

# **Policies to foster trans-boundary economic cooperation in the Hindu Kush–Himalayan Region**

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## **Abstract**

Himalayan countries - Bangladesh, Bhutan, China, India, Nepal, and Pakistan, are located in a single landmass and share almost common cultural and historical background. Despite geographical proximity and cultural and historical commonalities, desirable economic cooperation has not yet developed. The question arises why? Based on analysis of relevant secondary information, this paper attempts to answer this question and suggest way forward to promote cross border economic co-operation. The central Asian countries together with Afghanistan also have contiguous borders and historical economic exchanges falling in the famous Silk Road trade route.

Our study and analysis reveal that first and foremost, historically hostile geo-political environment has prevented a meaningful economic co-operation. Besides, lack of communication and transportation links, restrictive trade policies, lack of finances and technologies and increasing security issues have proved to be the major constraints to cross border economic co-operation and trade linkages among the countries of the Hindu Kush-Himalayan (HKH) region. Also, tariff and non-tariff barriers and complicated bureaucratic rules and regulations also act as barriers for economic cooperation in the region. Inadequate trade facilitation mechanisms contribute to the unrealized potential of intra-regional trade in certain areas. Landlocked countries face high handling and transportation charges and undue delays in delivery of consignments, thus hampering the smooth to and fro flow of regional and international trade. Restrictive trade policies practiced by almost all HKH countries have also caused the low level of intra-regional trade. The restrictions have been more severe on the export interest of especially South Asian Association of Regional Cooperation (SAARC) countries. However, experts feel that multilateral liberalization such as provisioned under South Asian Free Trade Agreement (SAFTA) would not much benefit the South Asian, especially smaller, countries. Instead, they feel that, unilateral liberalization will be more beneficial.

In recent years, however, every country has been liberalizing its trade under different multilateral and bilateral regimes, according to which almost 5000 products from all member countries are entitled to preferential duty treatment. Further opening-up of the borders and liberalization is expected under the SAFTA which was launched in 2004. Trade between SAFTA region and China has also hugely expanded. The expansion of regional trade among the HKH countries can yield tremendous economic gains in production specialization, efficiency and improved quality of exports, which can benefit all the countries. The SAFTA has great potential for all South Asian countries but there will be short-term costs for long-term benefits. The HKH countries also need enabling policies and institutional reforms to strengthen the regional and bilateral economic co-operation since many economic issues transcend geopolitical boundaries and require a coordinated approach from all the countries of the region. Due to the failure of the World Trade Organisation (WTO) led negotiations and global financial slow-down, as well as with increasing mobility and access to knowledge and information, enhanced regional economic cooperation and networking among the HKH countries only can address the challenges and harness benefits to all.

## **Introduction**

Geographically, all the countries of Hindu Kush-Himalaya region: Afghanistan, Bangladesh, Bhutan, China, India, Myanmar, Nepal and Pakistan are located in a single landmass making it possible to have a better economic cooperation. The countries of HKH region not only are geographically contiguous but also historically linked. However, the economic cooperation in the region is low. However, increasing number of efforts is being made to improve it. Cross-border economic cooperation can enhance welfare of a nation through enhancing economies of scale in production and facilitating specialization, reducing monopolies, expanding market (Pigato et al, 1997; Madawela, 2003; Sobhan, 2004). The question arises why economic cooperation has not grown in this region in spite of geographical proximity and cultural commonalities? Understanding of the bottlenecks may help in designing appropriate policies and strategies to

overcome them and creating an enabling environment for cross-border cooperation. The objective of this paper is to understand this question and suggest way forward to promote cross border economic co-operation in the HKH region.

Some scholars (such as Kemal , 2004; Panagariya, 2006; Das, 2007) believe in Ricardian comparative advantage and argue that geographical proximity and cultural unity is not a determinant factor of regional integration. Comparative advantage is the primary determinant of regional integration. Low trade complementarity among the HKH member countries because of limited comparative advantage is primarily responsible for low level of economic integration among SAARC countries. A number of scholars (e.g., Krugman, 1991, Hirantha, 2003; Pitigala, 2005; Sobhan, 2006,) however, argue that trade complementarity is not enough for deeper economic cooperation. Political will, geo-political context , communication and transportation facilities, as well policies relating to export, import, exchange rate, tariff, and administrative and institutional mechanism play important role in facilitating or constraining trans-border regional cooperation. In view of these views, this paper focuses on policy and institutional aspects of trans-border economic cooperation in HKH region.

## **Historical and Geopolitical Context**

The HKH region has always been of great interest to the world due to its geo-political, cultural, developmental and bio-cultural importance and of late security factors. The region is also physical, political and cultural juncture of two most populous civilizations in the world.

Historically hostile politics and absence of an environment of trust and co-operation have played a major role in coming on the way to regional economic co-operation. Despite geographical proximity, Himalayan countries are caught by the mistrust and suspicion of each other's physical size, geo-political interest and asymmetrical relationships. China and India, two giant countries in this region had a less than co-operative relationship for a long time due to border dispute. China never accepted the McMahan line, which has been a major cause of contention. The situation was further aggravated when Dalai Lama fled to India in 1959. The two giants fought a war in 1962 and closed the border that ended centuries old trans-Himalayan trade routes and economic relationships. As a result cross-border economic cooperation could not grow between China and India. The situation, however, started improving since 2000s through signing of China-India bilateral trade agreement.

The cross-border economic cooperation was further hindered by the geo-political problems within South Asia. The two large countries of South Asia India and Pakistan fought three wars since 1947. Territorial dispute has remained a constant source of enmity and hostility between the two countries which has hindered trade and economic cooperation between these two large economies of South Asia. India has a predominant role in this region, in terms of her size, economic and military power, and technological status. This has made her weaker neighbours like Bangladesh and Nepal feel vulnerable and disadvantaged. On the other hand, India is also uncomfortable of the possibility of its smaller neighbours organizing against her or taking negative attitudes and therefore it always pushes for bilateral arrangement rather than multilateral regional cooperation. These mistrust and apprehension are the major impediments for trans-boundary economic cooperation in the HKH region.

## **Importance of the HKH countries in Global Economy:**

Globalisation and economic liberalisation have been major factors in converting the economies of India, Pakistan, and China into growth poles of the world economy (Kemal, 2004). In the process of globalization, the global economy has undergone a profound change over the last one and half decade. The most spectacular change has taken place in the Himalayan countries of China and India. China is likely to become the second biggest economy in the world by 2016, and India the third largest by 2035(Kaplinsky and Messner, 2008). With their growing economic power, China and India are, now, in a position to play a major role in the global economic, technological, and political arenas and influence the “rules of the game” on international trade and in the global political economy. Kaplinsky and Messner (2008:197) rightly mentioned that “the rise of China and India as global economic and political powers is one of the most important transformative processes of our time - challenging the international political economy dominated by the “transatlantic West.” It is likely to remain significant for many years to come”. Similarly, the World Bank in its recent publication:

*Global Economic Prospects: Managing the Next Wave of Globalization* has predicted that 'in the next 25 years the growth in the global economy will be powered by the developing countries, whose share in global output will increase from about one-fifth of the global economy to nearly one-third'. The publication argues that future drivers in the global economy will be China and some major countries from South Asia, especially India and Pakistan. Table 1 below indicates the asymmetrical economic positions of the HKH countries.

**Table 1: Macroeconomic overview of the SAFTA + Myanmar + China region in 2006**

Indicator	Afghanistan	Bangladesh	Bhutan	China	India	Myanmar	Nepal	Pakistan	Sri Lanka
GDP (US\$ billions)	2.96	65.42	0.70	2 095.95	703.33	8.80	6.70	100.89	21.27
Per capita GDP	143.00	419.41	1 086.34	1 597.77	633.74	174.00	242.48	634.50	1 069.66
GDP growth	6.50	6.63	8.47	10.70	9.20	2.90	2.80	6.92	7.35
Share of GDP									
Agriculture	32.60	19.61	22.34	11.71	17.53	50.00	34.36	19.39	16.46
Industry	27.80	17.21	7.37	48.48	16.28	35.00	7.68	19.47	13.93
Services	39.60	52.48	39.77	39.91	54.58	15.00	49.31	53.41	56.47
International trade-GDP ratio		44.22	76.79	72.39	48.78		45.29	38.61	74.78

*Source:* World development Indicators, 2008, World Bank.

The emergence of Asian drivers has created both opportunities and challenges for both developing and developed countries. It is necessary to understand the dynamism of the HKH countries' economies in order to promote trans-border economic cooperation in the HKH region.

### **Rationale and Significance of Regional Economic Co-operation**

It is a matter of global concern that around 40 per cent of South Asian's population lives below poverty line which is nearly half of the world's poor population. Even though China has achieved a historical reduction in poverty figures, the mountainous provinces, especially TAR and Sinjiang still have large pockets of poverty. A number of factors come into play when we discuss the issues related to economic cooperation in South Asia in general and the HKH mountains in particular. The most important point that such mechanism can significantly contribute to are: a) increased and mutually beneficial economic development, b) increased bilateral and regional trade, c) improved political and people-to-people relationships etc. However, such a co-operation will only be possible if the countries would be collectively deciding as they have done in their various summits to tackle the common problem afflicting them all i.e., persistent poverty through enhanced regional co-operation and knowledge sharing. This is by far the most essential element in economic cooperation.

Experience from European and more recently Southeast Asian economic union indicate that regional economic co-operation actually can help towards conflict resolution (Sharif, 2004). The HKH countries have initiated a number of regional instruments for promoting economic co-operation. South Asian Free Trade Agreement (SAFTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Co-operation (BIMSTEC) are the important ones. However, the success of SAFTA, BIMSTEC and other bilateral co-operation mechanisms will largely depend on either the resolution or sidelining of the existing political/border issues (example being the way India & China have done) and moving forward with strong political will to address the common problem affecting all countries viz. rampant poverty and environmental degradation.

### **Constraints to Cross-Border Trade in HKH Region.**

Besides, geo-political factors explained above, there are several other factors constraining cross-border regional economic cooperation in the HKK region. Key factors are explained below briefly:

#### ***Political Problems:***

Political differences due to unsettled boundary disputes and other geo-political interests have also affected various efforts to foster regional economic cooperation in South Asia. The region, although with huge potential, has lagged behind all other regions in achieving minimal cooperation not only in economic but also political, cultural and communication areas. The implications are that the countries have not been able to realise even the partial potential of their bilateral and intra-regional trade owing to various political compulsions and bureaucratic hurdles. Table 2 below indicates the situation in a sub-region with less political problems:

**Table 2: Pattern of intraregional trade in BCIM (Bangladesh, China, India, and Myanmar) sub- region**

(Source: Estimated from the International Monetary Fund Direction of Trade Statistics Database, 2008.

Note: Export data are taken as FOB and import data as CIF)

Country	1990	1995	2000	2005	2007	1990	1995	2000	2005	2007
Bangladesh	2.80	1.79	1.08	1.96	2.39	8.06	24.62	18.16	27.82	29.49
China	0.96	1.35	1.19	1.61	2.39	0.40	0.45	0.66	1.53	1.58
India	1.78	4.14	3.91	8.36	10.41	0.57	3.05	3.39	7.74	10.98
Myanmar	19.10	23.88	14.97	19.64	22.15	20.98	30.11	19.73	32.27	37.21
BCIM as a whole	1.37	1.91	1.86	3.04	4.40	0.96	1.45	1.89	3.15	4.07

Notwithstanding the potential of economic gain, there are a number of constraints that need to be overcome to realize the dream of regional economic co-operation. Similar comparative advantage, marginal differences in competitive edge, historically hostile politics and environment of mistrust, lack of seamless communication and transportation links, restrictive trade policies, lack of finances and advanced technologies and perceived and real security problems are some of the major constraints to cross border economic co-operation and trade linkage in Asian mountain countries (Kemal, 2004). These are briefly elaborated below:

#### *Identical Comparative Advantage*

Most of the HKH countries have an almost identical type of comparative advantage in a relatively narrow range of products perhaps due to the predominance of agriculture sector in the economies. Similarly, their bilateral trade structures do not show much in terms of complementarities. In spite of major structural reforms and expansion of industrial sector, the industrial sector is still not diversified enough although in recent years China, India and to some extent Pakistan has started the process. These constraints have rather aggravated the problems of smaller HKH countries. They are unable to invest in high value-added exportable products, and therefore have become more dependent on industrialised neighbours for their capital goods and technology. The regional exports largely consist of raw materials and traditional products, such as textiles and garments, and some regional countries are direct competitors in the world export market for these products. The import requirements of the region mainly consist of capital goods, finance and high-tech products. In this way, the trade pattern of the South Asian countries is tilted towards the developed countries.

#### *Lack of Communication and Transportation Links*

There are no integrated transportation and communication links between the HKH countries. Also, the production, consumption and trade patterns of potential trading partners within the region are not well documented and shared. Three land locked countries Bhutan, Nepal and Afghanistan have to depend on the goodwill and facilitation by their neighbours to move their trade. However, since these countries themselves lack efficient mechanisms, both export and intra-regional trades suffer from inherent disadvantage and vulnerabilities. For example, Nepal's trade with other countries in the region as well with overseas partners depends on transit facilities provided by India. These facilities often involve high handling and transportation charges and delays in delivery, thus hampering the flow of trade between Nepal and its trading partners in the region. Consequently, Nepal's international trade has never developed.

#### *Restrictive Trade Policies*

Most of the HKH countries still practice restrictive trade policies that is causing low level of intra-regional trade (Kemal,

2004). The restrictions have affected the intra-regional export trade in the region. However, since the onset of globalization, the HKH countries have gradually liberalised their economies and the consequences are seen in the growth of trade volume especially between India and China. Some trade liberalisation has also occurred under the SAFTA regime, according to which almost 5000 products from all SAARC member countries are entitled to preferential duty treatment. However, there is still a long way to go.

**Table 3. Non-tariff Barriers and Para-tariffs in SAARC Countries**

Country	Non-tariff barriers	Para-tariffs
Bangladesh	Health, religious, environmental and balance of payments purposes: <ul style="list-style-type: none"> <li>• Quantitative restrictions</li> <li>• Quasi-tariffs</li> <li>• Import through state trading enterprises (salt)</li> <li>• Restricted port of entry</li> </ul>	<ul style="list-style-type: none"> <li>• Infrastructure development surcharge</li> <li>• Supplementary duties</li> <li>• Regulatory duties</li> <li>• Vat exemptions for specified domestic products</li> </ul>
Bhutan	None	None
India	<ul style="list-style-type: none"> <li>• Tariff rate quotas</li> <li>• Import through state trading enterprises</li> <li>• Health and sanitary regulations (quarantine fees)</li> <li>• Restricted ports of entry</li> <li>• Anti-dumping and countervailing duties</li> <li>• Customs valuation</li> </ul>	Extra protection of certain products through restricted port of entry
Nepal	None	<ul style="list-style-type: none"> <li>• Special fees</li> <li>• Local development fee</li> <li>• Agricultural development fee</li> </ul>
Pakistan	<ul style="list-style-type: none"> <li>• Mostly free from NTBs</li> <li>• Exception: ban on imports from India of products not on the positive list of 771 items (corresponding to about 1500 8-digit HS lines)</li> <li>• Local content requirement in the auto industry</li> </ul>	<ul style="list-style-type: none"> <li>• Income withholding tax</li> <li>• Extra protection for some products through sales tax</li> <li>• Regulatory duties (mostly phased out)</li> </ul>
Sri Lanka	<ul style="list-style-type: none"> <li>• import ban (tea and certain spices)</li> <li>• import monopoly (wheat)</li> <li>• health and sanitary regulations</li> <li>• quantitative restrictions</li> <li>• quasi- QRs</li> </ul>	

	<ul style="list-style-type: none"> <li>• import through state trading enterprises (salt)</li> </ul>	
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Source: Compilation by Authors, 2009

**Potentials and Limitations of SAFTA & BIMSTEC:**

The SAARC Summit held in Islamabad (2004) had committed South Asian countries to move towards a South Asia Free Trade Area (SAFTA) within a decade or so. However, the progress so far has been dismal and experts now feel that multilateralism has limited scope and therefore suggest unilateral liberalisation saying that it would benefit the South Asian, especially smaller countries, much more than SAFTA (Sobhan, 2004).

Sobhan (2004) argued that one of the prerequisites for cross border or regional trade is the integration of the infrastructure of the region which is not the case in South Asia. He went on to indicate that for a region that aspires to be an Economic Union, South Asia has one of the lowest levels of intra-regional trade. Prevailing trade barriers and structural asymmetries in the national economies do limit the scope for trade. Despite this, intra-regional trade has increased significantly in the last decade, but there is an inherent lop-sidedness in this otherwise healthy trend. Intra-regional trade has increased through India's growing exports to all countries of the region, with the exception of Pakistan (Sobhan, 2004; Kamel, 2004).

Since the SAFTA has failed to address the problem of regional trade asymmetries due to its slow progress, bilateralism has filled the gap. India has already entered into bilateral FTAs with Nepal, Bhutan and Sri Lanka, and is negotiating a bilateral FTA with Bangladesh. These bilateral FTAs need not necessarily act as impediments in the movement towards SAFTA. In fact they may actually facilitate SAFTA through already enhanced regional trade.

Sobhan (2004) suggested that stimulating investment by offering access to regional and global investors to an unrestricted South Asian market may push regional economic co-operation more than SAFTA. However, the HKH countries must alter traditional mindsets to be a favourable destination for foreign investments. Restrictive trade policies and archaic regulations must be changed by these potential host countries to make investors feel welcome and secure. Financing arrangements for investment through both public and private sector sources would have to be ensured to facilitate commerce and capital flows in the region.

There is also need of integrating labour markets, allowing thereby the free flow not only of commodities and capital, but also labour, a recognized factor of production. HKH countries have not, at least so far, proved capable of transcending their differences inherited from the past, or those now emerging, to move on a fast track towards regional economic integration. That does not auger well for the idea of an economic union. However, the relentless pressures of globalization are helping to break down the economic walls within the region. Trade volumes have surged. The paper explicated the distinct advantages for South Asian countries in cooperation in the energy sector. Cross-border energy trading offers vast potential and associated with it is the issue of regional water governance. It can fuel energy security, efficiency, economies of scale and sustained higher economic growth in an integrated South Asian power and gas market.

BIMSTEC aims to combine the 'Look West' policy of Thailand and ASEAN with the 'Look East' policy of India and South Asia. BIMSTEC is therefore described as a link between ASEAN and SARRC. Seven members of BIMSTEC covers 13 Priority Sectors lead by member countries in a voluntary manner namely, Trade & Investment, Technology, Energy, Transport & Communication, Tourism, Fisheries, Agriculture, Cultural Cooperation, Environment and Disaster Management, Public Health, People-to-People Contract, Poverty Alleviation and Counter-Terrorism and Transnational Crimes. BIMSTEC differs from other organizations as it represents one of the most diverse regions of the world in terms of socio-economy, religion, language, culture, etc. BIMSTEC has identified 13 Priority Sectors besides focusing only on economic cooperation thus making it more focused on development and trade issues. BIMSTEC is largely free from any security or political baggage of the past like South Asia Association of Regional Cooperation (SAARC). The progress in BIMSTEC has great positive implications for development of India's north-eastern region transforming it from a

subsistence economy to India's economic gateway to the East. But much of that agenda has not been addressed so far. The current volume of intra-regional trade in BIMSTEC is not large (The Financial Express, 2008).

Notwithstanding these positive steps, the South Asian countries need to further intensify economic cooperation in a number of areas to catch up with other regions and especially if they wish to realize the dream of forming an economic union on the pattern of European model. These include: a) The creation of a South Asian Economic Union; b) Co-operation in energy and water management sectors; c) Strengthening transportation, transit and communication links, d) Harmonization of standards and simplification of customs procedures, e) Public and private sector cooperation through joint ventures; f) Setting up a South Asia Development Bank; g) Cooperation among Central Banks; h) Development of tourism within South Asia; i) Discussing, coordinating and exchanging information to adopt common positions in multilateral forums, and j) Approval of the Plan of Action on Poverty Alleviation prepared as agreed in 2004.

## **Conclusion:**

HKH countries have not so far succeeded in transcending their differences inherited from the past, or those now emerging, to move on a fast track towards regional economic integration and co-operation. This does not auger well for the idea of an economic union enshrined in the vision of SAARC and SAFTA.

However, the relentless pressures of globalization are helping to break down the economic walls within the region. Trade volumes have expanded significantly between major economies. A revival of past nature of integrated South Asian economic situation of the subcontinent is now re-emerging. China has expanded its economic co-operation with a number of South Asian, especially LDC, countries with liberal offer of credits, technologies and investments. India together with China must take the responsibility for leading the region towards political, economic and social cooperation. The challenge is to lend high political energy to the process by major countries.

The signing of SAFTA has created a lot of euphoria in the South Asian countries. However, if the countries continue to keep a very large negative list of products that includes most of the products of export interest of South Asian countries, trade would not expand as per the projected potential. The SAARC countries must make combined effort by showing political will to make SAFTA a success. This will surely expedite economic development by addressing the ongoing problems in global market access and the higher transaction and transportation costs of producing for the world market. The expansion of regional trade can yield tremendous economic gains in products specialisation, efficiency and improved quality of exports, and lower costs which will benefit all the countries of the region. Similarly, the central Asian countries including Afghanistan will also benefit by integrating their energy, water resources management, transportation, environment conservation, university education and common economic policies. For deeper economic cooperation, it is necessary to create enabling policy and institutional environment by removing political mistrust and suspicion. Tariff and non-tariff trade barriers need to be removed and infrastructure and trade facilities need to be created. Finally, it is necessary to change the mind set. Strong political will can solve many problems facing by the region and promote trans-border economic cooperation.

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