TRADE AND INVESTMENT FLOWS IN SAARC REGION

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I

Regional trading blocks generally play a significant role in theory and practice of international economics. South Asian Association of Regional Co-operation (SAARC), one such regional block, was established in 1985 at its first summit held in Dhaka, Bangladesh, to address complex problems and issues and to seek their solutions at the regional level. The idea of regional co-operation in South Asia first evolved during 1977 to 1980 on the initiative of Bangladesh. SAARC is an important endeavour on the part of seven countries of South Asia to accelerate economic and social development through the concept of collective self-reliance, co-operation and harmony in selected areas.

Each SAARC country has a dominant agricultural sector whose prominance has been declining over the years. Among them, India and Pakistan possess relatively strong manufacturing and commercial sectors. Each SAARC country pursued an inward-looking economic policy until 1990. Most of them have undertaken various measures to stabilize their economies and have announced major reforms in trade, industrial and foreign investment policies. These aim to improve resource mobilization, increase efficiency and enhance the international competitiveness of the economy.

The average annual growth rate of the SAARC region was 4.6 per cent during 1990 to 1995, far below that of seven per cent achieved by the ASEAN region (Table 1). However, this growth rate of SAARC increased to around 6.5 per cent during the

Table 1
Average Annual Growth Rate of Basic Indicators of SAARC and ASEAN Region

Region	GDP	Agriculture	Industry	Services	Exports	Imports	Inflation
SAARC							
1965-80	3.28	2.04	4.20	4.60	0.46	0.13	10.18
1980-90	5.33	3.65	5.85	6.26	7.47	3.06	8.80
1990-95	4.64	2.30	6.78	6.00	13.52	8.02	9.76
ASEAN							
1965-80	7.48	3.90	10.25	7.20	6.42	5.84	12.62
1980-90	5.12	3.87	5.70	5.70	9.88	6.06	6.00
1990-95	7.14	2.55	7.90	6.98	17.42	12.96	6.10

Source: Computed from *World Development Report 1992-97.*

Table 2
Share of International Trade of SAARC and ASEAN

(percentage of world total)

	Exports	Imports
SAARC		
1980	0.656	1.244
1987	0.800	1.210
1992	0.880	1.010
1995	0.895	1.125
ASEAN		
1980	4.309	3.784
1987	3.380	3.200
1992	5.030	5.110
1995	8.357	6.524

Source: Computed from *World Development Report 1989-1997.*

Table 3
Growth Rate of GDP of SAARC Countries

(per cent per annum)

	Average 1981-90	1991	1992	1993	1994	1995	1996	1997	1998
Bangladesh	4.1	3.4	4.2	4.5	4.2	4.4	4.7	5.4	6.0
Bhutan	7.5	3.5	4.5	6.1	6.4	7.5	6.4	—	—
India	5.6	0.8	5.1	6.2	7.2	7.1	6.8	7.0	7.0
Maldives	12.1	7.7	6.3	6.2	6.6	7.2	6.5	—	—
Nepal	4.7	6.4	4.6	3.3	7.9	2.9	6.1	4.5	5.0
Pakistan	6.2	5.6	7.7	2.3	4.5	4.4	6.1	5.2	6.5
Sri Lanka	3.8	4.6	4.3	6.9	5.7	5.6	3.8	5.7	5.9
SAARC	5.5	1.8	5.4	5.5	6.6	6.4	6.5	6.6	6.8

Source: ADB, *Asian Development Outlook 1997-98.*

latter part of the 1990s. In the agricultural sector it declined from 3.7 per cent during 1980 to 1990 to 2.3 per cent during 1990 to 1995. This was due to a shift from agriculture to manufacturing and services sectors. SAARC had an impressive growth rate of 6.8 per cent in industry in 1990 to 1995, comparable to that of the ASEAN during the same period. The growth rate in the service sector, too, was comparable with that of the ASEAN. The annual average rate of exports of SAARC increased from 7.5 per cent during 1980 to 1990 to 13.5 per cent during 1990 to 1995. The growth rate of imports, too, increased during the same period. However these were far behind the ASEAN. SAARC's share of exports of international trade is insignificant (0.9 per cent), but that of ASEAN was 8.4 per cent in 1995 (Table 2). Share of SAARC's imports in world imports accounted for only 1.1 per cent, compared to 6.5 per cent in the case of ASEAN.

India's performance has been the most impressive among all the countries in

SAARC. It achieved a growth rate of seven per cent during 1995 to 1999 (Table 3). The average growth rate of GDP of Bangladesh increased from 4.2 per cent in 1992 to six per cent in 1988. It was five per cent in the case of Nepal in 1998. As for Pakistan it fell from 7.7 per cent in 1992 to 2.3 per cent in 1993, but again rose to 6.5 per cent in 1998. The growth rate of Sri Lanka's GDP fell from 6.9 per cent in 1993 to 3.8 per cent in 1996 because of the ethnic conflict, but picked up to reach six per cent in 1998.

Export-GDP ratio was very low in all the countries except Sri Lanka, where it was around 36 per cent in 1996. In India, it improved from six per cent in 1991 to 10 per cent in 1996. Nepal, too it rose from six per cent to eight per cent mainly because of the increase in the exports of carpets. Pakistan recorded a ratio of 13 per cent in 1991 because of opening up to international trade, but failed to expand further, upto 1996. Pakistan increased its exports of cotton manufactures at the expense of raw cotton but failed to carry out any diversification during this period. Sri Lanka, with a relatively a long history of economic liberalization, since 1977, achieved a relatively high ratio of exports to GDP of 29 per cent in 1991 and increased it further to 36 per cent in 1996. Intermediate and capital goods, linked to its rapidly expanding textile market have dominated Bangladesh. Sri Lanka's exports commenced with a low ratio of seven per cent in 1991 and raised it to 13 per cent in 1996 through concerted efforts to increase exports of readymade clothing, frozen shrimps and fish, replacing traditional jute and jute goods.

In the theoretical literature, growth, structural changes and developments are considered highly interrelated phenomena. Structural change is an integrated part of the process of growth and development. The economic structure is considered in terms of shares of three broad sectors: agriculture, industry and services. The process of growth and, in particular, of industrialization is supposed to reduce the share of agriculture, raise that of industry and, at a later stage, increase the share of the services faster than that of industry. Thus the services sector takes the dominant position in the economic map of the country. The sectoral share of GDP in SAARC countries is given in Table 4. It is evident that there has been a significant shift from

Table 4
Sectoral Share of GDP of SAARC Countries

	Agriculture			Industry			Services		
	1970	1980	1996	1970	1980	1996	1970	1980	1996
Bangladesh	—	49.4	31.9	—	14.8	19.7	—	35.8	48.4
Bhutan	—	56.7	35.3	—	12.2	31.3	—	31.1	33.4
India	44.5	38.1	26.1	23.9	25.9	31.7	31.6	36.0	42.2
Maldives	—	—	—	—	—	—	—	—	—
Nepal	—	61.8	41.4	—	11.9	19.1	—	26.3	39.5
Pakistan	40.1	30.6	24.8	19.6	25.6	26.4	40.3	43.8	48.7
Sri Lanka	30.7	26.6	19.1	27.1	27.2	32.1	42.2	46.2	48.7

Souce: ADB, *Asian Development Outlook, 1997.*

Table 5
Exports of SAARC Countries

(in $ billion)

Year	Bangladesh	India	Nepal	Pakistan	Sri Lanka	SAARC
1985	1.0	9.5	0.1	2.5	1.3	14.7
1986	0.9	10.2	0.1	3.2	1.2	16.0
1987	1.1	11.9	0.2	3.5	1.4	18.3
1988	1.3	13.7	0.2	4.4	1.5	21.4
1989	1.3	15.8	0.2	4.6	1.6	24.0
1990	1.5	18.2	0.2	5.0	1.8	27.4
1991	1.8	20.5	0.2	5.7	2.1	31.1
1992	2.0	23.6	0.2	6.3	2.4	35.5
1993	2.1	25.7	0.2	6.3	2.8	37.1
1994	2.5	31.8	0.4	6.7	3.2	44.6
1995	3.5	41.4	0.4	7.8	3.8	56.9
1996	3.9	44.8	0.4	8.3	4.3	61.7
1997	4.4	52.5	0.4	9.3	5.0	71.6
1998	5.2	61.4	0.5	10.6	5.9	83.6

Source: ADB, *Asian Development Reports.*

agriculture to industry to service in the economy of every SAARC country. In India, the services sector constitutes 42 per cent of GDP, and 48 per cent in Bangladesh, Pakistan and Sri Lanka. The share of the industries sector in GDP is the second highest in India, Pakistan and Sri Lanka. But agriculture dominated Bangladesh, Nepal and Bhutan in 1996. The data reveal that the fall in the share of agriculture and the increase in that of industry were slow during 1970 to 1996; but the share of the services sector in all the countries has grown relatively faster than the other sectors, during this period.

The objectives of this paper are to analyse the flow of trade and investment and to find out whether foreign direct investments promote exports of manufactured goods.

The organization of the paper is as follows: Section 2 is devoted to analyzing trade flows in the SAARC countries. Section 3 analytically studies investment flows in the region. Section 4 tests the hypothesis that foreign direct investments promote exports of manufactured goods and section 5 concludes the discussion.

II

Trade Flows in SAARC Countries

There has been significant growth in the foreign trade of SAARC countries. Exports grew at an average rate of 36 per cent per annum during 1985-86 and imports at 19 per cent per annum during the same period (Tables 5 and 6). Exports of Bangladesh doubled and imports expanded by more than 50 per cent between 1991 and 1995. Political unrest and the non-co-operation movement in Bangladesh resulted in a fall in the growth rate of exports by 11.8 per cent and a rise in imports by 18 per cent in 1996. However, exports of Bangladesh showed a robust growth of 14.5 per

Table 6
Imports of SAARC Countries

(in $ billion)

Year	Bangladesh	India	Nepal	Pakistan	Sri Lanka	SAARC
1985	2.2	15.1	0.4	6.0	2.0	26.4
1986	2.3	15.7	0.4	6.0	2.0	27.0
1987	2.4	17.7	0.5	5.8	2.1	29.0
1988	2.7	20.3	0.7	6.9	2.2	33.5
1989	3.2	22.8	0.6	7.2	2.2	37.0
1990	3.6	26.0	0.6	7.2	2.5	41.4
1991	3.8	28.3	0.7	8.0	2.7	45.2
1992	4.2	31.1	0.7	8.2	3.1	40.3
1993	3.8	31.5	0.7	8.4	3.2	47.6
1994	3.8	31.8	1.0	8.7	4.3	49.6
1995	5.2	41.4	1.3	10.3	4.7	62.9
1996	6.2	44.8	1.4	12.0	5.1	69.5
1997	7.5	52.5	1.5	13.1	5.9	80.5
1998	8.7	61.4	1.7	14.3	7.0	93.1

Source: ADB, *Asian Development Reports*.

cent and 16.6 per cent in 1997 and 1998 respectively. India's trade has improved substantially since the implementation of the macroeconomic stabilization programme and structural reforms in 1991. Exports increased around 20 per cent on an average during 1994 to 1998, but imports fell from 27 per cent in 1994 to 17 per cent in 1998, due to a significant slowdown in non-oil imports. Exports grew slowly at three per cent in Nepal in 1997. The country has a narrow export base, concentrating on two product areas (carpets and garments). With the growing concern in the West about the employment of child labour and the use of environmentally unfriendly dyes, exports of these two products have slowed down. In 1998, however, exports showed significant growth of 25 per cent mainly due to a new trade and transit treaty with India. Imports of Nepal, too, fell during 1995 to 1998. Pakistan's exports fell to seven per cent in 1996, but increased to 14 per cent in 1998. The composition of its exports has become more diversified with more manufactured and semi-manufactured goods. Its imports fell from 18.5 per cent in 1995 to nine per cent in 1998. Sri Lanka's exports increased from 12 per cent in 1996 to 18.5 per cent in 1998, due to the growth of non-traditional exports. Its imports too, grew from nine per cent in 1995 to 19 per cent in 1998, mainly due to an increase in the import of consumer goods, capital goods and intermediate goods, such as fertilizer and petroleum. The share of manufactures in total exports was more than 76 per cent in India and Sri Lanka, and was more than 85 per cent in Bangladesh, Pakistan and Nepal.

The product composition of exports of SAARC has changed significantly in the past 10 years, shifting away from primary commodities to labour-intensive manufactures, particularly garments and textiles, gems and jewellery and leather products. The share of the garments sector rose from about five per cent in the early

Table 7
Intraregional Trade of SAARC

(in percent)

	Share of Intra-regional exports in total exports			Share of Intra-regional Imports in total imports			Share of Intra-regional trade in total trade		
	1990	1995	1996	1990	1995	1996	1990	1995	1996
Bangladesh	3.6	2.7	1.7	6.8	17.6	17.7	5.8	12.8	12.5
India	2.7	5.0	4.8	0.4	0.5	0.4	1.4	2.6	2.4
Nepal	7.2	9.0	11.2	11.7	17.6	21.4	10.2	15.0	18.2
Pakistan	4.0	3.1	2.5	1.6	1.4	2.4	2.6	2.1	2.5
Sri Lanka	3.3	2.4	2.2	6.7	7.8	8.5	5.3	5.8	6.1
SAARC	3.1	4.3	4.0	1.8	3.6	3.6	2.4	3.9	3.8

Source: *Direction of Trade Statistics, IMF.*

1980s in both India and Pakistan to 15 per cent and 22 per cent respectively in 1996. In Sri Lanka and Bangladesh, garments exports have risen from an insignificant quantity to 46 per cent and 54 per cent respectively during the same period. The shift in exports from traditional products to differentiated technologically advanced goods in the manufacturing sector has been only marginal in this region. In India, the share of technologically advanced goods in total exports of manufactured products was only eight per cent in 1994. In Pakistan and Sri Lanka the respective figures were only two per cent and 3.4 per cent. In contrast, the share of technologically advanced goods in the total exports of manufactured goods in the ASEAN ranged from 22 per cent to 70 per cent in 1995.

Intra-regional trade in goods and services in SAARC is very small compared to the overall trade of the region. Intra-regional exports were 3.1 per cent of their total exports in 1990. They rose to 4.3 per cent in 1995 mainly because of the increase in the trade between India and Nepal (Table 7). The intra-regional exports of Bangladesh and Pakistan declined between 1991 and 1996. Indo-Nepal trade, however, increased significantly during this period. Intra-regional exports of Sri Lanka have remained stable around 2.2 per cent. There was a significant increase in intra-regional imports of Nepal and Bangladesh. These were marginal in the case of Pakistan and insignificantly small in the case of India. India's exports to the rest of the SAARC counties were than trebled between 1990 and 1995, but its imports from the region grew slowly.

The share of Bangladesh's exports in the total exports of the region to India increased from 0.2 per cent in 1992 to 1.1 per cent in 1995 and then fell to 0.6 per cent in 1996 (Table 8). No definite trend could be identified of the share of its exports to other countries. India's share of exports to Bangladesh has been steadily increasing since 1991, but it remained more or less stagnant in relation to the rest of the countries of the region during 1990 to 1996. Nepal's exports have been directed mainly to India and have remained insignificant as far as the other countries of the region are concerned. Bangladesh shared two per cent of Pakistan's exports, and Sri

	World	454	500	477	527	614	750	730	100	100	100	100	100	100	100
Pakistan	Bangladesh	38	37	50	38	24	35	36	0.5	0.4	0.5	0.4	0.3	0.3	0.3
	India	46	44	52	67	72	81	212	0.6	0.5	0.6	0.7	0.8	0.7	1.7
	Nepal	0	4	4	1	0	1	0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
	Sri Lanka	37	34	33	41	42	50	45	0.5	0.4	0.4	0.4	0.5	0.4	0.4
	South Asia	121	120	139	147	139	166	292	1.6	1.4	1.5	1.6	1.6	1.4	2.4
	World	7383	8431	9375	9494	8888	11460	12150	100	100	100	100	100	100	100
Sri Lanka	Bangladesh	9	4	15	7	4	13	3	0.3	0.1	0.4	0.2	0.1	0.2	0.0
	India	118	220	307	343	367	422	481	4.5	7.2	8.8	8.6	7.0	6.6	7.1
	Nepal	0	0	24	0	0	0	0	0.0	0.0	0.7	0.0	0.0	0.0	0.0
	Pakistan	51	74	67	55	77	61	88	1.9	2.4	1.9	1.4	1.5	1.0	1.3
	South Asia	178	298	413	405	448	495	572	6.7	9.7	11.9	10.1	8.5	7.8	8.5
	World	2636	3061	3473	4005	5246	6351	6745	100	100	100	100	100	100	100

Source: *Direction of Trade Statistics, IMF*

Sri Lanka	Bangladesh	10	5	7	7	6	10	9	0.5	0.2	0.3	0.3	0.2	0.3	0.2
	India	20	13	12	20	28	35	42	1.1	0.6	0.5	0.7	0.9	0.9	1.0
	Nepal	0	0	1	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Pakistan	32	32	29	35	38	45	40	1.7	1.6	1.2	1.2	1.2	1.2	1.0
	South Asia	63	49	48	63	73	90	92	3.3	2.5	1.9	2.2	2.3	2.4	2.2
	World	1895	1987	2488	2859	3220	3740	4107	100	100	100	100	100	100	100

Source: *Direction of Trade Statistics, IMF.*

Table 9

SAARC Intraregional Imports, 1990-1996

Country	Partner	1990	1991	1992	1993	1994	1995	1996	1990	1991	1992	1993	1994	1995	1996
		(Million US $)							(Share in per cent)						
Bangladesh	India	170	189	284	380	467	994	1138	4.7	5.5	7.6	9.5	10.1	15.3	16.2
	Nepal	2	0	0	0	1	4	5	0.0	0.0	0.0	0.0	0.0	0.1	0.1
	Pakistan	70	57	88	90	110	138	87	1.9	1.7	2.4	2.2	2.4	2.1	1.2
	Sri Lanka	8	5	6	7	7	11	10	0.2	0.1	0.1	0.2	0.1	0.2	0.1
	South Asia	250	252	378	478	584	1147	1241	6.8	7.4	10.1	11.9	12.7	17.6	17.6
	World	3656	3421	3731	4015	4605	6504	7017	100	100	100	100	100	100	100
India	Bangladesh	15	6	10	13	34	79	42	0.1	0.0	0.0	0.1	0.1	0.2	0.1
	Nepal	15	19	23	19	14	27	36	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	Pakistan	45	58	146	47	47	37	49	0.2	0.3	0.6	0.2	0.2	0.1	0.1
	Sri Lanka	22	12	14	17	31	39	46	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	South Asia	97	94	192	96	126	183	173	0.4	0.5	0.8	0.4	0.5	0.5	0.2
	World	23990	19636	23197	21497	25486	34456	40488	100	100	100	100	100	100	100
Nepal	Bangladesh	8	13	0	8	16	11	1	1.8	2.5	0.1	1.5	2.6	1.5	0.1
	India	43	85	80	83	93	118	150	9.6	17.0	16.8	15.7	15.2	15.7	20.6
	Pakistan	1	1	2	0	4	3	6	0.3	0.1	0.3	0.1	0.6	0.4	0.8
	Sri Lanka	0	0	1	0	0	0	0	0.0	0.0	0.2	0.0	0.0	0.0	0.0
	South Asia	53	98	83	91	113	132	157	11.7	19.6	17.4	17.3	18.3	17.6	21.4

Table 8
SAARC Intraregional Exports, 1990-1996

Country	Partner	1990	1991	1992	1993	1994	1995	1996	1990	1991	1992	1993	1994	1995	1996
		(Million US $)							(Share in per cent)						
Bangladesh	India	22	23	4	13	24	36	20	1.3	1.4	0.2	0.5	0.9	1.1	0.6
	Nepal	7	12	0	7	14	10	1	0.4	0.7	0.0	0.3	0.5	0.3	0.0
	Pakistan	23	39	30	26	19	26	35	1.4	2.3	1.5	1.1	0.7	0.8	1.0
	Sri Lanka	8	6	11	9	4	11	3	0.5	0.4	0.5	0.4	0.1	0.4	0.1
	South Asia	60	79	46	54	61	84	58	3.6	4.7	2.2	2.4	2.3	2.7	1.7
	World	1672	1687	2037	2277	2652	3129	3343	100	100	100	100	100	100	100
India	Bangladesh	297	2325	353	430	521	960	882	1.7	1.8	1.8	2.1	2.2	3.1	2.5
	Nepal	40	77	73	75	85	107	137	0.2	0.4	0.4	0.4	0.3	0.4	0.4
	Pakistan	43	40	52	58	59	70	196	0.2	0.2	0.3	0.3	0.2	0.2	0.6
	Sri Lanka	102	175	231	247	334	383	441	0.6	1.0	1.2	1.2	1.4	1.3	1.3
	South Asia	482	617	709	810	998	1521	1656	2.7	3.4	3.7	3.9	4.1	5.0	4.8
	World	17813	17873	19230	20818	24196	30537	34603	100	100	100	100	100	100	100
Nepal	Bangladesh	1	0	0	0	0	4	5	0.6	0.0	0.1	0.1	0.1	1.1	1.4
	India	14	17	21	17	13	25	33	6.4	6.8	5.9	4.7	3.6	7.7	9.7
	Pakistan	0	4	3	1	0	0	0	0.2	1.5	0.9	0.2	0.1	0.1	0.1
	Sri Lanka	0	0	22	0	0	0	0	0.0	0.0	6.1	0.0	0.0	0.0	0.0
	South Asia	16	21	46	18	13	29	39	7.2	8.3	13.0	4.9	3.8	9.0	11.2
	World	216	257	352	367	350	322	345	100	100	100	100	100	100	100
Pakistan	Bangladesh	103	101	136	105	119	153	109	1.8	1.5	1.9	1.6	1.6	1.9	1.2
	India	49	47	136	53	46	39	41	0.9	0.7	1.9	0.8	0.6	0.5	0.4
	Nepal	1	0	1	0	3	3	6	0.0	0.0	0.0	0.0	0.0	0.0	0.1
	Sri Lanka	69	68	85	57	70	55	80	1.2	1.0	1.2	0.9	1.0	0.7	0.9
	South Asia	222	216	358	216	238	250	236	4.0	3.3	4.9	3.2	3.2	3.1	2.5
	World	5587	6494	7270	6703	7344	7991	9299	100	100	100	100	100	100	100

Lanka around one per cent. The share of its exports to India have been falling continuously since 1992. The share of Sri Lanka's exports to India and Pakistan was around one per cent and almost negligible to the rest of the countries in the region.

Bangladesh's imports from India was significant and its share increased from 4.7 per cent in 1990 to 16.2 per cent in 1996 (Table 9). However, its share of imports from other countries of the region was either stagnant or declining. India's imports from other countries of the region was very low. Nepal's share of imports from India was 21 per cent in 1996 as against 9.6 per cent in 1990. Pakistan's share of imports from India was only 1.7 per cent in 1996, and was low from other countries as well. Sri Lanka's share of imports from India was significant at 7.1 per cent in 1996. But, the share of its imports from Pakistan fell from 2.4 per cent in 1992 to 1.3 per cent in 1996.

The low volume of trade among SAARC countries can be attributed to several factors. These countries have similar patterns of resource endowments. Hence, gains from specialization and exchange cannot be meaningfully exploited by them with similar factor intensities, according to the Heckscher Ohlin-Samuelson trade theory. There is a very low complementarity index among SAARC countries. Perennial hostility between India and Pakistan has stifled the growth of trade links between them. Trade, commerce, finance and investment have not been the top priorities of any of these countries. There is a boom in illegal trade, and such trade between India and Bangladesh is almost equal to the volume of legal trade. The easing of bilateral border regulations between India, Bangladesh and Nepal would lead not only to expanded trade and reduced trade imbalance, but also less illegal trade.

The composition of SAARC intra-country exports indicates that manufactured goods constitute 72 per cent of the region's exports. Among these, engineering goods account for 26 per cent followed by textiles (24 per cent). Exports of agricultural goods and allied products constitute only 21 per cent of total regional exports.

Comparative Advantage in Agricultural Products

The SAARC group has revealed comparative advantage (RCA) in agricultural products, and both labour-intensive and capital-intensive manufactures (see Panchamukhi et al., 1996). Such RCA applies to minerals and machinery as well. Among product groups, the SAARC region has RCA in clothing, textiles, leather and footwear, raw foodstuffs, agricultural materials and minerals (ibid). Bangladesh has a rising trend of RCA in raw foodstuffs, but, for India it is in agricultural materials. Nepal, Pakistan and Sri Lanka have rising RCA in textiles. Bangladesh, Nepal, Pakistan and Sri Lanka achieved RCA in clothing in the 1990s. Bangladesh, Nepal and Sri Lanka have a rising RCA in leather and footwear. India's RCA is in chemicals, rubber and plastic products, glass, non-metal product and metal product (ibid). however, RCA changes over time with advances in technology and changes in the structure of industry.

A major initiative for promoting greater economic co-operation among SAARC countries was taken in 1993 with the Preferential Trading Arrangement (SAPTA) which became operational in April 1995, when minor concessions were negotiated.

This resulted in intra-regional trade liberalization affecting an estimated six per cent of traded goods. India's preferential imports under the first round amounted to about US$ 12 million, more than half of which came from Bangladesh. India received concessions of roughly US$ 40 million mainly from Sri Lanka. More significantly, the first round did not address non-tariff barriers. The second round agreement (effective March 1997) apparently adopted more far-reaching measures, with an exchange of preference on around 2,000 products.

Potential for Increased Indo-Bangla Trade

India offered concession on 513 items (tariff reduction of 50 per cent on 200 items) and agreed to remove quantitiative restrictions on 330 items from Bangladesh. In exchange Bangladesh agreed to a 10 per cent reduction on tariffs on 204 items. The bilateral exchange of concessions between India and Bangladesh is of little consequence as only two low-ranked products among the top 50 traded in Bangladesh have been offered concessions (Mukherji, 1997). For Pakistan and Sri Lanka, the number of concessions offered is higher, but still limited. International experience suggests that preferential trading agreements and regional co-operation can help in so far as they promote greater openness to the world (see Krueger, 1995, Frenkel J, 1995). Easing of border restrictions could significantly increase trade. The flourishing illegal trade among members of SAARC, particularly along the border of Bangladesh and India, indicates that trade between those countries has the potential to increase significantly.

Pigato et al. (1997), with the help of a general equilibrum model, projected that the SAARC region would emerge as a major force in world trade in the next 25 years. The annual growth of exports in 1992 to 2020 would outpace that of output in India and other countries of the region. India's share in world exports would increase from one per cent in 1992 to four per cent in 2020. The abolition of the Multi Fibre Arrangement (MFA) would increase exports of textile and clothing significantly. Pigato et al. predicted that India's comparative advantage would shift from labour-intensive to more capital and skill-intensive sectors, such as light and heavy manufactures and machinery and equipment. The comparative advantage of the rest of the region would remain in labour-intensive products, and textile and apparel would continue to account for about half of the region's exports.

III

Foreign Direct Investment (FDI) Flows in SAARC

FDI inflows in SAARC rose tremendously from $ 470 million in 1991 to $ 4,379 million in 1997 (Table 10). However, this was very small compared to ASEAN and China. In 1995 to 1996 ASEAN received $ 20 billion, while China alone received $ 38 billion. In India, FDI inflows have increased from $ 155 million in 1991 to $ 3,264 million in 1997, accounting for three-quarters of the total inflows in the region. India's potential for FDI inflow remains substantial. These have remained low in other economies of SAARC. FDI inflows in Pakistan, the second largest recipient in

Table 10
FDI Inflows by Host Country

(US$ millions)

Countries	1985-90	1991	1992	1993	1994	1995	1996	1997
Bangladesh	2	1	18	10	8	2	14	15
Bhutan	—	—	—	—	—	—	—	—
India	169	155	233	574	973	1964	2382	3264
Maldives	4	7	7	7	9	7	8	10
Nepal	2	2	1	4	6	5	19	20
Pakistan	167	257	335	347	419	719	770	800
Sri Lanka	37	48	123	195	166	56	120	140
SAARC	381	470	717	1137	1581	2753	3313	4379

Source: UNCTAD, *World Investment Report-1998.*

SAARC region, have increased marginally during the last three years. Their growth has been hampered by structural bottlenecks and further slowdown in economic growth. Sri Lanka and Bangladesh had only insignificant FDI inflows during the 1990s. However, Bangladesh attracted $ 145 million in 1997.

The level and pace at which FDI increases are important indicators of financial integration. FDI inflows as a percentage of gross fixed capital formation have increased significantly in all countries of the region except Bangladesh (Table 11). In India the ratio has increased significantly from 0.3 per cent in 1991 to 2.9 per cent in 1996, in Pakistan from 3.3 per cent to 7.10 per cent and in Sri Lanka from 2.4 per cent to 3.6 per cent during this period. Mergers and acquisitions (M&As) have been important modes of entry for FDI in the region, reflecting the importance of its industry structure and stronger technology-based competition. While greenfield FDI add to the stock of capital in the host country, M&As may not lead to capital formation in the short run. The immediate effect of M&A is merely an asset transfer from a host country-owner to foreign MNCs. But the acquirer may carry out modernization and capacity expansion or induct other related investments. Often

Table 11
Inward FDI Flows As a Percentage of Gross Fixed Capital Formation

(Percentage)

Countries	1985-90	1991	1992	1993	1994	1995	1996
Bangladesh	0.3	0.1	0.6	0.3	0.2	—	0.3
Bhutan	—	—	—	—	—	—	—
India	1.2	0.3	0.4	1.0	1.4	2.4	2.9
Maldives	—	—	—	—	—	—	—
Nepal	0.7	0.4	0.2	0.5	0.6	0.5	2.1
Pakistan	5.1	3.3	3.7	3.8	4.6	7.1	7.1
Sri Lanka	6.9	2.4	5.4	7.5	5.3	1.7	3.6

Source: UNCTAD, *World Investment Report-1998.*

acquisition may have been undertaken just to eliminate competition by eventually closing down the acquired firm.

In India, FDI in the manufacturing sector has declined from 85 per cent in 1991 to 59 per cent in 1995, following the opening up of infrastructure and services. Fuel, chemical, services and metals have accounted for more than 50 per cent of FDI since 1991. FDI inflows in India have targeted domestic markets especially in the service sector, rather than export markets. The share of FDI in telecommunications was 24 per cent of the total in 1996. The US has accounted for one-third of the FDI approved in the post-liberalization period, followed by the UK (7.5 per cent), Japan (5 per cent), Switzerland (4.6 per cent) and Germany (3.2 per cent). Korea was the leading source of FDI in India in 1996, second only to the US. The LG Group of Korea has announced its intention to invest about $ 2 billion in pharmaceuticals, petrochemicals, cosmetics, household goods and other processed goods. In Pakistan, too, FDI inflows into the export sector has been limited but for textiles and agri-business. An increasing amount of FDI has gone to the service sector and infrastructure. By contrast, Bangladesh has been fairly successful in attracting FDI in its export processing zones, particularly in the readymade garment sector, exploiting the quota restrictions imposed under the MFA. Bangladesh has attracted FDI in electric and electronic parts, metal products and telecommunications. In Sri Lanka, more than 55 per cent of the FDI have gone to the manufacturing sector, within which the share of textiles has declined, even though it attracted 30 per cent of the inflow.

IV

FDI and Manufactures Exports

An econometric exercise was undertaken to find out whether FDI would promote export of manufactured goods and whether the larger the inflow of FDI, the larger the presence of the countries concerned in the manufactured goods trade.

The specification of the model is given as:

$$Xm = \beta_0 + \beta_1 TX + \beta_2 FDI + \beta_3 GDP + \mu$$

Table 12
Model Results

	β_0	β_1	β_2	β_3	R^2	R^{-2}	F	DW
Bangladesh	−110.2 (1.2)	0.65* (7.21)	35.1 (1.7)	4123.3 (1.21)	96	94	81.2	1.83
India	452.0 (0.73)	0.45* (7.31)	8.35* (2.81)	−632.1 (0.52)	95	94	79.2	1.92
Sri Lanka	−1521.2 (3.38)	0.71* (6.21)	1.52 (0.91)	0.05** (2.62)	81	80	41.2	1.73
Pakistan	42.3 (0.31)	0.62* (8.74)	0.52 (0.31)	−7312.2 (2.0)	92	91	181.2	1.84

Note: Figures in brackets indicate t-ratio
* indicate singificant at 5 per cent level ** indicate singificant at 10 per cent level

Where	Xm	=	Exports of manufactures
	Tx	=	Total exports
	FDI	=	Foreign Direct Investment
	GDP	=	Gross Domestic Product
	μ	=	Random error

The model was estimated by OLS over the period 1990 to 1997. The result is given in Table 12. It is evident that FDI is a significant variable in promoting export of manufactures only for India. It is not significant for Pakistan, Bangladesh and Sri-Lanka. The plausible explanation for this may be that exports of manufactures depend on many other factors, such as technological capabilities of the country, the existing status of the manufacturing sector, infrastructure, etc.

Conclusion

Regional Trading blocks play an important role in the theory and practice of international economics. SAARC is an important endeavour on the part of seven countries of South Asia to accelerate economic and social development through collective self-reliance, co-operation and harmony in selected areas. The average annual growth rate of the SAARC region was only 4.6 per cent during 1990 to 1995, at a time when the ASEAN region had a growth rate of seven per cent. Among the SAARC countries, India performed extremely well during 1995 to 1997.

There has been significant growth in exports and imports of SAARC countries. However, intra-regional trade is very small compared to the overall trade of the region. The low volume of trade-flows among SAARC countries can be attributed to the low complementarity index, similar patterns of resource endowments, etc. SAARC, as a group, has RCA in agricultural products and both labour-intensive and capital-intensive manufactures. Preferential trading arrangements have been made to promote greater economic co-operation among the countries of the region. International experience suggests that preferential trading agreements and regional co-operation can help in so far as they promote greater openness to the world.

FDI inflows in the SAARC region have increased to the ASEAN region and China. India accounts for three-quarters of the total inflows in the SAARC region. Mergers and acquisitions (M&As) are important modes of entry for FDI in the region. FDI has promoted exports of manufactures in India, but, it is not a significant variable for exports of manufactured goods in the rest of the countries of the region. The plausible explanation for this may be that exports of manufactures depend on many other factors, such as technological capabilities of the country, the existing status of the manufacturing sector, infrastructure, etc.

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An Apology

The names of the following contributors to the June 2001 issue were left out in this page:

Sumit Mustafi is Assistant Professor, Management Development Institute, Gurgaon.

Dwarka Nath Chatterjee is a former diplomat, was India's ambassador in France for several years and presently resides in Luxembourg.

I wish to offer my most profound apologies to our valued contributors for this inadvertent error.—Editor