

The Institutions of Regionalism in South Asia—Do Institutions Matter?

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ABBREVIATIONS

AFTA	ASEAN Free Trade Agreement
ASEAN	Association of South East Asian Nations
ASEC	ASEAN Secretariat
BIMSTEC	Bay of Bengal Multi-Sectoral Technical and Economic Cooperation
BOOT	build operate own transfer
BTILS	BIMSTEC Transport Infrastructure and Logistics Study
BWG	Bangkok Working Group
CAM	Country Advisors Meeting
CEPA	comprehensive economic partnership agreement
CGE	Computable General Equilibrium
ESCAP	Economic and Social Commission for Asia and the Pacific
EWEC	East West Economic Corridor
FDI	Foreign Direct Investment
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GEP	Group of Eminent Persons
GMS	Greater Mekong Subregion
ICT	Information and Communication Technology
ISLBFTA	India-Sri Lanka Bilateral Free Trade Agreement
ITeS	Information Technology Enabled Services
LDC	least developed country
MW	megawatt
MFN	most favored nation
MOU	memorandum of understanding
NAFTA	North American Free Trade Agreement
NEA	Nepal Electricity Authority
NTBs	non-tariff barriers
OECD	Organization for Economic Cooperation and Development
PPP	public private partnership
RCI	regional cooperation and integration
RCSP	Regional Cooperation Strategy and Program
RETA	Regional Economic Technical Assistance
SAARC	South Asian Association for Regional Cooperation
SAFASA	SAARC Framework Agreement on Trade in Services
SAFTA	South Asian Free Trade Agreement
SAPTA	South Asian Preferential Trade Agreement
SARI/E	South Asia Regional Initiative for Energy
SASEC	South Asia Subregional Economic Cooperation (Program)
SDF	SAARC Development Fund
SIPA	SAARC Integrated Programme of Action
SRETS	SAARC Regional Energy Trade Study
SRMTS	SAARC Regional Multimodal Transport Study
TA	technical assistance
UNCTAD	United Nations Commission on Trade and Development

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ABSTRACT

This paper assesses the contribution of the key institutions of Regional Cooperation and Integration (RCI) in South Asia in the context of the prevailing political and security environment, and to suggest ways in which the Asian Development Bank and other development partners can strengthen their support to them within the constraints imposed by this challenging environment. In an attempt to enhance our understanding of the interplay between politics and RCI it uses examples to show how political factors have constrained RCI, and continue to do so in many cases, as well as how good bilateral political relations or improvements in them have advanced RCI. Because the overall political environment is improving, it also suggests the time may have come for the South Asian Association for Regional Cooperation (SAARC) to consider strengthening the capacity of the SAARC Secretariat to meet the growing challenges and work load of managing the anticipated increase in RCI.

I. INTRODUCTION

1. Although growing rapidly, South Asia remains one of the poorest regions in the world. And for reasons largely to do with political differences, it enjoys perhaps the least connectivity of all regions, very low intraregional trade, little sharing of energy surpluses, and very little intraregional tourism other than for visiting relatives. Regional cooperation has been stymied by the fact that the regions' two largest countries, India and Pakistan, have fought three wars and are still at loggerheads over the Kashmir dispute, as well as by India's asymmetrical advantage in size, resources, and geographical location in the center of the region. This has led, in the past, to perceptions of India as "big brother" among some of its smaller neighbors, just as it has led India to feel "ganged up" on in any multilateral regional formation.

2. These factors, and a host of bilateral differences among some South Asian Association for Regional Cooperation (SAARC) countries, partly explain why the organization was set up only in 1985—almost four decades after the largest countries of the region gained independence—and its relatively weak charter and institutional structure. A conscious political decision was taken to keep most of the areas that make for economic cooperation and integration out of the SAARC ambit. Only recently, through successive declarations at SAARC annual summits, were such areas included. These issues also explain the relative lack of cooperative action undertaken in SAARC's first two decades, when it was forced to limit its activities largely to declarations of intent at annual summits of heads of government and state, and to a range of activities in the social, cultural, and scientific spheres.

3. However, a significant change has come over the region in the last few years. Emboldened by rapid growth, India has made it explicit policy that henceforth it will be satisfied with "asymmetric and non-reciprocal" benefits in dealings with smaller neighbors. It is also much less suspicious of multilateralism in the region. The suspension of hostile rhetoric between India and Pakistan with the ongoing "composite" dialogue between the two countries—despite ups and downs, and the current suspension in the wake of the November 2008 terrorist attack on Mumbai—has also improved the atmosphere for regional cooperation.

4. The vast potential of regional cooperation and integration (RCI) has always been clear. Indeed, there have been several examples of cooperation to mutual benefit, mostly bilateral, such as Bhutan's hydropower sales to India, the Indian-Bangladeshi agreement to share the waters of the Ganges, and the Indo-Sri Lanka Free Trade Agreement (FTA). But there has also been multilateral cooperation, such as the establishment of the South Asian Free Trade Agreement (SAFTA). More recently, Nepal allowed private foreign investment in hydropower for export of electricity to India, and Bangladesh and India exchanged long held-up concessions on transport and transit through each other's territories, including use of ports and rivers in Bangladesh. The two countries have agreed to interconnect their electricity grids, and India has offered assistance to strengthen Bangladeshi railways and improve its waterways. Significantly, they reiterated their desire to "work together in making SAARC a purposeful organization".¹ Thus the outlook for greater RCI has greatly improved in the eastern part of South Asia and remains strong in the southern part. Most cooperation will continue along bilateral lines, but considerable interest has been shown in South Asia's three multilateral forums in enhancing connectivity in transport and energy along the lines suggested in various ADB sponsored studies. This would seem a good time therefore for ADB to review its RCI activities as part of the exercise to formulate the new Regional Cooperation Strategy and Program (RCSP) for South Asia for 2011–2015.

¹ Joint Communiqué, 12 Jan 2010 (SAARC 2010).

5. The current RCSP for South Asia aims to help the region realize its full potential in economic and social development and to enable it to participate effectively in wider Asian integration. It has five key operational objectives: to (i) improve connectivity, (ii) facilitate trade and investment, (iii) develop regional tourism, (iv) facilitate cooperation in energy, (v) and promote private sector cooperation. To further these objectives, ADB follows a “multi-pronged approach” by working with (i) SAARC, the main regional institution, (ii) the South Asia Subregional Economic Cooperation program (SASEC), a sub-grouping of the four SAARC countries in the eastern part of South Asia, and (iii) the Bay of the Bengal Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), a cross-regional institution with five South Asian and two Southeast Asian members.

6. The main purpose of this paper is to assess the contribution of these institutions to RCI in the context of the political and security environment that prevails in South Asia, and to suggest ways ADB and other development partners can strengthen their support to them in this challenging environment. To enhance our understanding of the interplay between politics and RCI, it uses examples to show how political factors have constrained RCI, and continue to do so in many cases, as well as how good bilateral political relations or improvements in them have advanced RCI. Because the overall political environment is improving, it also suggests the time may have come for SAARC to consider strengthening the capacity of the SAARC Secretariat to meet the growing challenges and work load of managing the anticipated increase in RCI.

7. The structure of the paper is as follows. Section 2 reviews the structure and working of key RCI institutions. Section 3 reviews the extent to which RCI institutions have effectively carried out their mandates in the key economic sectors (as opposed to the social and cultural) of trade in goods and services, investment, transport connectivity, and energy sharing. Section 4 briefly describes the internal and external political and security factors constraining and supporting RCI. Section 5 examines issues relating to strengthening the RCI institutions, and especially the SAARC Secretariat. Section 6 looks at how the policies of the RCI institutions fit into the context of an open and modern Pan-Asian regionalism. Section 7 summarizes the implications for development partners and attempts to answer the question posed in the paper’s title.

II. THE STRUCTURE AND WORKING OF KEY RCI INSTITUTIONS²

8. As noted above SAARC, BIMSTEC, and SASEC are the main RCI institutions in South Asia.

A. SAARC

9. Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka formally approved the SAARC Charter on 8 December 1985. Afghanistan became the eighth member in April 2007. Australia, the People’s Republic of China (PRC), the European Union (EU), Iran, Japan, the Republic of Korea, Mauritius, Myanmar and the United States have joined SAARC as observers. The country hosting the annual summit holds the chair, Bhutan, which hosted the sixteenth summit, in 2010, is the current chair.³ The Seventeenth Summit is to be held in the Maldives in 2011. SAARC’s institutional structure and activities are described more fully in Appendix 1.

² The information in this section is based solely on desk research and is based on a perusal of websites, ADB documents, and so on.

³ Although required to be held annually, some summits have been postponed for logistical or political reasons.

10. SAARC cannot, by its charter, discuss any “bilateral or contentious” issue or take any decisions except by consensus (Article X),⁴ and the secretariat can only coordinate and monitor but take no initiative on its own. SAARC consists of four tiers, the annual “Summit” of heads of state or government, the biannual meeting of the Council of Ministers, consisting of foreign ministers, the Standing Committee, comprising the foreign secretaries, and a Programming Committee, consisting of officials below the rank of foreign secretary. Apart from meetings of the above bodies, there have also been a large number of ministerial level meetings, on as many as 15 subjects over the years, to focus attention on specific areas of common interest.⁵ SAARC also has technical committees and working groups which coordinate programs and activities in such areas as agriculture, forestry, human development, energy and culture, which are carried out through institutions and agencies in member countries. These together constitute the SAARC Integrated Programme of Action (SIPA).⁶ It also has 11 regional centers, which directly implement cooperative activities themselves.⁷

11. The main working level institution charged with promoting the charter objective of accelerating the growth of member states is the Committee on Economic Cooperation, consisting of the commerce/trade secretaries. Apart from promoting intraregional trade and investments, its functions are to analyze global and inter-regional developments and evolve common approaches to them. It oversaw the formulation of the South Asia Preferential Trade Agreement (SAPTA) which came into effect in December 1995, and SAPTA’s replacement by SAFTA on 1 January 1996. The SAFTA Ministerial Council is the highest decision making body of SAFTA. The goal of creating a South Asian Economic Union was announced at the Kathmandu Summit in 2002. An Inter-Governmental Expert Group on Financial Issues is reported to be developing the road map for achieving it in a gradual and phased manner. In order to strengthen coordination on macroeconomic policies, where appropriate, meetings of officials from central finance ministries and the governors of central banks have been held under the auspices of SAARC FINANCE.

12. The SAARC Development Fund (SDF) has come into operation with three windows (social, economic, and infrastructure) and an initial paid up capital of \$300 million. The permanent secretariat of the SDF has been operationalized in Bhutan and a CEO appointed.⁸ Through a memorandum of understanding (MOU) with Japan, SAARC also set up the SAARC-Japan Special Fund in 1993, which is used both for projects and program approved by the Standing Committee as well as for activities directly administered by Japan. Apart from partnerships with a whole host of international organizations, SAARC entered into cooperation agreements in 1994 with the Asian Development Bank (ADB) and the World Bank. SAARC has set up a SAARC Food Bank which became operational with agreement on the quantity of stocks to be maintained by members.⁹

⁴ There is no such restriction in the ASEAN Charter, which does not rule out any manner of decision in the summit, although, in practice, voting is rarely resorted to.

⁵ As of 2004, according to the SAARC website, “SAARC – A Profile”, those directly relevant to RCI have been meetings of the ministers of commerce (5 meetings), communications (2) and tourism (1). However, since then there have been meetings of the ministers of transport and energy.

⁶ Appendix 1 contains a brief assessment of the SIPA and the regional centers.

⁷ There are presently 11 regional centers, for (i) Agricultural Information (in Dhaka) (ii) Tuberculosis (Kathmandu) (iii) Documentation (New Delhi) (iv) Meteorological Research (Dhaka) (v) Human Resource Development (Islamabad) (vi) Coastal Zone Research (Maldives) (vii) Culture (Sri Lanka) (viii) Disaster Management (India) (ix) SAARC Information (Kathmandu) (x) Forestry (Bhutan) and (xi) Energy (Islamabad).

⁸ See Appendix 1.

⁹ See Appendix 1 for details.

13. The SAARC Chamber of Commerce and Industry has been active in promoting interaction between the private sectors of the member states—including the possibility of public-private sector partnerships, through an annual Economic Cooperation Conference—and in providing inputs for SAPTA and SAFTA. It organizes the annual SAARC Trade Fair and has been recognized as a SAARC Apex Body, along with similar apex bodies of lawyers, accountants, and writers.

14. Of the several studies SAARC has carried out under ADB regional technical assistance, those of relevance for RCI are on trade (in 1991), customs matters (2004), transport (2006), services (2008), and energy trading (2009).¹⁰

B. The SAARC Secretariat

15. The SAARC Secretariat is located in Kathmandu, Nepal. Article III of the Memorandum of Understanding on the Establishment of the Secretariat, signed in 1986, limits its formal role strictly to coordination and monitoring of SAARC activities and to servicing meetings of the association. The secretariat is headed by a Secretary General (SG) appointed by the Council of Ministers on the basis of nomination by members in alphabetical order. Dr. Sheel Kant Sharma of India is the current SG. The Male Summit extended the term of the SG from two to three years, and there is provision to extend her term for up to another three years in special circumstances.¹¹ Expenditure on the secretariat is shared according to an agreed formula.

16. The secretariat is very small, with a set of eight directors under the SG, one from each member-country, who are deputed from their respective foreign offices, and tend therefore to be generalist diplomats. They are mostly mid-level officials on secondment for three years. Although each of them is in charge of a particular subject, they are usually without subject-matter expertise, and with tenures (and time horizons) too short to build it up. Also, according to Baru 2009, “instead of acting as an independent collegium, they function as representatives of their respective countries at the secretariat”.¹² Under the directors, there are about 13 professional staff from member-countries, and support staff from the host country. These are appointed by the SG, subject to no-objection by the government of the appointee concerned.

17. The SG acts as the channel of communication and linkage, “when so empowered by the Standing Committee”, between SAARC and other international organizations. “In so doing the SG shall be guided by the decision of the Council of Ministers that initiatives for collaboration with external agencies should stem from SAARC itself, based on its own determination of priorities” (Article VIII of the Charter or MOU).¹³ It is interesting that the circumscribed role of the secretariat and SG (and sensitivity to sovereignty and perceived possibility of outside interference) implied by this and other stipulations is similar to that in the Association of Southeast Asian Nations (ASEAN) in its early days. As the requirements of actively managing growing regional cooperation in ASEAN made themselves felt, however, ASEAN moved to strengthen its secretariat in successive stages, as discussed in Section 5. This process has barely begun in SAARC, although there have been some initial steps taken to give him greater

¹⁰ The last three of these are discussed below.

¹¹ The Maldives, which will appoint the next SG, has announced she will be a woman.

¹² They are designated after their country rather than their functional area e.g. “Director for India” etc. instead of “Director, Trade”.

¹³ In keeping with this restriction, the SAARC Council of Ministers laid down the guideline in 1997 that “Each case of request for formal contact, cooperation, linkage or consultative status between outside organizations and countries should be submitted to the Standing Committee and the Council of Ministers”. It is possible to detect here the influence of India’s former aversion to multilateralism.

flexibility and autonomy with respect to the recently set up SAARC Development Fund. Issues relating to strengthening the secretariat are discussed in Section 5. This is a matter likely to be taken up by the South Asia Forum of eminent persons just set up by the Thimpu Summit in SAARC's Silver Jubilee Year, to formulate a new vision statement, chart out the future course of SAARC, and improve existing mechanisms.

C. BIMSTEC

18. BIMSTEC is of interest because it is a cross-regional institution consisting of five South Asian countries (SAARC minus Afghanistan, the Maldives, and Pakistan), and 2 ASEAN countries (Myanmar and Sri Lanka). It was established at the initiative of Thailand in furtherance of its Look West policy, which matched the Look East policy being articulated by both Bangladesh and India in the early 1990s, and offered the four South Asian members (other than Sri Lanka, which is an island country) a potential land bridge to southeast Asia, and one which looked all the more attractive in view of the impediments to regionalism in the SAARC area posed by the India-Pakistan relationship

19. BIMSTEC is also a cross between a "supra-structure" and "infra-structure" institution in terms of the parlance developed in ADB 2010. It displays the following characteristics of supra-structure institutions: they are intergovernmental institutions whose decisions are based largely on consensus, most of their agreements are non-binding, their summits often involve heads of state/government and they usually have weak standing secretariats (ADB 2010). However BIMSTEC also partakes of the characteristics of an infra-structure institution in that it is of a much more functional nature than SAARC and focuses almost exclusively on economic matters (it eschews any political or security agenda, apart from counter-terrorism).¹⁴

20. BIMSTEC was established in 1997, initially by Bangladesh, India, Sri Lanka, and Thailand, joined later in the year by Myanmar, as a regional group of countries situated around the Bay of Bengal. Although the organization had to change its name after Bhutan and Nepal joined in 2003, the leaders decided to retain the acronym at the first Summit in Bangkok in 2004.¹⁵

21. BIMSTEC has set economic development squarely at the top of its agenda. The Bangkok Declaration which serves as the charter of the organization states that the organization seeks to "create an enabling environment for rapid economic development through identification and implementation of specific cooperation projects".

22. One of the key areas of cooperation is the BIMSTEC FTA, which provides for liberalization not just of merchandise trade, but also of services and investments. Negotiations on the FTA are being carried out under the Framework Agreement signed in 2004. The final text of an agreement on trade in goods has been agreed at the official level, including agreements on rules of origin, certification procedures, and customs cooperation. Agreements on investments and services are yet to be negotiated.

23. Another key area of cooperation is the development of cross-border infrastructure, since one of the main attractions of BIMSTEC for the four South Asian countries, other than Sri

¹⁴ SAARC is classified as "quasi-supranational" in the same taxonomy (ADB 2010).

¹⁵ The original name was Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation. The Bangkok Declaration, which serves as the charter of the organization, lays down that countries seeking membership should satisfy the conditions of territorial contiguity to, or direct opening into, or primary dependence on, the Bay of Bengal for trade and transportation purposes.

Lanka, is the prospect of it serving as a “land bridge” to Southeast Asia.¹⁶ To this end, BIMSTEC prepared the BIMSTEC Transport Infrastructure and Logistics Study (BTILS) under an ADB technical assistance in 2008.

24. BIMSTEC’s main policy making bodies are the periodic summits of heads of state or government and two sets of ministerial meetings, one consisting of foreign ministers, the other of trade and economic ministers. Only two summits have been held so far, the second one in Delhi in 2008. While the Foreign Ministerial Meeting acts as the prime mover determining overall policy, including recommendations for the summit, the Trade/Economic Ministerial Meeting monitors progress in the trade and investment sectors, including the ongoing negotiations on a BIMSTEC FTA.

25. At the operational level there is a similar division of responsibilities between Senior Officials Meetings (SOM) and a Senior Trade/Economics Official’s Meeting.¹⁷ They receive reports from the Bangkok Working Group (BWG), which consists of representatives of the BIMSTEC countries posted in Bangkok and the Director General of the Thai Department of International Economic Affairs. BWG is chaired by the ambassador to Thailand of the country which holds the chairmanship of BIMSTEC, and thus rotates. The BWG meets every month to consider progress in each of 14 priority sectors of cooperation. Each sector has been allotted to a “lead country” which is responsible for coordinating action in its particular sector, through expert group meetings it convenes from time to time. It then reports to the BWG, which reviews progress based on these reports and forwards them with recommendation to one of the two officials meetings, depending on whether they relate to trade and economic matters, or other matters.

26. The original thirteen sectors and their lead countries were trade and investment (Bangladesh), technology (Sri Lanka), transportation and communications (India), tourism (Thailand), fisheries (Thailand), energy (Myanmar), agriculture (Myanmar), cultural cooperation (Bhutan), environment and disaster management (India), public health (Thailand), people-to-people contact (Thailand), poverty alleviation (Nepal), counter terrorism and transnational crime (India). A fourteenth sector, climate change (Bangladesh) was added recently at the 12th Ministerial Meeting in 2009.

27. On transportation, the BWG has been asked to liaise with ADB on further steps on the BTILS study. BIMSTEC has also set up two regional centers, one on tourism in Bangkok, and another on energy in Delhi. The permanent secretariat is being established at Dhaka, Bangladesh.

28. It will be interesting to see to what extent the members apply the experience gained from the SAARC and ASEAN secretariats. In particular, to see whether BIMSTEC opts for a stronger and more autonomous secretariat than SAARC, with political control and guidance continuing to be exercised by the local ambassadors posted to the capital in which BIMSTEC decides to locate its headquarters (similar to the Committee of Permanent Representatives being set up by ASEAN in Jakarta). Also, to see whether it opts for a more permanent set of directors than in SAARC, at least some of whom have subject-matter background better suited to identifying projects and directing project implementation.

¹⁶ However, as discussed in the Section 3.6, attainment of this objective lies some distance in the future.

¹⁷ The 13th Ministerial Meeting and the 15th SOM are to be held in 2010 in Myanmar.

D. SASEC

29. ADB launched SASEC in 2001 to support the South Asia Growth Quadrilateral set up by the four SAARC members in the eastern part of South Asia (Bangladesh, Bhutan, India, and Nepal) with the blessings of SAARC. SAARC recognizes subregional groups provided they consist of at least four SAARC members. SASEC follows a project-based approach aimed at building confidence among countries by demonstrating tangible results. Participating countries have identified the six priority sectors of (i) energy and power; (ii) the environment; (iii) information and communications technology (ICT); (iv) tourism; (v) transport; and (vi) trade, investment and private sector cooperation. Transport connectivity has emerged as the major sector of emphasis given the landlocked nature of two of the four countries and the northeastern region of India.

30. SASEC's two-tiered structure consists of a Country Advisers Meeting (CAM) consisting of finance ministers, and sector working groups consisting of senior sectoral officials. Four CAM meetings and an informal Country Advisers Conclave have been held. Since it has no secretariat, it is better described as a program than an institution. SASEC has received three technical assistance grants from ADB which have provided a forum for enhancing cooperation among the four countries and have helped identify and prioritize six transport corridors and develop the following subregional projects: the SASEC Information Highway Project and the South Asia Tourism Infrastructure Development Project,¹⁸ which are under implementation, and three Subregional Transport Logistics and Trade Facilitation Projects—for Bangladesh, India, and Nepal—which are in the pipeline (on the latter see also Section 3.5).

31. An institutional issue that has constrained the SASEC program is the absence of foreign ministries in the CAM, which has weakened country ownership and caused difficulties in obtaining endorsement for the processing and implementing of projects, since it is foreign ministries which are responsible for negotiating and finalizing cross-border agreements.¹⁹ Despite this, SASEC has several regional projects to its credit, which are discussed in the next section.

III. THE CONTRIBUTION OF KEY INSTITUTIONS TO RCI SO FAR

32. In discussing the contribution of South Asian RCI institutions the focus will be on the key sectors of trade in goods and services, investment, transport connectivity, and energy sharing. However, tourism, environment, ICT, research cooperation, and private sector cooperation are also briefly considered. It should be emphasized that SAARC's many activities and achievements in the social, cultural, educational, scientific research, and other fields are not covered.

A. Trade

33. Intraregional trade in South Asia is much lower than in most other regions of the world, but it has been creeping up.²⁰ This is partly because of SAPTA,²¹ which became effective in

¹⁸ Sri Lanka is also part of this project.

¹⁹ Bangladesh is reported to have sought a way around this difficulty by forming an RCI coordination committee that brings all the key stakeholders together.

²⁰ It has reached about 6% from about 3.5% in 1993. The comparable shares for ASEAN are 25%, the EU 55%, and the North American Free Trade Agreement (NAFTA) 61%. There is also a large volume of informal trade, estimated a few years ago at up to \$3 billion for India, of which from \$250 million to \$2 billion was between India and Pakistan (Taneja 2006). Informal trade between India and Pakistan is currently estimated at \$6 billion.

²¹ According to Mukherjee 2000, the proportion of preferential imports under SAPTA ranged from 40% (Pakistan) to virtually nothing for Bangladesh and the Maldives. In a more recent paper on India-Pakistan trade, Mukherjee 2008 shows that the share of India's preferential imports from Pakistan increased faster between 1996 and 2005 than its non-preferential imports or imports from the rest of the world.

December 1995, and its successor trade agreement, SAFTA, which took effect in July 2006. Under the first phase of SAFTA, least developed country (LDC) members reduced their maximum tariffs to 30% by 2008, and non-LDC members to 20%. The latter also had to reduce their tariffs for LDC members to 0%–5% by the end of 2008. Thereafter, for the other non-LDC members, they started reducing their tariffs with a view to reaching a level of 5% or less by 2013, while the LDC members were given 8 years to reduce their tariffs, i.e. until 2016, to reach the same level. The Maldives has been given the status of an LDC, making for five LDC and three non-LDC parties. SAFTA also requires the parties to remove non-tariff barriers (NTBs), review sensitive lists at least once every four years, promote investments, and compensate the LDCs for possible revenue losses as they reduce tariffs.

34. There was some pessimism about the prospects of SAFTA when it was launched.²² However, there has been progress in reducing the size of the sensitive lists, especially by non-LDC members, and the reduction of tariffs on items in the positive lists has been on track, so that the five LDC members now enjoy zero tariffs on the majority of tariff lines in their intraregional exports. However, a number of items of export interest to them, especially garments and agricultural products, remain protected in the sensitive lists of the non-LDC members, although these are shrinking.²³ There has also been progress in reducing NTBs.²⁴ Partly as a result of these measures, the exports of two LDCs, Bangladesh and Afghanistan, to India, the largest importing country, more than doubled between 2005, the year before the SAFTA came into effect, and 2008, the last year for which statistics are available.²⁵ Overall, however, India's exports to the region (\$8.4 billion in 2008–09) have grown faster than its imports (\$1.8 billion) and trade deficits with India have widened. This is the case even in Bangladesh, whose exports to India have gone up by 142% over the four years, as compared to India's exports to Bangladesh, which have increased by 48%, because of the huge trade imbalance between the two countries of 1:8 in 2008–09. While a country's overall deficit is more important than deficits with individual countries, the latter are of course politically sensitive, and have been a political issue in Bangladesh, with respect to India in particular.²⁶

²² See for instance Baysan et al. 2006.

²³ For instance, India's sensitive list has been reduced to 480 items out of a total of about 5,500 and should see further reductions in the sixth round of negotiations currently under discussion in the SAARC Secretariat. Tariffs under these items are mostly around 10% and India has been using the promise of further reduction in the length of its sensitive list as leverage in its attempt to persuade the LDCs to reduce tariffs on items in their own sensitive lists, even if they don't reduce their length. It has offered a tariff quota of 8 million garments to Bangladesh, worth \$60–65 million annually, which is not fully utilized. Tariff concessions under SAFTA, memorandums of understanding between standards institutions in the two countries, and an improvement in banking facilities in eastern India, are all contributing to an increase in imports from Bangladesh. ADB and UNCTAD 2008 contain a useful analysis of how sensitive lists could be reduced further.

²⁴ As Jayram Ramesh, the then Indian minister of state for commerce was candid enough to put it in 2008, India has "demonstrated leadership" in imposing NTBs, in very "creative and ingenious ways" (Banerjee and Manoharan 2008). The insistence on testing products in India was one of the most vexatious NTBs practiced by India. India and other SAARC countries have made progress in this respect by accepting certification by accredited laboratories in the exporting country. Agreement has also been reached on establishing a South Asian Regional Standards Organization in Bangladesh to harmonize standards in SAARC.

²⁵ Pakistan's exports to India have also almost doubled, but not because of concessional tariffs under SAFTA.

²⁶ In the case of some of the smaller LDCs with large shares of trade with India in their total trade, such as Nepal, the trade balance with India of course largely determines the overall balance. Bhutan is the only country in South Asia which has a positive balance in goods and services with India because of its electricity exports. For Bangladesh, as Mustafizur Rahman of the Centre for Policy Dialogue, Dhaka, points out, "Of course, imports from India provide Bangladesh access to consumer good, raw materials and inputs such as fabrics for import oriented sectors, at competitive prices. Consumers, producers and importers in Bangladesh benefit from these imports. Indeed, imports from India help Bangladesh sustain a trade surplus with the US that surpasses its bilateral deficit with India" (Rahman 2010). As Jayram Ramesh puts it "we need blockbuster imports from our neighbours", referring to cement as a possibility in this regard (Banerjee and Manoharan 2008).

B. Services

35. In the long run the only way to rectify payment imbalances among the SAARC countries is to increase the ambit of cooperation by including trade in services and energy, and to underpin trade in all three (goods, services, and energy) through much higher investment flows. One of the findings of the ADB-sponsored SAARC Regional Study on Potential for Trade in Services under SAFTA (SAARC 2008) is that the already considerable trade taking place in services among SAARC countries (much of it informal and not captured by the data) is more balanced than their trade in goods, with some of the smaller economies enjoying trade surpluses with India.²⁷ Services already account for more than half the output of all South Asian countries except Afghanistan, and South Asian services trade is growing faster than merchandise trade, reaching a share of 2.5% of the world total in 2005.²⁸

36. An important part of the rationale for multilateral or regional liberalization of trade in services is that by increasing the access of countries to low-cost service sector inputs, it enhances the competitiveness of their real-sector exports. Banking, insurance, accountancy, legal, telecommunications, design, engineering, and transport services are crucial inputs into products that compete on the international market. The SAARC region has already developed a comparative advantage in information technology (IT), Information Technology Enabled Services (ITeS), telecom, health, education, and, to some extent, professional services. A regional arrangement for trade in services could give a boost to outsourcing activities within the region by regional companies that have become global in their operations. It could also serve to attract greater foreign direct investment (FDI), the bulk of which worldwide goes into services. The report describes complementarities in service sector specializations within the region, and identifies several sectors with trade potential. It also discusses existing impediments which need to be removed.

37. The report recommended that SAARC adopt a framework agreement as an adjunct to SAFTA providing for negotiations on deep and far-reaching liberalization, which would go beyond commitments already made in the General Agreement on Trade in Services (GATS) or measures that have already been taken autonomously. Negotiations would be on a positive list basis and adopt the requests-and-offer approach followed by GATS and, indeed, by SAFTA itself. It would provide for special and differential treatment of the LDCs, capacity building to augment supply capabilities to be funded out of the SDF, mutual recognition agreements on qualifications of professionals to facilitate the movement of natural persons, rules of origin, and cooperation in the development of regulatory capacity, collection of statistics, and the taking of common positions in GATS negotiations. The framework agreement was approved as the SAARC Agreement on Trade in Services by the 16th Summit held in Bhutan, which called for early conclusion of negotiations on the specific schedule of commitments under it.

²⁷ Thus, both Bangladesh and Pakistan enjoy a services trade surplus not only with South Asia as a whole, but with India too. In the migrant remittances sector, India is estimated to remit \$1.8 billion to Bangladesh per year but receive only \$ 0.8 billion as workers' remittances from Bangladesh. Similarly, India sends almost 1.1 million tourists to South Asia a year, but receives only 0.8 million (SAARC 2008).

²⁸ Although still well below potential, this is higher than its share of world trade in merchandise goods. The growth of services trade was driven primarily by India, at 67% a year between 2000 and 2005, but Bangladesh, the Maldives, Pakistan, and Sri Lanka also showed robust growth, ranging between 15% and 21%.

C. Investment

38. Along with intraregional trade, intraregional investment is increasing slowly in South Asia and stood at 7% of total FDI in 2005.²⁹ With a view primarily to attracting global investment, countries in the region have taken a number of steps to liberalize the investment environment, such as augmenting the automatic approval route, lowering sectoral investment caps, easing foreign exchange controls, and intensifying investment promotion efforts. According to Aggarwal (2008) Pakistan has the most liberal investment environment, followed by Bangladesh, India and Sri Lanka. Until 2006–2007, Pakistan had attracted more global FDI in relation to its size than India, with FDI constituting 24.1% of total investment in the economy, as against 9.3% for South Asia as a whole.³⁰ During 2002–2006, intraregional investment was particularly important for Nepal (47% of total inflows)³¹ and Sri Lanka (7%). Among regional investors, India had the highest share of number of investments, accounting for 40% of the total number of investments in Sri Lanka during 2002–2006, 27% in Bangladesh, and 6% in Pakistan. Sri Lanka has the highest number of investments in India among regional partners, and has even invested in a special economic zone for garments.

39. Box 1 shows how the India-Sri Lanka Bilateral FTA (ISLBFTA) led to a sharp increase in investments. One of the lessons learned from the ISLBFTA is that to protect the partnership from political opposition, even in the country with the trade surplus (India), it is important that only products with a genuine comparative advantage should be encouraged to prevent trade diversion (rather than creation). The main lessons of the ISLBFTA are, however, that the economic benefits of trade liberalization do and can override political problems provided the latter are not too intractable, and that size disparities do not hinder bilateral free trade when the weaker partner is accorded special and differential treatment. The new Sri Lankan government is reported to be keen on finalizing negotiations on a Comprehensive Economic Partnership Agreement (CEPA) with India.

40. Interestingly, with the exception of the BIMSTEC Framework Agreement of 2004 (the substantive provisions of which are still being negotiated) and the proposed CEPA between India and Sri Lanka, none of the various bilateral trade treaties and regional trade agreements³² into which South Asian countries have entered have investment promotion and protection as a component. There are also relatively few bilateral investment treaties and double taxation avoidance agreements between member countries. The SAARC Agreement on Protection and Promotion of Investments sought to fill this lacuna, the first draft of which was prepared in 1997, but it has yet to see the light of day.³³

²⁹ See Aggarwal 2008, on which this section is largely based. See also ADB 2007, which discusses the following bottlenecks that hinder FDI in South Asia: poor business climate, poor infrastructure, restrictive labor policy and labor unrest, political uncertainties and civil conflicts, weak regulatory systems, and rampant corruption. However, these are factors which hinder growth generally, not just FDI, even less, intraregional FDI. Until 2006, Pakistan ranked highest in South Asia on the Inward FDI Performance Index, whereas India ranked highest on the Inward FDI Potential Index. Interestingly, out of 7 regions, South Asia ranked second, only after the OECD, on the ease of starting business and protecting investors.

³⁰ Pakistan attracted \$4.3 billion in that year, as against India's \$16.9 billion, Bangladesh's \$0.6 billion, and Sri Lanka's \$0.5 billion. In 2007–08, however, total FDI in India shot up to \$25 billion.

³¹ In Nepal, most of the investments went into small and medium enterprises, with many investors individuals rather than corporations. Indian investments in Nepal tended to go into manufacturing, Sri Lankan into services, and Pakistani and Bangladeshi investments represented a diversified range.

³² For a description see Taneja 2006

³³ It is understood that the text of the agreement has been nearly finalized, except for differences on its application to bilateral or multilateral investments already signed by a country prior to this agreement. Another problem may be the reluctance of India to extend MFN treatment in investments to Pakistan, for security reasons.

Box 1. The India-Sri Lanka Bilateral FTA

The India-Sri Lanka Bilateral FTA (ISLBFTA), which became operational in March 2000, eliminated tariffs on 5,112 items of bilateral trade over a period of 8 years, leaving both countries with short negative lists on which trade takes place at most favored nation rates. In keeping with the principle of special and differential treatment for the smaller partner, Sri Lanka enjoys more favorable rules of origin, and a much longer negative list (determined primarily by the desire to minimize loss of customs revenue), with the freedom to reduce its length at its own comfort level.

The agreement has seen Sri Lankan exports grow more rapidly than India's and managed to reduce Sri Lanka's trade imbalance with India from 10.3:1 in 1999 to 4.5:1 in 2007. It has activated dormant complementarities, since the bulk of Sri Lanka's exports to India now consist of items which found no place in the export basket before the agreement. It has also triggered unilateral liberalization measures by both sides in services, unrelated to the original agreement: in 2002 Sri Lanka granted Indians visas on arrival, leading to an increase in tourism from India, and India reciprocated by granting Sri Lankan airlines four additional destinations, making it the largest foreign carrier in India.

Perhaps most importantly, it gave further impetus to Indian investments already taking advantage of Sri Lanka's conducive investment environment as South Asia's earliest liberalizer. A wave of Indian as well as third-country investments sought to take advantage of the new preferential tariffs, to export back to India. While there was considerable distress among domestic producers and manufacturers in some of the sectors affected—such as pepper, hydrogenated oil, and copper, in India, disputes about compliance with rules of origin and complaints by the Sri Lankan side about the persistence of non-tariff barriers in India (such as state sales tax, and the designation of specific ports as entry points for imports) as well as unhappiness with some of the safeguard measures taken by India—the two sides had the political will to forge ahead.

A joint study group submitted its report in 2003 on broadening the FTA into a comprehensive economic partnership agreement (CEPA) which would deepen preferential trade, reduce the negative lists, relax rules of origin, arrive at mutual recognition agreements on product standards and the certification of professionals, liberalize the service sector beyond the coverage of GATS, further liberalize investment, and strengthen the supply side in Sri Lanka through Indian credits. In the service sector, Sri Lanka has requested liberalization in tourism, retail trade, finance, insurance, maritime services, and aviation. India has proposed an even longer list and would like to see greater movement of professionals.

One of the lessons learned is that to protect the partnership from political opposition, even in the country with the trade surplus (India), it is important that only products with a genuine comparative advantage should be encouraged to prevent trade diversion (rather than creation).

The main lessons of the ISLBFTA are, however, that the economic benefits of trade liberalization can and do override political problems provided the latter are not too intractable, and that size disparities do not hinder bilateral free trade when the weaker partner is accorded special and differential treatment. The new Sri Lankan government is reported to be keen on finalizing negotiations on a CEPA. It has the potential to break new ground in South Asia.

Source: Based on Kelegama, Saman and Indra Nath Mukherji. 2006.

41. A more important obstacle to an immediate and large increase in intraregional FDI (than the absence of legal protection of investments) has to do with political factors, or the continuing deficit in trust and confidence among South Asian countries. It is significant that Tata International was willing to make a large investment in Bangladesh despite the absence of an investment protection agreement, but was turned down by the Bangladesh government on what were widely perceived at the time to be at least partly political considerations, as discussed in Box 2.

Box 2. Rectifying Trade Imbalances through Investment

In 2005 India's Tata Group proposed a \$3 billion investment in a set of complementary steel, fertilizer, gas, and coal mining projects in Bangladesh. The investment would have gone a long way in rectifying Bangladesh's adverse balance of trade with India and the rest of the world by substituting imports of steel (running at between 1 and 1.5 million tonnes a year at the time) and of urea (800,000 tonnes a year) with local production, and by exporting steel and any urea surplus to domestic requirements back to India.

A recent study by the Economist Intelligence Unit estimated that at full production the project would have reduced the trade deficit by about \$1 billion, and that with its assistance, Bangladesh's overall current account could have swung into surplus by 2015. Further, the project would have had a strong "signaling" effect on other investors, since it would have been the single largest foreign investment received by Bangladesh so far, apart from being Tata's largest outside India by then. The Bangladesh government was offered the option of a 10% stake in the project.

Land for the 2.4 million tonne steel plant had been identified near Bangladesh's western border, making it easy to carry iron ore from India and ship part of the finished steel back to India. The 500 megawatt (MW) power plant would be located at the coal pit-head in north-western Bangladesh, and the 1 million tonne fertilizer plant in Chittagong, close to gas supplies.

The project did not go through. Since this was a private sector project the reasons will never be known for sure. Nor can it be known what the relative weight of economic and political factors was in the final decision. Tata had over the course of the negotiations doubled its price offer to \$3.10 per unit of gas, and halved the required sovereign guarantee period to 10 years. Other issues reported to have been sorted out were fiscal concessions for the project, an international arbitration clause, and assurances on the required strengthening of infrastructure, such as improving the railway line, augmenting gas pipelines, and dredging the river channels for barge traffic. The project would have consumed 2.14 trillion cubic feet (TCF) over its life, out of a consensus estimate at the time of proven reserves of 14 TCF, a figure widely expected to go up with new exploration.

There is no presumption here that the decision by the Bangladesh government not to approve the project was on balance not the right one. It is merely offered as an example of political considerations in investment approvals and how investments within the region can put trade relationships on a more equal footing, and serving to reduce, in this case, a major irritant in bilateral relations.

Source: Based on interviews with Tata and Bangladeshi officials in Dhaka, 2005

D. Energy

42. There has always been immense potential for energy cooperation in South Asia with two countries, Bhutan and Nepal, endowed with huge resources of hydropower that could be exported to energy-hungry southern neighbors.³⁴ The need to share these surpluses, which are non-depletable, has become all the more compelling with the growing dangers of climate change.³⁵ Increasing the share of hydropower in its energy sources is one of the most important steps India, by far the largest carbon and greenhouse gas emitter in the region,³⁶ could take to reduce its dependence on high carbon-emitting, high ash-content coal, and on firewood, which leads to deforestation, loss of carbon sinks, aggravated erosion, greater siltation, flooding, and lower agricultural productivity.

43. Formal recognition by SAARC of the need for regional cooperation in energy came first in 2004, when the 12th Summit at Islamabad constituted a standing Working Group on Energy to study the concept of an “Energy Ring”. Since then the SAARC Energy Centre was established in Islamabad in 2006 (and has received capacity building assistance from ADB), the Energy Ministers have met three times, the Working Group on Energy six times, and five specialist groups have been constituted to energy trade, electricity, oil and gas, renewable energy, and technology to develop recommendations and action plans in their respective areas. A SAARC Regional Energy Trade Study (SRETS) was brought out by the SAARC Secretariat, supported by ADB funding, in August 2009 (SAARC Secretariat 2009). The 15th Summit, held in Colombo, called for the preparation of draft terms of reference for an Inter-Governmental Framework Agreement on Energy Cooperation to facilitate the phased development of an energy market and energy trade. A SAARC Experts Group meeting is expected to finalize the draft agreement soon.

44. Politics has been no less salient in the energy as in other sectors of potential regional cooperation, but fortunately appears to be waning as a factor. In the past, in the case of Nepal, populist and nationalistic appeals, heightened by domestic party political competition, managed to block the larger, joint, government-to-government India-Nepal water resource projects, even after they had been formally embedded in a treaty, as in the case of the Pancheshwar dam project in the Mahakali treaty.

³⁴These are not just India, Bangladesh, and Pakistan, which are closest, but eventually Afghanistan and Sri Lanka too, through a common grid (see below). Bhutan is currently exporting about 1,500 MW to India (about 85% of its total generation, contributing about 25% of gross domestic product and more than half of total government revenue), which is only 5% of its potential. India stands committed to import 10,000 MW by 2020. Bhutan’s hydropower projects have all been run-of-the-river schemes, mostly financed by India through buy-back arrangements. However, one of the projects is being promoted by an Independent Power Producer (IPP) and two major storage schemes are being planned. Nepal has potential of about 43,000 MW. With current generating capacity of about 750 MW, it has a summer season shortage of about 100 MW, and imports more power from India than it exports. Domestic demand is not expected to exceed 3,500 MW by 2025. India also has huge hydro potential in its northeast (about a third, or 40,000 MW, of its total potential), only some of which is being developed. Although it is much further from India’s main load centers than Nepal or Bhutan, it could be shared with Bangladesh. Pakistan also has undeveloped hydro potential. It has developed only 15% of its total identified potential of 45,000 MW.

³⁵ Bangladesh and Maldives are threatened by sea-level rise. Moreover, Afghanistan, Bangladesh, India, Nepal, and Pakistan are all affected by increasingly erratic rainfall, and in the foothills, by the rising menace of glacial dam formation and outbursts, causing enhanced siltation, ever more damaging flash floods, and loss of agricultural productivity. These and other impacts of climate change are discussed at length in Moinuddin 2010.

³⁶In 2000, India contributed 73.4% of the region’s total greenhouse gas emissions, of which, 40.4 percentage points consisted of carbon dioxide, 17 of methane, and 16 nitrous oxides (chart in Moinuddin 2010). South Asia’ carbon dioxide emissions are slated to rise from 4%–5% of the world today to 13%–15% by 2030 unless low carbon strategies are adopted.

45. Sensing that projects implemented by Independent Power Producers (IPPs) may attract less hostility than government-to-government projects, the interim government formed after the end of the civil war took the pragmatic step of activating the existing 2001 Hydropower Policy to take the build operate own transfer (BOOT) route to building medium-size run-of-the river projects geared to exporting a major part of the energy produced to India.³⁷ While these projects are not immune to the turmoil of domestic politics and opposition from a vocal civil society (as Box 3 illustrates) they appear to stand a better chance of being implemented, and that too with much shorter gestation lags.

46. Several projects have either been awarded or are in an advanced state of being awarded. Most of them are located near India's northern region, which faces the most severe power shortages, especially in the summer months when Nepal's rivers overflow with waters. The first among several prospective transmission links has also been finalized by the two countries for construction. The links will first be used to supplement existing transmission lines to import power from India, and will later be used to export power to India when the new projects come on line.

47. Similarly, Bangladesh and India took a step forward during the visit of the Prime Minister of Bangladesh to India in December 2009, when it was announced that India would supply Bangladesh 250 megawatts (MW) from its grid. The technical details of the interconnection scheme between western Bangladesh (which suffers from both power capacity and energy deficits) and the Indian state of West Bengal have already been finalized and costed.³⁸ Power can be traded through this line in both directions, the potential for which arises from the daily and seasonal diversity of demand in both countries, the difference in weekly and festival holidays, and the 30-minute time difference.

48. Another transmission interconnection under serious consideration is a submarine cable between India and Sri Lanka to address rising energy demand and energy security concerns in Sri Lanka, as well as to export any seasonal surpluses that may arise in future, from Sri Lanka to India.³⁹ Sri Lanka has also signed an MOU with India to set up a coastal thermal power station based on imported coal.

49. Encouragingly, political difficulties did not stand in the way of an offer from Pakistan to sell power, which was temporarily in surplus, to India in 1998 through a 50-kilometer line that would have had to be built. The stumbling block turned out to be the price of the power on offer (about 200 MW).⁴⁰ If such a line were built (and it should be accorded high priority), along with new and strengthened interconnections between India-Nepal, Bangladesh-India and India-Sri Lanka, seven of the SAARC countries would be interconnected (Afghanistan through Pakistan).

³⁷ The 750 MW West Seti Hydropower project in which ADB is an equity partner and for which \$45 million is included in the lending program for 2010, was approved much earlier.

³⁸ See Annex 5 of SAARC Regional Energy Trade Study (2009).

³⁹ Technical details and costing are contained in Annex 6 of SRETS. The design, like that of the Bangladesh-India interconnector, allows for enhancement of capacity from 500 MW to 1,000 MW when required.

⁴⁰ Political and security considerations did not prevent India from also giving serious consideration to joining the Iran-Pakistan-India gas pipeline, although they appear to be a factor in its decision not to join for the time being. Since South Asia is likely to remain in energy-deficit in the medium term, even after optimal development of existing energy resources (including development of renewable options such as wind, solar and nuclear), and is surrounded by energy-rich areas to the west and east, this is one of the inter-regional project SRETS discusses, others being the CASA (Central Asia South Asia) 1,000 power transmission project, the Turkmenistan-Afghanistan-Pakistan-India gas pipeline, and the Myanmar-Bangladesh-India gas pipeline. The last of these is an example of an energy sector project that did fall foul of political differences, over right of way in this case.

Box 3. Nepal Takes the PPP Route to Develop Export Hydropower

The history of Indo-Nepal water resource cooperation is a litany of dashed hopes, shelved projects, unimplemented treaties, and mutual recrimination. The small-neighbor-big-brother syndrome that pervades relations in every sphere invariably arouses suspicion of unequal benefits when the government of India is involved.

In early 2008, after peace returned to Nepal, the new interim government decided to harness Nepal's single most valuable resource, by taking the public private partnership (PPP) route, and offering 30-year build-operate-own-transfer contracts in accordance with Nepal's Hydropower Policy of 2001.

Two memorandums of understanding (MOU) of huge significance were signed between the Nepal government and private Indian developers to build and operate hydropower projects for export of electricity to India. The first of these was with GMR for the 300 MW Upper Karnali project and the second with Satluj Jal Vidyut Nigam (SJVN, a Himachal Pradesh state government joint venture with the Indian central government) for the 400 MW Arun III project. A third project, Budhi Gandaki, for 600 MW, was re-tendered.

Bids were evaluated according to pre-announced criteria, including the share of free power the developer would make available to the Nepali partner, the Nepal Electricity Authority (NEA), for the domestic market, and the share of equity it would offer NEA.

There was considerable interest, with several Indian companies, two Chinese companies, and a Dutch company in the fray. Based on their winning bids, and subsequent negotiations in consultation with a parliamentary committee, GMR would share 12% of the electricity produced as free power and offer 27% as equity to NEA, while Satluj would share 22% as free power, apart from paying 7.5% of the total revenue generated by the project as royalty. In addition, the government would have the right of first refusal to a further 10% of the power produced.

GMR and SJVN are now in the process of forming joint ventures with the NEA, applying for survey licenses, tying up the financing, entering into PPAs with the Indian Power Trading Corporation or other buyers, and preparing DPRs. Construction is expected to take another five years. Based on its investigations so far, SJVN is reported to be considering raising the size of Arun III to 990 MW.

Nepal's rivers can produce 43,000 MW through economically viable projects. At present their highly seasonal waters are largely wasted during the monsoons as they run down to the sea through India, causing floods on the way. Dry season flows are insufficient to irrigate even Nepal's Terai. Meanwhile, Kathmandu undergoes blackouts, the rural areas suffer even more, Nepal imports power from India during the summer months, and a huge power-hungry market sits just across the border waiting to be served.

In the run up to the 2008 elections, when the MOUs were signed, hydropower seemed to enjoy the support of all the major parties, including the Maoists, whose manifesto talked of adding 10,000 MW of capacity in mission mode over the next ten years, through both short-term and long-term projects, and both domestic and external financing.

However, a number of civil society groups remained opposed, and one of them challenged the MOUs in the courts on the grounds that under the interim constitution, agreements entailing the export of natural resources require the approval of a two-thirds majority of parliament. Fortunately, the courts refused to grant a stay, on the grounds that while water is a natural resource, electricity produced from it is not. (Hydropower is, after all, non-depletable, unlike oil or minerals).

Another objection, raised (unsuccessfully) by the Kiratee National Liberation Front, a *Madesi* group, to stop joint survey investigations for the Sapta Kosi High Dam, a bilateral, multipurpose storage project in eastern Nepal, was that it was not known what federal arrangements the new constitution would propose for the sharing of benefits of hydropower projects with the localities.

A third concern was that all projects should be selected out of a carefully investigated long-term master plan for the river basin concerned so that they do not pre-empt the use of the same site for possible future storage reservoirs which provide irrigation, flood control, and navigation benefits in addition to power. However, this does not seem to be an issue with the present set of projects, which were run-of-river schemes entailing no displacement and resettlement, a fourth possible concern.

Dams and storage reservoirs decrease excessive monsoon flows, alleviating floods, while increasing flows in the dry season, rendering the water much more valuable for irrigation. A few Nepali nongovernment organizations argue that these regulated flows are a valuable joint product of hydropower projects, which India should be willing to pay for, just as it is willing to pay for hydropower.

This fifth issue has come up in discussions of the huge “high dam” projects on the four major river basins that have been under investigation for decades now. It has even arisen in the case of storage projects designed primarily for hydropower production, since stored waters are drawn down for electricity production during the winter and summer months, as in the 750 MW West Seti project being promoted by the Australian Snowy Mountain group with Indian, ADB, and Chinese investment.

The promoters argue that they have no way of charging for downstream irrigation and flood control benefits, which lie within the purview of irrigation departments in the Indian States of Uttar Pradesh and Bihar. Irrigation water is a notoriously under-priced resource in India as it is elsewhere, including Nepal. This is an area where the governments may have to come in eventually, but should not affect the current crop of private run-of-the-river projects.

Source: Based on discussions with the Nepal government and Indian officials in Kathmandu, 2008.

50. For the interconnections to operate as a single integrated grid with open access to transmission infrastructure to allow trade in any surpluses that a country may have over time of day or seasons would require an intergovernmental agreement, preceded by studies to identify the optimal interconnection points, the likely amount of exchanges, the configuration of nodal and regional load dispatch centers, and transmission system requirements, which would need to be established in a phased manner. As SRETS points out, negotiations under a proposed framework agreement would have to lead to an energy trade and cooperation agreement which would have to promote and protect investments in subregional energy projects, develop harmonized technical and commercial codes and regulatory standards, and create and protect access for cross-border energy grids and pipelines, among other matters. Until then, energy exchanges could proceed in accordance with bilateral agreements, progressing to short-term trading on a multilateral basis, gradually moving on to a spot market in the last phase.⁴¹

51. Apart from energy trading, there is scope for joint projects in generation and transmission, especially the larger ones designed to supply power to more than one country, with equity participation from all or some of them.⁴²

⁴¹ The 16th (Thimpu) Summit noted India’s proposal for preparing a roadmap for a SAARC Market for Electricity (SAME).

⁴² To the question from a conference participant from Bangladesh: “is New Delhi ready to consider exporting energy for example to the northeast of Bangladesh” Jairam Ramesh, the former minister for commerce, referring to a proposed 750 MW gas-based project in Tripura in India’s northeast said “it makes good sense for India to build this as a regional project of India, Bangladesh, and somebody like the ADB ...I don’t think you will find many of these projects in the northeast making economic sense unless you bring in Bangladesh.”(Banerjee and Manoharan 2008). The 4,000 MW Manas and other storage projects in Bhutan and Nepal are other candidates for joint projects.

52. Lastly, there is scope and great need for cooperation in sharing knowledge and experience on renewable energy sources with which South Asia is well endowed, promoting energy efficiency and conservation, building a comprehensive and reliable data base, and capacity building in all these areas.⁴³ The SAARC Energy Centre and the United States Agency for International Development's South Asia Regional Initiative (SARI/E) are playing a useful role in some of these areas.⁴⁴

E. Connectivity

53. The high costs South Asia incurs by not being better connected are well recognized and will not be discussed here.⁴⁵ But formal recognition of the importance of connectivity was articulated by SAARC at the highest level only in 2004, when leaders stressed the need to intensify cooperation in “strengthening transport, transit and communication links across the region” at the 12th Summit in Islamabad. Thereafter, an intergovernmental group at the secretaries level was set up to review and coordinate activities related to SAARC transport cooperation, as well as review studies on identification and prioritization of regional projects, and report to the SAARC Transport Ministers Meeting.

54. A major study undertaken (with support from an ADB TA) was the SAARC Regional Multimodal Transport Study (SRMTS) which submitted its report in 2006, identifying priority road, rail, inland waterway, maritime and air corridors. (SAARC 2006). The 14th Summit in New Delhi called for its extension to Afghanistan as well, and for “an early implementation of its recommendations in a phased manner”, a recommendation repeated by the 15th Colombo Summit.⁴⁶ The study forms an important framework for prioritizing and implementing cross-border projects. However, the model cross-border transport and transit agreements on both motor vehicles and railways—which were developed with ADB support in pursuance of one of the recommendations of the SRMTS, and submitted for consideration in March 2008—have yet to emerge from the SAARC's complex consensus-based process of consultations.

55. Nor is SAARC, for all its declarations of good intent, in a position to implement the corridors identified in the SRMTS, except through bilateral cooperation by the pairs of countries the corridors pass through. Fortunately a major step forward has been taken at the political level with the agreements announced in the communiqué issued after the visit of the Bangladeshi Prime Minister to India in January 2010. Box 4 describes how the agreements move several corridors in the eastern part of South Asia forward to becoming a reality. A sense of the radical departure they represent from the position that obtained a few years ago is conveyed by Box 5, which also conveys a sense of what is possible through transport cooperation through the example of a road corridor in the Greater Mekong Subregion (GMS) region.

56. It should also be noted that, as in other sectors, the lack of progress in cross-border transport connectivity is not holding up what the ADB calls “national transport projects with regional implications” undertaken either by the countries themselves, or by the ADB as part of its Regional Cooperation Strategy. A High Level Forum of country representatives facilitated by the ADB in Manila in April 2009, and the country consultations which followed, agreed that

⁴³ The 16th Summit has just called for South Asia to become a “world leader in low-carbon technologies and renewable energies” and agreed that the SAARC Secretariat would prepare an Action Plan on Energy Conservation.

⁴⁴ SRETS also proposes taking advantage of economies of scale for the benefit of the smaller SAARC countries by undertaking SAARC projects to set up a regional refinery, a regional liquefied natural gas terminal, and a regional power plant. However the cost-effectiveness of these proposals would have to be examined carefully.

⁴⁵ For example, see the literature reviewed in Srinivasan (2010).

⁴⁶ The just concluded 16th Summit declared 2010–2020 the “Decade of intra-regional connectivity in SAAARC”.

projects and activities should focus on transport and trade facilitation as a priority area (along with energy, trade and investment, tourism, and environment and climate change). Indeed, of the 15 projects in the Regional Cooperation Operations and Business Plan for 2010–12 (ADB 2009), eight are in the transport sector (Table 1). Three of these are multi-country regional projects (the Subregional Transport Logistics and Trade Facilitation Project to be implemented in 2010 in Bangladesh and Nepal, and in 2011 in India). Box 6 describes the package of lending and non-lending activities entailed in these projects.

Box 4. Improving Political Relations Lead to Implementation of Priority Corridors Identified in the SRMTS

Bangladesh and India took a major step forward on connectivity between the two countries during the Bangladeshi Prime Minister's visit to India in January 2009. First, it was agreed that Bangladesh would allow use of Mongla and Chittagong sea ports for movement of goods to and from India through road and rail. The use of Chittagong, in particular, will give much shorter access to the Indian northeastern states for goods destined to and from other parts of India and to third countries. While the benefits to India are obvious, Indian traffic will improve capacity utilization and earn revenue for the new one million tonne mooring container terminal in Chittagong.

Second, Bangladesh conveyed its intention to give Nepal and Bhutan access to Mongla and Chittagong ports. This will give them an alternative to using Indian ports should this turn out to be cheaper. Giving them this option was the basis for inclusion of SAAARC Highway Corridor 4 (Kathmandu-Kakarbita-Banglabandhu-Mongla/Chittagong) and SHC 8 (Thimpu-Phuentsholing-Jaigon-Burimari-Mongla/Chittagong) in the list of 10 road corridors selected by SRMTS.

On railways, it was decided to build the Akhaura-Agartala "missing link" on the eastern border of Bangladesh with India, to be financed by a grant from India, thereby adding a second crossing on the eastern border, and enabling shorter rail access to Chittagong port. There are already three rail crossings on the western border. One of these, the Rohanpur-Singabad broad gauge link would be available for transit to Nepal. This is SAARC Railway Corridor 4. In addition, India would extend a line of credit of \$1 billion for much needed railway infrastructure improvements as well as supply of rolling stock, including broad gauge locomotives.

India agreed to provide nine dredgers for deepening the drafts and improving waterways for riverine traffic, which is the cheapest mode of transport between the two countries, and can even carry containers. The SRMTS identified two inland water corridors on these waterways connecting Bangladesh and India. The two prime ministers agreed to declare Ashuganj in Bangladesh and Silghat in India as additional ports of call and to amend the Inland Water Transport and Trade Protocol accordingly.

Dr. Rahmatullah, a transport expert with the Centre for Policy Development, argues that Bangladesh should become a major exporter of transport services and reclaim the role that Chittagong played in undivided India as the transport hub of the eastern region. All rail traffic should be containerized and, because Indian locomotives and wagons are too heavy for Bangladesh's lines, Bangladesh Railways flat cars should be allowed to pick up containers in Kolkata and carry them to any point in Bangladesh or the Indian northeast. This is likewise true for high-value perishable goods, which should be containerized and transported across Bangladesh in Bangladeshi trucks, which he points out are lighter than Indian trucks and more suited to local road conditions.

An additional reason for giving Bangladesh at least a temporary monopoly over transit trade is the need to rectify the overwhelming trade imbalance. India should also give Bangladesh road transit rights on the Sylhet-Silchar-Moreh-Tamu route, the shortest to northern Myanmar and the PRC. "Bangladesh needs to change its perspective on issues of transport connectivity" says Dr. Rahmatullah. Instead of viewing these and other proposals as "gestures of unilateral benevolence", both sides should seize the opportunities provided to improve connectivity with neighbors and widen economic opportunities in the region.

Source: Based on Communiqué dated 12 January 2010 issued on occasion of the Bangladesh Prime Ministers' visit to India, SRMTS, and participation in meetings of the Kunming Initiative

Box 5. Economics versus Politics in Charge: The East West Economic Corridor in the Greater Mekong Subregion and the Asian Highway in eastern South Asia

This is a tale of two roads. The first is being rapidly upgraded to connect the South China Sea with the Indian Ocean, a distance of about 1,500 kilometers (km). It runs from Da Nang port in Viet Nam, through landlocked Laos, to Thailand, and then on to the port of Mawlamyine, near Yangon, in Myanmar. ADB, which is partly financing it, calls it the East West Economic Corridor (EWEC), to distinguish it from four other similar corridors being developed to connect the six countries participating in the Greater Mekong Subregion (GMS) Economic Cooperation Program. The second road is the section of the Asian Highway passing through India to Myanmar and beyond, through Bangladesh. That road has fallen foul of regional non-cooperation.

Important parts of the infrastructure of the EWEC are already in place. Da Nang port, at the eastern end, has a new breakwater, container berth, and handling equipment, with plenty of excess capacity to absorb the expected increase in freight as the EWEC is completed. A few kilometers out of Da Nang, the highway passes through a new 6 km tunnel financed by Japan, which saves trucks winding up and down 22 km of a steep coastal mountain-side. Tourists benefit from reduced driving time to the old imperial city of Hue where new hotels are coming up to feed Viet Nam's ongoing tourism boom. Continuing west, through what was the demilitarized zone between the North and South Viet Nam, itself a major tourist attraction, a special economic zone at the Lao Bao border crossing with the Lao People's Democratic Republic (Lao PDR) hums with activity.

A single-stop, single-window customs clearing point jointly operated by the two countries has reduced clearance time for trucks and buses to 20 minutes. Ten other border crossings between the six GMS countries are expected to be operationalized soon under a Cross-Border Transport Agreement which covers in one document all the relevant aspects of cross-border facilitation, including visas, mutual recognition of driving licenses, vehicle permits, and so on. A short distance further along the road in to the Lao PDR, an Australian gold and copper mine has gone into production on schedule, assisted greatly by ongoing improvements in infrastructure. With the new bridge over the Mekong at the Lao-Thailand border near Savannakhet in the Lao PDR, this and other enterprises now have access also to Bangkok port, apart from an upgraded airport in Savannakhet. From being landlocked Lao PDR is rapidly becoming land-linked. It grants visas on arrival at six land border points. Thailand and Cambodia have introduced a common visa, and other countries are expected to join.

It is hard to believe that Thailand was on the opposite side in the Viet Nam war, Viet Nam invaded Cambodia in 1975, Viet Nam and the PRC fought in 1979 and Thailand had a border skirmish with Lao PDR as recently as 1988. Regional cooperation in the GMS has come a long way since.

Cut to the Asian Highway, a network of roads connecting the capitals, main industrial centers, major ports, and tourist attractions of the countries lying between Tokyo in the east and Bulgaria in the west. Under discussion since the late 1950s, an intergovernmental agreement sponsored by the UN Economic and Social Commission for Asia and the Pacific (ESCAP) was opened for signatures in 2004 and went into effect in 2005, with 32 members identifying roads they would develop in a coordinated manner according to minimum design standards. To minimize costs it was agreed that the underlying principle would be to include only major national roads and make the maximum use of existing roads. Thus the roads India selected for the Asian Highway take the shortest route across India after exiting Nepal before entering Bangladesh from the west at Benapol near Kolkata and exiting at Dawki near Sylhet. However, the Asian Highway then takes a rather circuitous route through India's northeast before exiting India at the Moreh-Tamu border with Myanmar. From here it connects with Mandalay, and then runs down to Yangon, from where it connects with the EWEC.

Bangladesh was unhappy with the alignment of the Asian Highway through India's northeast and did not sign on to the agreement in 2004. It argued that the shortest route for the Asian Highway from Dhaka to Yangon and beyond was down through Chittagong and Cox's Bazaar and on to its border with Myanmar at Teknaf, to connect with minor roads in southwestern Myanmar across a boundary river.

But it would take many years before Myanmar would be in a position to upgrade these roads to the requisite design standards, and it clearly preferred the existing alignment. So did the PRC, since Mandalay is where the Asian Highway connects up with the road to Kunming in Yunnan Province. Neither country was willing to support Bangladesh, which was left with the option of either staying out of the agreement, or signing on and attempting to secure the agreement of other members to change the alignment later, when traffic in south-western Myanmar (both domestic and cross-border) had improved enough to make upgrading this route viable. In the event, it chose the former. Its real concern was that the existing alignment could one day strengthen India's case for transit to the northeast. It argues that "we cannot have the road going from India to India". Bangladesh does have a case for cutting out the loop through India's northeast and seeking a shorter alignment connecting Sylhet on the eastern border with India, to the Myanmar border directly, and thereby saving 400 kilometers. India should have no objection to agreeing, although it would have to upgrade that stretch, something it is planning to do anyway. Bangladesh joined the agreement in 2009.

The EWEC was not planned (let alone developed) overnight. Years of studies and meetings between officials were necessary, which the ADB was in a position to finance. However, the crucial ingredients were trust and the political will, based on a recognition of common benefits. Replicating these is the challenge before South Asia

Based on field visit to EWEC, discussions in ESCAP, interview with the Bangladeshi minister of transport, and participation in meetings of the Kunming Initiative.

Box 6. A Multi-Faceted Agenda for Transport Logistics and Trade Facilitation Projects

With the progressive reduction in tariffs, other transactions costs, raising constraints to intraregional trade, are becoming increasingly important. These include a set of factors amenable to ADB lending assistance such as (i) the lack or high cost of connectivity because of the poor state not just of cross-border roads and railway lines, but of road and networks within countries essential for carrying cross-border goods to and from borders once they have entered a country; (ii) the physical inadequacy of trade-related infrastructure at land border points such as customs stations, parking and transshipment facilities, access roads, warehouses, banking facilities, communications services, x-ray scanners, and computerization; and (iii) the lack of inland container ports and services.

However, as important may be a set of policy related constraints which are not amenable to lending assistance but may be amenable to policy dialogue such as (iv) the lack of transit agreements; (v) the lack motor vehicle agreements necessitating costly transshipment at borders and often entailing discriminatory practices such as the protection of local trucking; (vi) non-tariff barrier such as overly restrictive standards for products and food safety and certification procedures; (vii) the need for harmonization of customs classifications, and so on.

A third set of constraints may be the outcome not so much of conscious policy decisions, or the failure to agree on them by regional countries, but on a set of impediments that are the unintended outcome of failures of governance, institutional arrangements, and capacity such as (viii) outmoded customs clearance procedures and inadequate staff capacity or strength at borders; (ix) a lack of coordination among the multiplicity of agencies represented there; and (x) corruption and so on. This last category may be amenable to what is referred to as trade facilitation assistance which is primarily of a non-lending nature.

The removal of constraints belonging to the second and third categories is an essential condition for the success of costly investments under the first category (often referred to as the need for "synergy") and, apart from packaging TA with loan projects, there would appear to be a case for being more aggressive in requiring substantial progress by countries in removing these constraints as a prior condition for loan assistance. The importance of country ownership is essential. Also, the particular constraints at each border that are binding will vary, and should be identified for trade between each pair of countries separately, for particular borders and corridors, as the SRMTS has made a good beginning in doing.

57. The other 11 are national projects with regional implications. Examples are the Padma Multipurpose Bridge Project, the Transport Corridors Project, and the Railway Sector Investment Programs, all in Bangladesh, the Road Network Project II in Bhutan, and the North–South Fast Track Corridor in Nepal. The regional projects were identified under SASEC, which conducted detailed analysis of six corridors through the ADB-supported Subregional Corridor Operational Efficiency Study in 2004.⁵¹

Table 1. Indicative Assistance Pipeline for Lending Programs, South Asia (2010–2012)

Sector Project/Program	Countries Involved	Targeting Classification	Thematic Priority	Responsible Division	Year of Project Preparatory Assistance	Cost (\$ million)						
						Total	OCR	ADB ADF ^a	Total	Govt ^b	Co-financing	
A. 2010												
Energy												
1. West Seti Hydropower Project ^{a,d}	NEP	GI	GRO/PSD	SAEN	2007	45.0	-	45.0	45.0	-	-	
Transport and Communications												
1. Padma Multipurpose Bridge ^c	BAN	GI	GRO/RCI	SATC	2005	TBD	250.0	50.0	300.0	TBD	TBD	
2. Transport Corridors Project ^c	BAN	GI	GRO/RCI	SATC	2006	TBD	100.0	-	100.0	TBD	TBD	
3. Railway Sector Investment Program ^c	BAN	GI	GRO/RCI	SATC	2007	TBD	150.0	-	150.0	TBD	TBD	
Multisector												
1. Subregional Transport Logistics and Trade Facilitation Project (BAN) ^c	BAN	GI	GRO/RCI	SATC	2007	TBD	-	18.0	18.0	TBD	TBD	
2. Subregional Transport Logistics and Trade Facilitation Project (NEP) ^c	NEP	GI	GRO/RCI	SATC	2007	TBD	-	33.0	33.0	TBD	TBD	
Total 2010						TBD	500.0	146.0	646.0	TBD	TBD	
B. 2011												
Transport and Communications												
1. Priority Road ^c	BAN	GI	GRO/RCI	SATC	2009	TBD	70.0	35.0	105.0	TBD	TBD	
2. Road Connectivity Project ^c	NEP	GI	GRO/RCI	SATC	2009	48.0	-	40.0	40.0	8.0	-	

Source: Table A1.1, Regional Cooperation Operations Business Plan, South Asia 2010–2012, ADB

58. As the SRMTS observes, trucking has become the dominant mode of transport in the mainland countries (carrying 65%-70% of the movement between them) because of the relatively extensive and good condition of the road network in South Asia. It estimates that less than 5% of the identified road corridors need physical improvement and another 5%, mostly near the border areas, need widening to 2 lanes (another form of the “last mile problem”).

59. The main constraints in the road sector are non-physical barriers, and especially the lack of a bilateral transport agreement to facilitate uninterrupted movement of goods and vehicles across the border between Bangladesh and India as well as between India and Pakistan,⁵² which, apart from necessitating costly transshipment, causes congestion, damage, pilferage, and corruption. Other non-physical barriers are long and complicated customs procedures, lack of transparency in inspection, and different working hours and weekly holidays. But physical, trade-related infrastructure is also inadequate, including parking, warehousing, immigration and customs offices, baggage scanning equipment, EDI and so on.

⁵¹ Cooperation in the transport sector is led by the SASEC Transport Working Group. The regional projects have been delayed because SASEC face challenges in identifying, developing, and implementing them given the multitude of subsectors and government agencies involved in the decision-making process.

⁵² Bhutan, India, and Nepal do have agreements to allow entry to each other's vehicles, although in practice only Indian vehicles take advantage of them because of the cost and difficulties of complying with the regulations and the fact that India generates most of the outbound traffic (the BTILS, ADB 208)

60. Rail transport is affected by the fact that the extensive railway systems of Bangladesh, India, and Pakistan, have been developed for the last 60 years with little attention to cross-border issues of technical compatibility of equipment, standards and design. Whereas over 70% of the track is broad gauge in India and Pakistan, in Bangladesh this share is less than 25%.⁵³ There is also a lack of standardization between braking systems, signaling equipment, rolling stock, and so on, which constrains through-movement of rolling stock across borders. Capacity constraints are also more important than with roads, including the strength of bridges, and will require extensive investments to remove. Once these investments are made, railways could recapture some of their share of traffic lost to roads since rail transportation is cheaper for long distance bulk loads. However, for this to happen, many of the same non-physical barriers that affect roads will have to be removed, such as duplication of customs checks, limited working hours, and the lack of bilateral or multilateral railway agreements for direct intraregional movement.⁵⁴

61. Inland waterway transport is the only transit mode for India through Bangladesh for serving the requirements of the Northeast Indian States. It also has great potential to provide cost effective transport between Bangladesh and India, but is underutilized for various reasons, the most important being again non-physical—the lack of a long-term protocol governing the movement of vessels, which is currently renewed on a short-term basis considered insufficient for transporters to book cargoes and vessels.

62. The SRMTS makes an extremely useful contribution by not only prioritizing 10 regional road corridors, 5 regional rail corridors, 2 inland regional waterway corridors (apart from 10 maritime and 16 aviation gateways that are used more for extra-regional freight and passenger traffic), but also identifying the crucial physical and non-physical barriers for each corridor separately and suggesting specific measures to remove them.

63. The basis of prioritization is not just the volume of existing and future traffic, but the potential to provide direct connectivity by enabling movement across the region, giving land-locked Nepal and Bhutan a choice of ports to access in either Bangladesh or India, potential to provide short cut routes with major transport cost savings, and revitalizing historical links. Finally, for each corridor the report identifies short-term actions, many of them non-physical, that could be taken immediately to bring about visible improvement to the corridor, as well as needed longer-term actions, such as widening and strengthening of bridges, gauge conversion, and doubling of lines.

64. The BIMSTEC Transport Infrastructure and Logistics Study, which ADB completed in 2008, does not identify specific transport corridors. But it does recommend the formation of an inter-governmental Road Development Expert Group to formulate a coordinated time bound program to upgrade “all key international roads on BIMSTEC corridors” to at least Asian Highway Class III standard, upgrade border link roads, and make good missing links with Myanmar. BIMSTEC should also encourage member states to examine incentives for fleet modernization, and support the development of road transport agreements permitting bilateral and through transport movements.

65. On rail transport, the report recommends that BIMSTEC promote discussion on the development of an integrated railway strategy minimizing gauge changes. It should support feasibility studies being undertaken by Indian Railways to examine the development of rail links to

⁵³ However the meter gauge network in Bangladesh, mostly to the east of Dhaka, allowing broad gauge movement almost as far as Dhaka.

⁵⁴ Despite these constraints sealed wagons are allowed to travel some distance inside borders, subject to restrictions, unlike motor vehicles.

Bhutan and new links to Nepal, support proposals to enhance the capacity of Bangladesh Railways, promote longer-term initiatives to develop missing links between Myanmar and Bangladesh, India and Thailand, and develop regular container services in the eastern part of South Asia.

66. On trade facilitation it recommends that BIMSTEC should encourage all members to become signatories of the World Customs Organization Revised Kyoto Convention that is a benchmark for customs modernization, require all members to have fully automated customs clearance systems, to encourage the development of DTI capability, conduct audits of infrastructure at all border crossings, preferably in “pairs” of borders. On implementation, the report proposed a transport ministerial meeting, a sectoral committee on transport, and expert groups on subsectors such as road, railways, transport facilitation etc. to coordinate, monitor and review progress in projects to be implemented.

1. A BIMSTEC “land-bridge”?

67. There has been some interest in BIMSTEC acting as a “land-bridge” between South and East Asia by supporting road and rail projects linking Bangladesh, India, Myanmar, and Thailand. Proposed alignments for the corridors already exist in the Asian Highway and Asian Railway networks, although BIMSTEC could modify these. However, long stretches of the road corridor would require rehabilitation and upgrading to Asian Highway standards in all four countries so as to be able to carry the heavier articulated vehicles required for long-distance traffic. Given the current absence of overland trade, all four countries are naturally more focused on developing internal connectivity, or on roads leading to ports to carry their trade by sea, which is currently much cheaper.

68. Myanmar is additionally handicapped by a lack of international assistance; India and Thailand are each helping it bilaterally to upgrade roads leading inland from their respective borders, but progress is slow. The terrain is especially difficult between Myanmar and Thailand, with mountain ranges and many rivers. Rail transport could possibly compete with the low-cost maritime mode given its ability to carry low-value cargo in bulk. But the development of a rail corridor appears to be even more problematic given missing links on Myanmar’s western and eastern borders, with the same problem of mountainous terrain on the eastern side, which would render the line uneconomic in all but the very long run. Gauge changes necessitating transshipment would also create problems.

69. While long distance road or rail transport between India and Thailand is unlikely to be competitive with the sea route for the foreseeable future, it could still be attractive for shorter journeys between Bangladesh and India’s northeastern states and Thailand, and for expanding bilateral trade with Myanmar. As BILTS points out, intermodal transport as a method of attracting through-traffic could also be developed if the road links between the railheads could be improved. It recommends in effect that while the concept of the “land-bridge” be adopted as a long-term goal, the countries concerned should work towards it in a phased manner, bilaterally if need be. Discussions should also be held with the PRC, since road traffic coming down from the southwest PRC destined for India or Bangladesh could join the corridor in Mandalay, and greatly strengthen the economics of connectivity west of Myanmar.

F. Other Sectors

1. Tourism

70. Given the contiguity and proximity of several of the world's major sites connected with the life of the Buddha in eastern South Asia, tourism suggested itself as an important area for cooperation in SASEC, which developed a sector roadmap in the shape of a Tourist Development Plan suggesting Buddhist circuits and ecotourism as the focus for cooperation. In line with the plan, ADB is now processing a subregional investment project, the South Asia Tourism Infrastructure Development Project for Bangladesh, India, and Nepal to improve connectivity and tourism-related infrastructure in key destinations along the identified circuits. Clearly, coordinated development could make it easier for tourists to visit several sites along the circuits, allowing countries to piggy back on each other. There is also scope for joint marketing, but apparently this has not been successful so far. The project will seek to involve local communities, and will include a training component, which could have externalities for the sector as a whole in each country. While the project promises to increase international visitor arrivals from Buddhist countries in particular, it is unlikely to attract as many intra-SASEC tourists, given restrictions placed on visas for each other's nationals.⁵⁵

2. Environment and Climate Change

71. ADB activities in this area have consisted primarily of knowledge-based cooperation including RETAs on establishing a regional air quality monitoring program (through SASEC), regional cooperation in the management of hazardous wastes, and support to a study on the regional economics of climate change.

72. In view of the increasing scarcity of water for agriculture and domestic use in South Asia generally, due to population growth, the need to ensure food security, and urbanization, and the increasing vulnerability of downstream countries—such as deltaic Bangladesh to flooding caused by deforestation and the increasing variability of rainfall caused by climate change, as well as loss of water quality caused by upstream pollution—a regional approach to the management of water resources in the major South Asian river basins is an important necessity. Being a regional public good, this is covered at some length in the sister paper by Moinuddin (2010) and will not be dealt with here, except to say it is an area which donors have been reluctant to enter into because of the sensitivities involved. However, upper and lower riparian countries have shown themselves capable of arriving at bilateral agreements on the more limited question of the sharing of river waters through two major treaties, the Indus Waters Treaty of 1960 between India and Pakistan and the Ganges Waters Treaty between Bangladesh and India.⁵⁶ Similar arrangements are called for between Afghanistan and Pakistan on the sharing of the waters of the Kabul River, a tributary of the Indus, and the large number of rivers other than the Ganges that flow into Bangladesh from India.

73. Another environmental issue on which cooperative action is called for is the fragile state of biodiversity in South Asia, especially in India and Sri Lanka, where a large number of species of both fauna and flora are critically endangered.

⁵⁵ To this extent, one of the benefits often mentioned for tourism, "people-to-people contact", will be attenuated.

⁵⁶ The communiqué issued pursuant to the visit of the Bangladeshi Prime Minister to India in January 2010 urges the two countries to conclude, expeditiously, the ongoing discussions on the sharing of the waters of the River Teesta in Sikkim State, as well as initiate discussions on seven other rivers. Both the Indus and Ganges treaties have survived periods of troubled relations, and in the case of the former, even war between the countries concerned. The Indus treaty requires India to allow the waters of the three western tributaries to flow into Pakistan, although India may construct run-of-the-river schemes on them for hydroelectricity generation subject to certain design restrictions. It provides institutional mechanisms such as the Indus Commission and arbitration to settle disputes.

3. Information and Community Technology

74. SASEC's Information Highway Project aims at connecting the four SASEC countries with fiber-optic and data interchange capacity, expanding broadband access, and building capacity in e-development, thereby bridging the rural-urban divide in ICT. The project stems from the ICT Development Masterplan, a source of further potential ICT projects in the region.

4. Research Cooperation

75. Recognizing the important role of research institutions in creating an awareness of the benefits of RCI, and in strengthening public opinion in support of it through the dissemination of research findings, advocacy in the media, and interaction in conferences with policy makers, the ADB has conducted two TAs so far through two regional networks of research institutions and think tanks, seeking to enhance the capacity of member institutions to generate policy recommendations on key RCI issues through studies and workshops.⁵⁸

5. Private Sector

76. Private sector cooperation cuts across most of the other sectors, especially in trade in goods and services and in investment. The SAARC Chamber of Commerce and Industry (referred to earlier) has played a useful role in bringing representatives of the private sector together in advocating greater RCI, and in ventilating common issues such as implementation of SAFTA and the need to liberalize the business visa regime.⁵⁹ The Dagachhu hydro plant is being set up in Bhutan through a public private partnership (PPP) with the Tata Power Company of India, and we have noted the IPPs being set up in Nepal with Indian companies. ADB has been supporting private sector cooperation and investment also in tourism (through, for example, the annual South Asia Sustainable Tourism Forum), and in ICT (in the SASEC Information Highway Project).

IV. INTERNAL AND EXTERNAL FACTORS SUPPORTING AND CONSTRAINING FURTHER RCI

77. It is clear from the foregoing discussion that the most important of the constraining factors are political and security-related and are internal to the region. Unlike in ASEAN, the initial impetus for RCI in South Asia did not come from a perceived common external security threat. On the contrary, the perceived threat was, if anything, internal—for most of the smaller countries an unstated reason for joining SAARC was to seek a counterweight to potential dominance by India. While the importance of this motivation appears to be waning, India and Pakistan, the two largest countries in the region, both perceive the most important threat to come from the other. Moreover, many of the countries of the region have harbored or continue to harbor groups that are, or are perceived to be, inimical to the security of their neighbors. As the Indian foreign minister said recently, the region has become "captive to the security

⁵⁸ This approach is in keeping with the recommendation of the Eminent Persons Group that ADB should aim at providing a platform for knowledge sharing rather than seeking to be a primary source of knowledge itself. The two participating research institution networks are South Asia Centre for Policy Studies, presently headquartered in Kathmandu, and the South Asia Network of Economic Research Institutes.

⁵⁹ The SAARC Visa Exemption Scheme is limited to only 100 identified businessmen from each country, and permits Indian and Pakistani businessmen to visit only three cities. The SAARC Chamber of Commerce and Industry advocates that this restriction be removed and the number of visas under the scheme be increased to 300, with the grant of an additional 500 five-year multiple-entry visas a year.

situation”.⁶⁰ These political differences and real or perceived security threats have an effect on cooperation in the various key sectors as summarized in the table below.

Table 2. Examples of Possible Political and Security Impacts on Key RCI Sectors

Sector	Impact of political differences.	Impact of perception of security threats
Trade	Restriction of trade to a positive list rather than most favored nation basis.	Limits number of cross- border routes and crossings and leads to tighter security controls at borders, both of which raise transactions costs. Denial of visas even to businessmen.
Energy	Resources such as hydropower viewed as “natural” resources, not to be “exported”. Refusal to grant right of way to gas pipelines and electricity lines. Lack of political confidence that deliveries will not be interrupted in a crisis kills projects.	The risk of sabotage to gas pipelines by non-state actors.
Connectivity	Although transit to third country trade is obligatory under GATT, it is in practice discretionary, used by South Asian countries as political leverage, allowed or denied according to political relations, often by allowing it subject to conditions impossible to meet.	Real or perceived and alleged security considerations often used to deny or restrict transit. Restrictions on entry of motor vehicles and certain types of railway wagons necessitate costly transshipment, raising transactions costs.
Tourism		Denial of visas to regional tourists, areas of potential tourist interest placed out of bounds.
Investments	Reduced or prevented altogether by absence of political confidence, terms made more restrictive for certain countries.	Prohibited altogether from certain countries (e.g. Pakistan investments in India) or in certain “sensitive” sectors.
Trade in services	More restrictive for certain countries.	Restrictions on entry visas, or on free movement of professionals.

78. Apart from conflicts and differences between member countries, Bangladesh, Nepal, and Pakistan have also experienced heightened internal political instability and conflict during the last decade, which has had a distracting effect on RCI. All eight of the SAARC countries have now made the transition to democracy and most of them are what have been called “noisy” democracies, with an active and vocal civil society, media, and party political competition.

79. Populist and nationalistic appeals against “alienation of natural resources” the dangers of being “swamped” by cheap imports, and so on, make it more difficult for South Asian countries to cooperate than in some other parts of the world (such as the GMS region or Central Asia). There is also a tendency for many South Asians to view agreements as zero-sum games rather than win-win situations.⁶¹ South Asians tend also to be obsessed with security

⁶⁰ Speech to conclave organized by SAARC Chamber of Commerce, ADB and FICCI as reported in the Financial Express, New Delhi, 20 September 2009. It is significant that one of the main reasons for the sudden recent improvement of relations between India and Bangladesh was the courageous decision of the government to allow the Indian security agencies to capture a prominent insurgent leader from the northeastern state of Assam seeking refuge in Bangladesh.

⁶¹ For example several joint inter-governmental river water projects proposed between India and Nepal, and in one case formally agreed to in the Mahakali treaty, were never implemented due to differences over the sharing of

considerations. Thus, many visa restrictions are widely perceived as unnecessary and irrational. Security considerations are particularly salient where the movement of people is involved, as in motor vehicles crossing borders, but not as much for some forms of energy sharing such as electricity trading, in which, for this reason, we may see the earliest progress. South Asians tend also to be too sensitive to perceived encroachments on sovereignty, including those by international institutions.

80. That said, South Asians enjoy deep-rooted cultural, civilization, and historical ties, and share a distinct South Asian identity, an identity which SAARC, for all its lack of performance on RCI so far, has probably strengthened through its active program of meetings of political leaders, officials, businessmen, academic institutions, representatives of apex professional bodies and other parts of civil society over the last two decades.⁶² A South Asian University has been set up on a 100-acre campus in New Delhi and started functioning from July 2010, with no more than 50% of the students from India and faculty drawn for all the SAARC countries.⁶³

81. Another factor supporting RCI is the fact that most South Asians were until recently part of the same country, which left behind an infrastructure of common institutions and standards, a potential common market, the English language, and rail, road, and riverine links which need relatively little investment to reactivate. Other supporting factors are the (i) inexorable advance of market forces, which is increasing investments and trade in services, and private sector interest in sectors such as hydropower in Nepal and Bhutan; (ii) India's growing realization that instability and lack of development in its neighborhood will continue to impose costs such as illegal migration, trafficking in drugs and women and children, and lack of credibility outside the region, and that it therefore needs to "carry" its neighborhood along with it into prosperity, (iii) the demonstration effect of successful examples of RCI such as ASEAN and the GMS⁶⁴ and the growing realization of the economic costs of not cooperating, (iv) the advantages of taking collective positions in global multilateral negotiations on trade, environment, climate change, and so on. Thus, despite the political and security challenges, and many ups and downs in the short term, the supporting factors are likely to prevail in the longer term.

V. STRENGTHENING RCI INSTITUTIONS

A. Strengthening the Secretary General and the Secretariat

82. The most comprehensive review of the achievements and limitations of SAARC remains that conducted by the Group of Eminent Persons (GEP) established by the ninth summit held in Male in 1997, "SAARC Vision Beyond the Year 2000". Apart from reviewing and making

benefits, although there was no dispute that both countries stood to benefit immensely. The Mahakali treaty had been either negotiated, signed, or ratified, by each of the three main political parties when it was in power, but was opposed by each of them when they lost power and were in the opposition. Fortunately the new private sector route to hydropower cooperation has escaped this fate so far, although for the larger projects where externalities such as flood control and irrigation are involved governments will have to get involved.

⁶² There are few activities that are not the subject of SAARC meetings and get-togethers, including boy scout and girl guide camps. Baru 2009 lists 21 SAARC-NGO initiatives. But people-to-people contact has been lacking due to visa problems caused by apprehensions of insecurity, and the lack of connectivity, while India and Pakistan even place restrictions on each others' publications entering their countries. It is no coincidence that Himal Magazine, perhaps the only publication that aims at a pan-South Asian readership, is published in Kathmandu.

⁶³ Here again, security controversies have intruded, with India reported to be insisting for the present that students and faculty from Pakistan be subjected to the usual restrictions on visas, reporting requirements, and freedom to travel within the country.

⁶⁴ ADB has organized an Indian media tour of the GMS in order to promote awareness of successes there, but these need to be repeated, especially for the media of the four countries that seem to have the most difficulties cooperating, and participants need to be more carefully selected.

recommendations on the substantive areas of SAARC cooperation, the EPG made detailed observations and recommendations on the SAARC Institutional Structure and on the Secretary-General and the Secretariat. The EPG sought to give the SG a more pro-active role, and in order to enable him to fulfill it, proposed giving him greater autonomy, at least in taking decisions on the crucial matter of hiring. It also sought to enhance his status so that he would be in a better position to follow up with members on commitments already made and decisions already taken in SAARC, but not fulfilled or implemented.

83. Specifically, the group recommended that in order to strengthen the secretariat:

- (i) the SG be accorded the status of a minister,
- (ii) that the current system of appointing him by rotation be dispensed with and instead, he and the directors be appointed on the basis of merit, with due regard to equitable representation,
- (iii) the SG should be appointed by the summit, and his tenure should be for five years,
- (iv) directors and professional staff be appointed from within the region directly by the SG from a short list prepared by a panel of experts,
- (v) more professionals be recruited (by the SG) from time to time to cope with the increased work load of deeper integration,
- (vi) member states should augment their budgetary contributions accordingly,
- (vii) and, of particular importance from the point of view of international financial institutions, it recommended that the SG should forge closer relationships with appropriate regional and international organizations. "The highest priority among these should be given to regional groupings which have experience of functional regional cooperation, and international financial agencies". Accordingly, the SG "should be able to take initiatives in this regard within the available resources".

84. Baru (2009) says that almost all the serving and former diplomats from the region he interviewed recognized the need for a "bigger, better funded and more politically empowered secretariat". He also says that some of them felt that if the secretariat were to be staffed by professionals from diverse backgrounds, and not just diplomats on secondment from foreign ministries, "some of the problems created by the mindset of foreign ministries in the region may get resolved". However, noting an apprehension among the smaller countries of domination by citizens of India and the other larger member countries, he suggests that no member government would like to push the idea of a better funded and more politically empowered Secretariat "for fear of being misunderstood".⁶⁵

85. As RCI gathers momentum in South Asia, there seems to be growing recognition of the need for a bigger, better funded, more professional, and more autonomous Secretariat, with more control of the SG over its budget and staffing. The ASEAN secretariat underwent a process of evolution to a strengthened secretariat in response to the growing requirements of managing and implementing the ASEAN FTA, as described in Box 7. Table 2 summarizes the differences between the role of the SG in the two organizations.

⁶⁵If this is the case there may be a case for "honest brokers" such as the ADB to push it. Baru (2009) also says that the present SG does not see the Secretariat's lack of autonomy as a handicap. The need to refer every decision to their parent ministries by the country directors has the advantage that decisions, once taken, have the backing of every member.

Box 7. The Growing Strength of the ASEAN Secretariat

ASEAN did not have a secretariat at all when it was set up in 1968 by its five original members. The ASEAN Secretariat (ASEC) was set up only in 1976 when the organization decided to pursue regional economic cooperation in formal ways. However, for the next 16 years ASEC was kept extremely weak and “held on a tight leash”. Like the SAARC secretariat today, it relied on deputationists from the foreign and trade ministries of member-governments, who remained on their government salaries, and generally came only for three years. Unlike SAARC, however, the Secretariat General (SG) was from the outset required to “initiate plans and programmes of activities for ASEAN regional cooperation”. A position of deputy secretary general was created in 1989.

However, the expansion, strengthening and increased independence of ASEC began only in 1992, with the requirements of managing the implementation of AFTA, which came into effect that year. The Secretary-General would now be the SG not just of the secretariat, but of ASEAN, with ministerial rank. (The SG is usually of deputy foreign minister rank, although the current SG is a former foreign minister of Thailand). Although selected by the foreign ministers, he would be appointed directly by the summit for a period of five years, on the basis of merit. The SG in turn selects two of the four deputy secretaries general on merit (the other two rotate alphabetically) as well as all other staff, keeping due regard to balanced geographical representation.

Finally, the ASEAN Charter, which took effect in 2008 and established ASEAN as a rule-based organization with binding legal obligations for the first time, gave the SG three new functions. He is required to (i) facilitate and monitor progress on the implementation of ASEAN agreements, in particular the ASEAN Economic Community Blueprint which seeks to introduce a single market by 2015, with detailed intermediate timelines (ii) monitor and report on compliance with ASEAN’s dispute-settlement rulings and (iii) provide good offices, conciliation and mediation when requested by parties to a dispute. The charter also establishes a Committee of Permanent Representatives in Jakarta charged with guiding and supporting ASEC, a step which is expected to streamline the task of day-to-day decision making, as the SG is still required to seek approval on all other matters from member governments.

However the charter takes a step backwards in reverting to the original system of rotating the position of the SG alphabetically. This was done to ensure that the smaller countries get a chance of provide the SG, but it takes away the element of competition in putting forward the best candidate. The charter also fails to remedy a major source of secretariat weakness—its dependence for resources on a system of equal contributions by all members so that the total operational budget is limited by what the poorest members can afford, currently \$1 million a year per member, raised last year from \$700,000. The enhancement yields \$10 million, which is supplemented by donor grants to result in a budget of \$13 million–\$14 million. This is inadequate however to pay for the expenditure required to handle all the new functions taken on by ASEAN’s expanding economic cooperation and integration activities (on 50 odd professional staff and more than 800 meetings annually of different ASEAN bodies). Funding uncertainties limit employment contracts to only three years at a time, which acts as a disincentive in attracting suitable staff, apart from the salary levels themselves, which are too low.

Based on Severino 2009 and discussion with Cung Minh Nguyen, Office of Regional Economic Integration, ADB.

86. At the very least it would seem necessary to give the SG more autonomy in hiring staff at the director and professional level. While regional balance would have to be maintained, it would be extremely useful to allow him to recruit at least some staff at this level from the “open market” on merit so that the more technical sectors in RCI are headed by persons with the appropriate qualifications and experience. Given suitable emoluments (which is essential) it is likely that regional professionals from the private sector, technical, and management institutions, consultancy organizations, civil society, and so on, would welcome the career opportunity to serve the region for a few years. Of course it would be advisable to maintain a mix of such staff with persons on deputation, since many of the RCI sectors are dominated by government and

require negotiating and “diplomatic” skills. Such persons could, in turn, continue to be nominated by member countries.

87. While any major advances in strengthening the Secretariat will clearly have to follow the development of the requisite political consensus, it is possible that SAARC might be interested in having the ADB conduct a study by a reputed management consultancy organization, similar to that which ASEAN undertook. It would be useful to have a picture of the direction in which the secretariat should be headed, even if it is not possible to get there just yet.

Table 3. Comparisons between the SAARC and ASEAN Secretariats

SAARC	ASEAN
Secretariat set up in 1986. Continues to remain weak	Secretariat set up in 1976 (nine years after inception of ASEAN). Although greatly empowered since then, still needs authorization for major initiatives from member governments.
SG co-ordinates, monitors and reports	Under ASEAN Charter (2008) SG can now “initiate, advise, co-ordinate and implement”. Required also to monitor and report compliance with dispute-settlement rulings, and provide good offices, conciliate and mediate when requested by parties.
Is the administrative head of SAARC. Does not have a separate budget for publicity and media relations.	Acts as spokesman and representative for ASEAN.
SG chosen by alphabetical rotation for 3 years initially, extendable by another term.	SG chosen by alphabetical rotation for 5 years.
Does not have ministerial rank (a senior official on deputation).	SG has ministerial rank (usually of Deputy Foreign Minister status).
	Senior staff enjoy diplomatic immunity in Jakarta and when travelling.
8 Directors, 13 professional staff .	4 deputy directors general, 4 bureau directors, 15 assistant directors and 15 senior staff.
Directors seconded by foreign ministries for 3 years. SG can hire professional staff after informing member countries.	SG can hire 2 out of 4 deputy secretaries general and all other staff on basis of merit.
Financial contributions are “voluntary”, in practice are made in proportion to gross domestic product.	Members make equal contributions, which limits total budgetary and personnel resources to below the level required by expanding RCI.

ASEAN = Association of Southeast Asian Nations; SG = Secretariat General; RCI = regional cooperation and integration;

88. ADB has extended three TAs to SAARC, to provide capacity building assistance to (i) the SAARC Secretariat and selected regional centers, (ii) the SAARC Energy Centre and (iii) for organizing a workshop on the SAARC Development Fund. A fourth, ongoing, TA also has a capacity development component, among others.⁶⁶ Since this study is based on desk research it has not been possible to look at the impact of these TAs or SAARC’s processes and personnel policies to identify levels at which further capacity building assistance might be useful. As noted earlier, the secretariat is very small, with a set of directors under the SG who are seconded from their respective foreign offices, and tend therefore to be generalist diplomats

⁶⁶ Promoting South Asian Regional Cooperation II approved in December 2008. The other components relate to (i) initiatives for food security to be implemented through the SAARC Agriculture Centre, (ii) trade, economic and financial cooperation (on data on trade in services, capital markets etc.) and (iii) programs to support institutional links with other regional organizations.

who are rotated regularly, so that any capacity building at their level would have to be repeated regularly. The staff of the regional centers also suffer from short tenures and the centers themselves from various generic structural difficulties described in Appendix 1.

89. There would appear of course to be possibilities for study tours and secondments to other regional organizations in Asia and other parts of the world. These would be useful not just for any technical or professional skills that might be transferred, but for broader exposure to different managerial cultures that are less hierarchical and less process-oriented than traditional South Asian systems of public administration from which SAARC personnel come.

90. Much more relevant than “capacity” as traditionally understood are likely to be the structural issues discussed above, and the fact that SAARC is mandated to take decisions by consensus which reduces all initiatives to the least common denominator of support.

91. As noted earlier, it will be interesting to see whether BIMSTEC opts for a stronger and more autonomous secretariat than SAARC, with political control and guidance continuing to be exercised by the local ambassadors posted to the capital in which BIMSTEC decides to locate its headquarters (similar to the Committee of Permanent Representatives being set up by ASEAN in Jakarta), and a more permanent set of senior management staff than in SAARC, some at least of whom have subject-matter background better suited to identifying projects and directing project implementation. Indeed, the ASEAN, current BIMSTEC (and indeed ADB) model of locating political control and guidance outside the management structure should be considered also for SAARC.

VI. TOWARDS A PAN-ASIAN REGIONALISM

92. In the results framework table of the South Asia Department’s draft trade facilitation sector paper, the goal of doubling intraregional trade within five years is laid down as a milestone and tracking indicator. While this goal seems feasible, especially if trade between India and Pakistan takes place on an most favored nation (MFN) basis and the activities proposed in the Regional Cooperation Operations Business Plan are carried out, there is a presumption in the paper that the growth of intraregional trade is in some sense superior to the growth of trade generally.⁶⁷ It is true that for the smaller landlocked countries with a high share of intraregional trade in total trade, a given increase in intraregional trade for SAARC as a whole will produce a much more perceptible impact in those countries. However, the efficiency and welfare enhancing benefits of trade accrue irrespective of their source. While it is important that SAFTA be made to show results,⁶⁸ especially by increasing the exports of the five LDC

⁶⁷ The same milestone refers to “outpacing South Asia’s overall growth of trade”. Because South Asia’s intraregional trade is so dramatically lower than that of other regions, there is a presumption that it should be much higher. The low share of intraregional trade is largely because the predominant part of India’s trade has necessarily to be with the rest of the world because it is so much larger than its neighbors, and second, because trade complementarities between the South Asian countries continue to be relatively low, although they are increasing with differential rates of growth. ASEAN’s high share of intraregional trade is explained largely by intra-industry trade in the electronics, machinery, automobiles and other technology-intensive industries. This pattern is unlikely to emerge soon in South Asia, because the largest economies, India, Pakistan and Bangladesh, contain within themselves supplies of low cost labor unlikely to be exhausted soon, and the skill sets required by different stages of the production chain. But South Asia does have some intra-industry trade in the textile industry, with Bangladesh and Sri Lanka having comparative advantage in clothing, and Pakistan in textiles (India has parity in both) (see Tiwari 2009). Another potential exception could be in IT and ITeS, in which the Indian educational system might not be able to produce suitable recruits to the workforce fast enough, forcing it to turn increasingly to outsourcing from its smaller neighbors, just as the industry has moved into the hinterland of smaller towns within India.

⁶⁸ Some of the more important steps required are to reduce the sensitive lists further, remove remaining NTBs, simplify rules of origin, improve trade-related infrastructure and logistics, and introduce trade between India and

members, it is as important not to lose sight of the importance for all the countries of the region of unilateral and multilateral liberalization in a global or pan-Asian framework. The risks of trade diversion rather than trade creation through bilateral and small regional groups are well known,⁶⁹ and the medium-term goal should be for the SAARC countries to reduce their tariffs generally, which would obviate the need for SAFTA and gradually put it out of business. Despite a lowering of tariffs, MFN protection remains much higher in South Asia than in East Asia. Baysan et al. (2006) suggest that to minimize the risks of trade diversion, the countries of the region need to reduce their general tariffs to 0%–5%.

93. Because South Asia followed an inward-oriented development model until the 1990s, South and East Asia were relatively isolated from each other.⁷⁰ However, trade and investment between the two regions grew rapidly from the early 1990s when the South Asian countries embarked on the process of liberalization and India adopted its “Look East” policy, although East Asia’s share of South Asia’s trade continues to be much higher than South Asia’s share of East Asia’s trade. Also, East Asia accounts for a much higher share of South Asia’s imports than exports. Several East Asian economies have doubled their trade with South Asia, while India is the only South Asian country to have shown comparable growth over the same period. Indeed, there has been a major reorientation in the direction of India’s trade, towards East Asia, although much of this is accounted for by its trade with the PRC. East Asia’s exports tend to be weighted towards finished and high-technology goods, while South Asian exports tend to be more natural resource intensive.

94. Mirroring developments in trade, East Asia now accounts for a much higher proportion of South Asia’s inward investments. While data for SAARC as a whole are lacking, East Asia accounts for 14% of India’s inward investment and 12.4% of outward investment (compared to 1% and 1.6% respectively of India’s FDI from and into South Asia). Intra-Asian services trade has also been growing, with the PRC concentrating on the export of construction and labor services, especially to Pakistan in South Asia, but increasingly to most of the other South Asian countries, and India trying to break into East Asian markets for IT services. However, many impediments remain to the free flow of goods, investments and services between the two regions, despite the growing number of FTAs between South Asian and East Asian countries.⁷¹

95. The benefits of a regional approach to trade liberalization, subsuming existing FTAs into a comprehensive agreement that eliminates tariffs and NTBs, reduces trade costs through infrastructure improvements, and liberalizes services, have been assessed recently in an ADB study based on a CGE model, which compares four scenarios (i) a South Asian FTA (ii) an ASEAN+3 FTA (iii) an extension of (ii) to include India and (iv) a pan-Asian FTA (Francois et al, 2009). The benefits under these arrangements have been measured against a do-nothing baseline for 2017. It turns out that the fourth, or pan-Asian, arrangement, offers the highest increases in income and wages. The inclusion of the “plus 3” countries (the PRC, Japan and the Republic of Korea) drives most of the gains for East Asia. Next in importance is the inclusion of

Pakistan on an MFN rather than positive list basis. These and other steps are discussed more fully in the section entitled “The Way Forward in SAFTA” in ADB and UNCTAD (2008).

⁶⁹ See World Bank 2006.

⁷⁰ This section relies heavily on the ADB sponsored study Francois, Rana and Wignaraja (2009).

⁷¹ India has comprehensive economic cooperation arrangements with Singapore (2005), and has implemented an “early harvest” scheme for reduction of tariffs pending finalization of a comprehensive free trade agreement with Thailand. It also has ongoing or completed joint study groups with Indonesia, Japan and the Republic of Korea, (see Table A1.3 of Francois et al. 2009). Similarly, Pakistan has negotiated FTAs with the PRC, and Malaysia and has them under negotiation or consideration with Indonesia, the Philippines, Singapore, and Thailand. Sri Lanka has proposed a Comprehensive Economic Cooperation Agreement (CECA) with Singapore.

India (especially the countries that share the Malaysian Peninsula (Thailand, Malaysia, and Singapore)).⁷² The other South Asian players have only a limited impact on gains to East Asia, but they stand to gain considerably themselves. It is crucial therefore that they be included.⁷³

96. The study points out that realizing the potential of such an agreement would have to overcome “a proven tendency in Asia to circumscribe trade concessions with rules of origin, NTBs and exclusion lists”. In the interim, it recommends that countries continue (i) lowering trade and non-trade barriers, (ii) investing in trade-related infrastructure and streamlining cross-border procedures, (iii) consolidating their FTAs (by broadening and deepening them in accordance with the concept of “open regionalism” so that they become stepping stones rather than stumbling blocks to a pan-Asian multilateral agreement when negotiated, (iv) deregulating and reforming policy in the service sector, and (v) embedding trade reform in a wider program of economic reform in South Asia.

VII. RECOMMENDATIONS FOR DEVELOPMENT PARTNERS

97. Despite the challenging political and security environment a great deal of regional cooperation and integration is taking place or being facilitated autonomously through unilateral changes in policy made by countries (on investments, trade in services, tariffs and so on), through bilateral agreements (on trade, energy trading, river water sharing), and through the activities of the private sector (in hydropower projects and transmission lines for example). There has not been as much movement forward on RCI multilaterally, except in sectors where there is political consensus, such as SAFTA. In that sense, to answer the question in the title, institutions do matter, but only when the underlying politics allows.

98. There are indications that the politics is set to allow much more. With the exception of the India-Pakistan relationship, which continues to undergo ups and downs, there has been a marked improvement in bilateral relations among most SAARC countries in the last few years, and the internal instability that plagued many countries in the region has subsided. While ADB has not implemented any regional projects for SAARC as a whole, or for BIMSTEC, which is still a very young organization and yet to acquire a secretariat, it has implemented several regional projects in the eastern South Asia under the aegis of SASEC, which is not affected by India-Pakistan bilateral relations.⁷⁴ It has also sponsored some very important analytical studies for all three RCI institutions.

⁷² As a percentage change from baseline income the countries that benefit the most are Thailand (12.9%), Viet Nam (9.5%), Malaysia (6.6%) and Singapore (5.7%). South Asian countries gain between 3.73% and 0.2%.

⁷³ Indeed, India just concluded an agreement on trade in goods with ASEAN in 2009 under which tariffs are to be reduced or eliminated by 2011, except with the Philippines, with which the reduction schedule runs until 2016. Negotiations commenced in 2003 under a framework agreement but were suspended several times over differences in the extent of tariff reductions on commodities such as palm oil, the size of the excluded list, and rules of origin. The Early Harvest Scheme with Thailand (see footnote 61) saw India's exports to Thailand go up by 63% the following year and generate several investments in manufacturing (including trucks and steel) and services (IT). The CECA with Singapore has seen economic relations between the two countries grow over a wide front. BIMSTEC's membership partially straddles SAARC and ASEAN, with 5 and 2 members respectively from each. It will be interesting to see to what extent the FTA it is currently negotiating serves to facilitate a wider coming together of the two regions.

⁷⁴ Since this applies to BIMSTEC too, it may be asked why there has not been more assistance to BIMSTEC. The answer probably has to do with BIMSTEC's own lack of preparedness to undertake project assistance without the secretariat it is planning to set up, and the unacceptability (for project assistance) of the present regime in Myanmar to ADB's major donors. However, ADB does have a TA in the pipeline for 2010 to support BIMSTEC with analytical work in the areas possibly of transport, tourism and energy, training programs and conferences.

99. Further, it could be argued that national projects with regional implications in sectors such as power (by creating surpluses for export) and transport (by enhancing capacity for carrying traffic to and from borders) have as much, perhaps more, to contribute to RCI than actual “last mile” connectivity, essential though it is. Such projects in power, transportation, irrigation and flood control will require huge resources, even after private sector involvement, as well as analytical support. There would thus appear to be a significantly stepped-up role for development partners such as the ADB in providing financial and analytical support to South Asian RCI, as political differences between the countries of the region continue to subside, or as member countries decide to not let these differences stand in the way of strengthening RCI.

100. Apart from project assistance and TAs, there may be scope for assisting in the process of strengthening SAARC “identify formation” (and thereby helping RCI indirectly) through lending assistance to “iconic” projects and institutions such as the SAARC University coming up in Delhi, and the SAARC Development Fund. ADB is already assisting think tanks in the region to study the issues that have stood in the way of cooperation and prepare a climate of opinion conducive to RCI. There may be scope to broaden this assistance to other sectors of civil society such as nongovernment organizations and the media and to other “Track II”⁷⁵ initiatives that may be in a position to play a more activist role in pressing for RCI.

101. We have seen how the requirements and exigencies of managing and implementing growing RCI in Southeast Asia have led to the gradual strengthening of ASEAN as a regional institution, and in particular the role of the ASEAN Secretariat and Secretary-General. As RCI gathers momentum in South Asia, there seems to be growing recognition of the need for a bigger, better-funded, more professional, and more autonomous SAARC Secretariat, with more control of the SG over its budget and staffing. As we have seen this was one of the recommendations of the Group of Eminent Persons who reported in 1999. The 16th Summit just concluded in Thimpu has decided to set up another group of eminent persons, a “South Asia Forum”, to formulate a new vision statement, chart out the future course of SAARC, and improve existing mechanisms. Hopefully, this time around, action will be taken on some of the measures identified, because the point may be reached very soon when the lack of an appropriately strengthened institution will matter very much, even if it does not matter as much as it should, yet.

⁷⁵ Thus the “Kunming Initiative” is a changing group of experts and think tanks from Bangladesh, the PRC (mostly Yunnan Province), India, and Myanmar who meet once a year in each other’s countries by rotation to discuss cooperation in their subregion. Track II may have been influential in facilitating the Ganges waters agreement between India and Bangladesh

SOUTH ASIAN ASSOCIATION FOR REGIONAL COOPERATION

A. Institutional Structure, Activities and Functioning

1. The South Asian Association for Regional Cooperation (SAARC) was established when its charter was formally approved on 8 December 1985 by Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. Afghanistan became the eighth member in April 2007. Australia, the PRC, the European Union, Iran, Japan, the Republic of Korea, Mauritius, Myanmar and the United States have joined SAARC as observers.

2. Article I of the SAARC Charter states that the objectives of the association are to promote the welfare of the peoples of South Asia, accelerate their economic growth, social progress and cultural development, promote collective self-reliance among its members, contribute to mutual trust and understanding, promote active collaboration and mutual assistance in the economic, social, cultural, scientific and cultural fields, strengthen cooperation with other developing countries and international and regional organizations with similar aims, and strengthen cooperation among themselves in international forums on matters of common interest.

3. Meetings of the Heads of State or Government (summits) are to be held at least once a year (Article III).¹ The country hosting the summit holds the chair. Bhutan, which hosted the 16th Summit in 2010 is the current chair of the association. The 17th Summit is to be held in the Maldives in November 2011.

4. The Council of Ministers (consisting of the foreign ministers) meets at least twice a year, to formulate the policies of the association, review progress, and decide on new areas of cooperation (Article IV). A third tier, the Standing Committee comprising the foreign secretaries, is charged with overall monitoring and coordination, approval of projects and programs and the modalities of their financing, determination of inter-sectoral priorities, mobilization of regional and external resources and identification of new areas of cooperation based on appropriate studies. It shall meet as often as necessary, and shall submit periodic reports to the CoM and make reference to it as necessary for decisions of policy matters (Article V).

5. Although not provided for in the charter, the Standing Committee is assisted by a fourth tier, the Programming Committee, which consists of officials below the rank of foreign secretary. It scrutinizes the budget, finalizes the annual calendar of events, and makes recommendations on reports received from the technical committees, working groups, and the regional centers, whose collaborative work together makes up the SAARC Integrated Programme of Action (SIPA).

6. The SIPA has been reviewed from time to time in an attempt to make it more results-oriented. Based on the report of an independent group of experts the Standing Committee consolidated the number of technical committees from eleven to seven in 1999 in an attempt to raise their quality and efficiency, and focus more on activities that would yield tangible benefits. Moreover, it was decided to conduct an expert review of the SIPA every three years. The SG is authorized to propose activities and programs for inclusion in the SIPA and seek funding for them. He reports to the Standing Committee on progress in implementation.

¹ This requirement is not strictly complied with, for logistical reasons. At least one summit has been postponed in the past, at the behest of India, for political reasons (although the ostensible reason was the lack of security in the host country).

7. In 2004, the 7 technical committees were in the fields of (i) agriculture and rural development, (ii) health and population, (iii) women, youth and children, (iv) environment and forestry, (v) human resource development, (vi) science and technology and meteorology, and (vii) transport. Their membership consists of representatives from the eight SAARC countries. They are responsible for the implementation, coordination and monitoring of programs in their respective areas. They are specifically charged with “determination of the potential and the scope for regional cooperation”, formulation of projects and programs, formulation of recommendations regarding apportionment of costs, implementation, and monitoring. Chairmanship rotates in alphabetical order every two years (Article VI of the charter).

8. In addition, although not provided for in the charter, there are 5 working committees devoted to telecoms and IT, biotechnology, energy,) tourism, and intellectual property rights.

9. There have also been a large number of ministerial level meetings, in as many as 15 areas over the years, to focus attention on specific areas of common interest.²

10. While all these bodies coordinate programs and activities that are carried out through institutions and agencies in member countries, SAARC also implements certain activities directly through its own set of regional centers.³ There are presently 11 regional centers, for agricultural information (in Dhaka), tuberculosis (Kathmandu), documentation (New Delhi) (iv) meteorological research (Dhaka), (v) human resource development (Islamabad), coastal zone research (the Maldives), (viii) culture (Sri Lanka), disaster management (India), SAARC information (Kathmandu), and forestry (Bhutan). Each center is managed by a governing board comprising representatives from the member states, the SG and the foreign ministry of the host government. The director of the center acts as the secretary of the governing board. In most cases the capital expenditure and 40% of the institutional expenditure on each center is borne by the host government, while the remaining 60% along with the entire program expenditure is shared by member states according to an agreed formula. The capital expenditure is usually borne by the host government.

11. Finally, the charter also provides for action committees, which may be set up by the Standing Committee to coordinate the implementation of projects of more than two but not all member states (Article VII).

12. Article VIII provides for a secretariat. Article IX lays down that the contribution of each state shall be voluntary. Article X lays down that decisions at all levels shall be taken on the basis of unanimity, and that bilateral and contentious issues shall be excluded from deliberations.

B. Review of the Working of the SIPA and Regional Centers

13. The most recent evaluation of the technical committees under the SIPA that was available to the author, was that conducted by Professor Lama for the South Asia Centre for Policy Studies, under ADB TA 6189, in 2008, along with the work of the regional centers, which were started later. His findings on both these sets of institutions are discussed in this section.

² Those relating to commerce (5 meetings), communications (2) and tourism (1) have been directly relevant to RCI. (Figures only up to 2004, listed in SAARC – A Profile).

³ The regional centers are also not provided for in the charter. It has been suggested they were started as a response to the lack of results shown by the Technical Committees and Working Groups. However, it is debatable whether they have been any more successful, as discussed below.

14. As the TA report says, the SIPA was at the core of the SAARC process in its early years and provided the foundation from which regional cooperation took off. It has led to broader contact between experts of the region, facilitated exchange of data and information, and organized seminars, conferences and training courses. However none of the technical committees have made much impact in their respective fields or have led to sustained cooperative action between two or more members. They have tended to function in isolation with insufficient contact with the private sector, academic institutions, recognized experts and NGOs. Their work has been affected by a lack of funds, by lack of coordination by the national and sectoral focal points within the countries, and lack of follow up on their decisions and recommendations.

15. The report recommends that in order to be more meaningful and effective the SIPA should select fewer projects and implement them in a time-bound manner, choose cross-border issues, conduct monitoring and evaluation on a continuous basis through an independent agency, enhance the budget of the technical committees substantially, give them a role in implementing their own recommendations, allow a member state to chair a technical committee for more than two years, and ensure participation of the NFPs in technical committee meetings to ensure better coordination of follow-up.

16. While at least one of the regional centers has played a useful role,⁵ they have by and large suffered from the same difficulties as the technical committees. As the TA report points out, the SAARC Secretariat does not have the requisite financial and human resources and technical capacity to monitor and evaluate the activities of the regional committees. The regional committees do not have full time directors, and do not publish annual reports. They tend to function in isolation, have weak outreach, their programs and projects are insufficiently demand-driven, and they have tended to function more as national rather than regional organizations. They experience difficulty in recruiting suitable professionals from other member countries on account of unattractive salaries and perks and because a tenure of three years is too short. The members of governing boards nominated by member countries, on the basis of their official position rather than personal standing, have very little continuity because their official positions keep changing. Like the technical committees they are short of funds, and the rules governing their use are cumbersome.

17. The report suggests they should be allowed to access funds freely from recognized outside sources, and more generally, that they should concentrate during the next decade on consolidation and dissemination of work already done, working closely with delivery agencies, including NGOs, educational institutions and the private sector. Based on audits and reviews of the regional centers,⁶ the SG has now issued a set of guidelines and a comprehensive performance index to be strictly followed by all regional centers.

C. Economic Cooperation

18. The main working-level institution charged with promoting the charter objective of accelerating the growth of member states is the Committee on Economic Cooperation

⁵ The SAARC Tuberculosis and HIV/AIDS Centre (see Lama 2008) and the SAARC Energy Centre.

⁶ The SG was asked by the Standing Committee to undertake a performance audit of the regional centers in 2001, and their financial and administrative arrangements were reviewed by a group of experts in 2002. Their recommendations were published in the form of a handbook entitled Guidelines for Technical Committees, Working Groups and Regional Centres in 2006. Another group of experts was asked to review and revamp the regional committees in 2007.

consisting of the commerce/trade secretaries. Apart from promoting intraregional trade and investments, its functions are to analyze global and inter-regional developments and evolve common approaches to them. It oversaw the formulation of the South Asian Preferential Trade Agreement (SAPTA) which came into effect in December 1995, and SAPTA's replacement by South Asian Free Trade Area (SAFTA) on 1 January 1996. The SAFTA Ministerial Council is the highest decision making body of SAFTA.

19. The CEC set up an intergovernmental Group on Customs Cooperation in 1996, and a Standing Group on Standards, Measurements and Quality Control in 1998. Several agreements and conventions have been signed by SAARC members. Among those of relevance for RCI are those on avoidance of double taxation, and arbitration. In pursuance of the charter objective of strengthening cooperation on matters of common interest in multilateral organizations, SAARC commerce ministers issued a SAARC Ministerial Communique at the Seventh WTO Ministerial Conference, and Bhutan, as the current chair, is convening an expert group meeting to arrive at a common position for forthcoming negotiations in COP16 and thereafter on climate change.

20. The goal of a South Asian Economic Union was announced at the Kathmandu Summit in 2002. The Inter-Governmental Expert Group on Financial Issues is developing the road map for achieving it in a gradual and phased manner. Talks are reported to be ongoing on setting up a customs union as the next step. To strengthen coordination on macroeconomic policies, where appropriate, meetings of officials from central finance ministries and the governors of central banks have been held under the auspices of SAARC FINANCE.

21. The SAARC Development Fund (SDF) has come into operation with three windows (social, economic and infrastructure) and an initial paid up capital of \$300 million. The permanent secretariat of the SDF has been established in Bhutan.⁷ Through an MOU with Japan SAARC has also set up the SAARC-Japan Special Fund in 1993, which is used both for projects and programs approved by the standing committee as well as activities directly administered by Japan.

22. Apart from partnerships with a whole host of international organizations, SAARC entered into cooperation agreements in 1994 with the ADB and the World Bank, and with ESCAP for joint studies, conferences and exchange of information on trade promotion and foreign direct investment, among other areas. Although it does not have a formal memorandum of understanding with ASEAN, the foreign ministers of the two organizations have met on the sidelines of the UN General Assembly and their agencies, such as secretariats and chambers of commerce have met to discuss issues of common interest.

23. SAARC set up a food security reserve in 1988, which is now referred to as the SAARC Food Bank. Agreement has been reached on quantities and locations of reserves to be held by members.

24. The SAARC Chamber of Commerce and Industry has been active in promoting interaction between the private sectors of the member states, including the possibilities of and public-private partnerships, through an annual Economic Cooperation Conference, and has been active in providing inputs for SAPTA and SAFTA. It organizes the annual SAARC Trade

⁷ An intergovernmental agreement, charter and bylaws were signed at the 15th Colombo Summit. A chief executive officer and consultants was appointed. Three areas have been identified for social projects, namely maternal and child health, empowerment of women, and teacher training. India has started implementing projects in the first two areas and Pakistan in the third.

Fair. It has been recognized as a SAARC Apex Body, along with similar apex bodies of lawyers, accountants, and writers.

25. Of the several studies SAARC has carried out, those of relevance for RCI are those on trade (in 1991), customs matters (2004), transport (2006) energy trading (2008) and services (2008).⁸

⁸ Most of these studies were carried out under ADB regional technical assistance.

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