries should create a Customs Union, preferably by the year 2015. This will require the establishment of single tariffs by all member states on imports from non-member states, and agreement on common non-tariff barriers and other measures for regulating trade. At this point in time, this recommendation too by the GEP appears visionary. The same comment could be made of the third stage, where the goal is to establish a South Asian Economic Union by the year 2020. The first step towards an Economic Union would be a Single Market, where it is presumed that the transport, telecommunications and energy infrastructures would be substantially integrated. The report notes the importance of trade and transport facilitation measures such as harmonization and mutual recognition of standards, adoption of common tariff nomenclature and harmonization of customs procedures, valuation methods and regional rules of origin. Among these measures, only the regional rules of origin are presently in place. SAARC should however, explore the possibility of further relaxing its rules of origin in order to assist the Least Developed and smaller developing countries in the region. Regarding transport facilitation, the report calls for providing transit facilities across national boundaries to goods of other SAARC member states, for facilitating through traffic, including motor vehicles agreements. The report calls for improvements of entry points by construction of railway sidings, provision of parking space for wagons, lorries etc. The transport facilitation measures may prove easier to achieve than the other measures. The proposed Economic Union will be required to adopt and implement a common

competition policy. A regional quasi-judicial mechanism will have to be set up to adjudicate on complaints and pronounce judgments. A common competition policy will be a difficult task, given the problems encountered in even adopting national competition policies in the SAARC countries. The Economic Union will also involve a transition from consultation on macro economic policies, towards their harmonization with the creation of a single market, and harmonization of macro economic policies in some areas, particularly exchange and interest rates. The GEP recommends a single monetary system, including a common currency. The harmonization of macro economic policies would involve an erosion of sovereignty over national macro economic policy making. This is inconceivable, and would not be politically viable or feasible, given the stuttering state of regional economic cooperation. More mature regional economic groupings have grappled with these issues unsuccessfully.

The GEP report also deals with investment and finance. The report recommends the early finalization of a draft regional investment agreement, before the implementation of SAFTA. A common investment area should be developed. The final agreement should contain provisions on entry, establishment, ownership and control of foreign investment from other countries of the region. There would have to be a harmonized incentive policy that would attract foreign private investment. They should remove restrictions on investments in their respective stock markets, and eventually move towards a common stock exchange. The investment agreement is a useful recommendation, since trade has increasingly become investment led, and at least in creating trade complementarities, investment liberalization should go hand in hand with trade liberalization. There is a need to establish a nexus between trade liberalization and investment liberalization, particularly in a situation where there is, at present, a lack of complementarities in the trade among SAARC countries.

The GEP recommends that South Asia, learning from the ASEAN experience, should pursue a policy of country specialization, industrial complementation and joint regional industrial ventures, as measures for linking trade expansion with industrial expansion in the region. The sectors where there is scope for SAARC level specialization, as well as vertical integration include textiles, leather goods, light engineering goods, software development, rubber products, automobiles, and exploitation of bio resources.

The GEP argues the case for a South Asian Development Bank (SADB), as a supporting mechanism for the coordinated restructuring of the South Asian economies. The bank should be funded by the World Bank, Asian Development Bank, and International Financial Corporation. The SADB should mainly finance commercially viable infrastructure projects and trade creating joint venture projects.

The GEP calls for SAARC to take common positions on emerging global economic issues, in such global fora as the WTO and the Bretton Woods institutions. The SAARC Commerce Secretaries and Commerce Ministers have met several times to examine WTO related issues and SAARC did take up a common stand at the Seattle meeting in 1999. There is a WTO Ministerial meeting in Doha in November this year, and it is likely that the relevant SAARC bodies will deliberate on their common position, before that meeting.

The GEP calls for more favourable measures for Least Developed Countries (LDCs) in SAARC, such as allowing a longer time frame for freeing trade, staggering the process of freeing trade in particular sectors, resort to safeguard measures for a longer period of time, creation of a special fund for compensating for the loss of revenue suffered as a result of reducing or eliminating tariffs, and creation of a reasonably large sized fund for the development of their infrastructure. It also suggests the facilitation of freer movement of private capital to the LDCs from the other member states. The LDCs cannot take advantage of the market opportunities to be opened by SAFTA unless the scheme of trade expansion is integrally linked with their industrial expansion. For this purpose, it will be necessary to set up export oriented joint ventures in the LDCs, with liberal financing from the proposed South Asian Development Fund (SADF) and other regional sources. The SADF resources should be fixed in advance, and contributions should come from member states on the basis of assessment, according to some criteria of capacity to pay.

Free trade areas being established these days provide for free trade, both in goods and services, including capital and labour. However, there are problems involved in freeing trade in labour and social services. With a few exceptions, the nations of the world are reluctant to permit free movement of labour for seeking employment in their respective countries. That is why movement of labour for seeking employment abroad was excluded from the WTO's General Agreement on Services (GATS), even though many

developing countries fought hard for its inclusion. The GEP points out that there is a considerable amount of de facto movement of labour from one country to another in the region, and steps be taken to regularize the informal labour movements.

Regarding financial services, the GEP recognizes the inherent problems in liberalizing financial services. The South Asian countries made limited offers of liberalization in the WTO negotiations on financial services. However, the GEP recommends that the relatively more developed countries of South Asia should permit partial convertibility of their respective currencies on capital account for the limited purpose of investment in the LDCs and small economies of the region.

#### **4. Conclusion**

What I have said before, would indicate that the GEP report is a landmark document in that it is an integrated package of measures. SAARC's approach towards regional cooperation up to now, had been compartmental rather than holistic, and the GEP report addresses this situation head on. SAARC's approach up to now was devoid of long term architecture, and lacked a vision.

Critics might say that the report is too visionary, too ambitious and is the work of dreamers. The Plan of Action for example is very ambitious and envisages a South Asian Economic Union by the year 2020. This would mean moving from a Preferential Trading area (which we now have, partially) to a Free Trade area, to a Customs Union, a Single Market and an Economic Union in just twenty years. This would be in half the time the European countries took to move to a European Union. Given the deep political divisions, which exist in the South Asian region, this may appear to be an impossible dream.

The authors of the report might say that when Jean Monet spoke of European integration in the 1950's, he too was dismissed as a dreamer. Europe had just emerged after two of the most devastating wars in history and the main combatants were the European countries themselves. However, the European Coal and Steel Community of the 1950's progressed through a Preferential Trading area, to a Free Trade area, a Customs Union, Single Market and now to a European Union, with a single currency, and European Central Bank. The dream of Monet was realized in forty years. Can the South Asian

dream be realized in half that time? Only time will tell, though at the moment it appears unattainable.

## **Discussion**

Discussant: H.N. Thenuwara

- Dr. Thenuwara said that knowledge is a fundamental ingredient of economic growth. What can SAARC do to promote the concept of a Knowledge Based Economy (KBE) in South Asia, and use knowledge as a factor of production? India ranks high in the use of knowledge. How can knowledge be disseminated? Trade is an effective method of disseminating knowledge. Hence SAARC is on the right track since SAPTA/SAFTA not only gives direct trade concessions, but also helps in transferring knowledge to countries. There is a lack of strategies for promoting and developing KBEs in the paper. What changes should be made to facilitate the development of KBEs, and how should they be implemented?
- Regarding the GEP Report, Dr. Thenuwara said that the concept of a food security reserve is an outdated and impractical idea, and questions pertaining to funding, administration etc. has not been addressed. The recommendation of the GEP report in favour of a South Asian Development Bank seems unusual, given that the world is moving away from such international banking ventures.
- In general comments, Dr. Thenuwara said that there should be a central place to undertake trade policy research, and a central information base for such research. He said that the Commerce Department or some other body should store this information.
- He posed the question why do we need cooperation? Would not an all-encompassing trade agreement between the individual countries suffice? Or perhaps both the SAPTA/SAFTA and individual Free Trade Agreements could run in parallel for maximum investor benefit. Reports and research in the area of regional cooperation and trade policy, need rigorous testing.

### **Open Discussion**

- The SAARC food security reserve was not suggested in the GEP report but a decision made at the SAARC Summit.

- The idea that one organization alone should engage in trade policy research is impractical. Research activities should not be centralized and should represent diversity of thought.
- The integration of SAPTA and the Free Trade Agreements are not that simple. It is not possible for them to run in parallel. It may perhaps be possible to substitute one for the other as in Latin America.
- The paper suggests that the KBE initiative be taken at national levels, and then propelled to a regional level. Since at the moment, there is no real government initiative, there is scope at a regional level for such advances.
- How feasible is knowledge transfer between India and Pakistan given the present political climate? The paper does not address the feasibility of such transfers, though the scope for KBEs is explored. Perhaps the potential for reduction of political tensions through knowledge sharing should be explored.

### **Response to above remarks**

- Research should not be centralized, but there should be a single institute to direct and motivate the research.
- Exporters should have access to the best deal and hence should have the option to have access either through SAPTA/SAFTA or the Free Trade Agreements.

### **Concluding Remarks: Ravi Yatawara**

- Liberalization in South Asia is relatively new, and its extent still peripheral. There is a need for strong political will for cooperation. There is a notion that one feeds the other, since increased cooperation fosters the political will, and vice versa. In South Asia, the political motivation towards cooperation remains poor. The lack of commitment is the main impediment to increased regional cooperation. South Asia has similar industrial structures, which serve as an avenue for regional cooperation. However, the different levels of development, and liberalization, and different sizes of economies remain as impediments. The move towards bilateral agreements would be an impetus to regional economic cooperation. It is also important that Sri Lanka should not restrict itself to the South Asian region but should develop its multilateral links as much.
- Trade deals should incorporate a 'packaging idea'. For example, initiating an investment plan along with the bilateral/regional agreements would provide additional benefits, and increase the level of commitment and motivation to regional cooperation. Given the concept of knowledge based economies, trade flows could be a source of gain to Sri Lanka from India.
- Economic cooperation should be multidimensional, the area of ocean and mineral exploration being an example. We should also adopt the negative list approach in negotiations. It is a smaller list, and could speed up the process of negotiations, and reduce the bureaucratic complications. It could also mean moving away from the present time consuming product-by-product approach.
- SAARC research and literature should be available on a website in order to provide valuable insight and information, and to foster research.



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