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IS FOREIGN DIRECT INVESTMENT GROWTH-ENHANCING IN BANGLADESH?

Abstract

The recent debate over the foreign direct investment (FDI)-economic growth nexus has generated sizeable theoretical and empirical investigation both for developed and developing countries. This study explores the nexus in the context of a South Asian less developed country, Bangladesh, using long run time series data from 1972 to 2005. The study finds that FDI can explain the variation in GDP, but the relationship between FDI and growth is Granger-neutral, *i.e.*, FDI does not cause economic growth. Various time series tests have been performed on the dataset, which show that the series FDI is stationary or random but GDP is not, and the variables are not cointegrated, which means there is no long-term relationship between the two variables.

Keywords: FDI, Economic growth, Causality, Stationarity, Cointegration.

1. Introduction

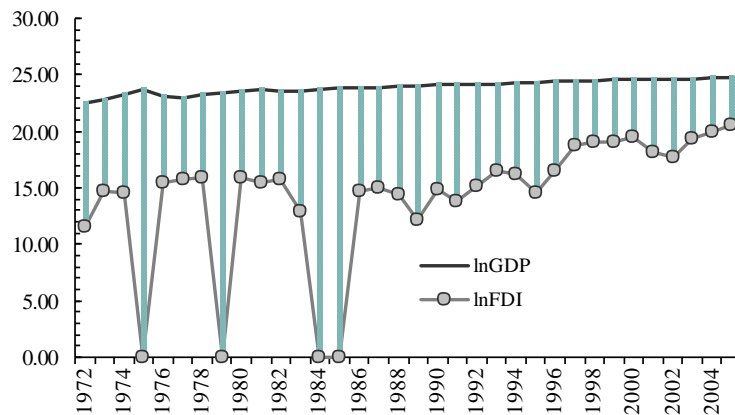
The recent debate over the impact of foreign direct investment (FDI) on economic growth has received a wide range of theoretical and empirical interest. The surge of FDI in developing economies during the last one and half decades is significant in terms of

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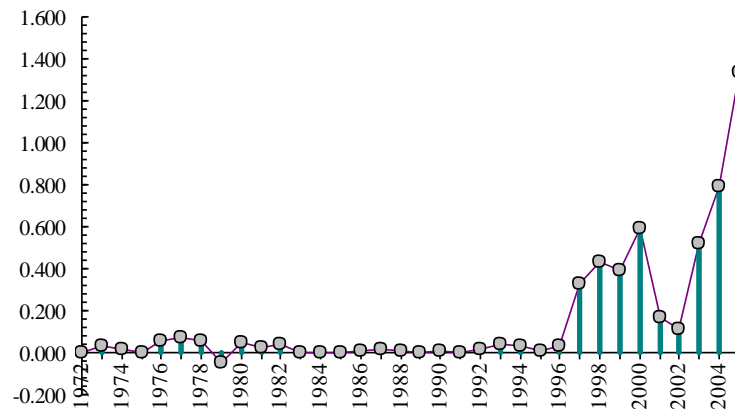
declining dependence on foreign aid, a more flexible policy regime conducive to attracting an increased quantity of FDI, and the overwhelming visibility of foreign firms in the domestic markets and their share of export earning of the host countries. A number of studies have been conducted on the topic in various countries and regions with mixed results. A recent analysis using long-term data from developing countries also demonstrated, to some degree, the significant impact of foreign investment on economic growth.¹

South Asia is home to almost one-fifth of the world population, about half of whom live in abject poverty. In order to achieve the heavily promoted Millennium Development Goals (MDGs) of poverty alleviation and social development, they need accelerated economic growth. The nations in the region are trying their best to gear up the pace of economic growth through a range of policy measures. In hosting FDI as one of most active economic instruments, the result has been an increased flow of foreign investment in the region.

Figure 1: Ratio comparison between net FDI and GDP (top) and net FDI as percentage of GDP (bottom) in Bangladesh



¹ N. Kumar, and J. P. Pradhan, "Foreign Direct Investment, Externalities and Economic Growth in Developing Countries: Some Empirical Explorations and Implications for WTO Negotiations on Investment", *Discussion Paper # 27/2002*, Research and Information System, New Delhi.



Bangladesh seems to offer perhaps the most attractive and liberal FDI regime in South Asia. The country has adopted a number of congenial policies and provided liberal incentives to attract FDI inflow. FDI is allowed in every sector of the economy except five sensitive industries reserved for the public sector². Foreign investment is entitled to receive a number of special treatments. They have the advantage of tax holiday for five to seven years since the month of production. Private sector power companies enjoy income tax exemption for fifteen years from the period of commercial production. Foreign enterprises and experts get tax exemption on their royalties and technical fees. For tax paying foreign enterprises there are bilateral arrangements with major trading partners to protect double taxation. Hundred per cent export-oriented firms do not have to pay any duty for importing machinery and spare parts. Full repatriation of profit and dividend by the foreign companies are permitted and at the same time re-investment of repatriable dividend is treated to be new investment. Foreign investors or companies are free to apply for full working capital loans from the local banks.³ Despite all these attractive terms, the net inflow of FDI is still meagre (less than 1.5 per cent of GDP in 2005) and it has not been

² The industries are defence equipments, nuclear energy, forest plantation, security printing, and railways.

³ See, for details, BEPZA Act 1980, Foreign Investment Act 1980, Companies Act 1994, and Industrial Policy 2004 of Bangladesh.

found to be growth-enhancing in Bangladesh in a recent study.⁴ Now, the important question is, if foreign investment does not have any significant influence on the economic growth of the country, why should Bangladesh welcome multi-billion dollar FDIs which would in fact be exploiting the country's scarce natural resources and receive special and differential treatment? It is in such a context that the present paper tries to investigate the nexus between FDI and economic growth in Bangladesh to help make appropriate policy decisions.

2. A Review of Literature

A growing body of literature suggests that FDI has a statistically significant strong positive impact on economic growth in host economies.⁵ Chen *et al* found a significantly positive relationship between FDI and economic growth in post-1978 China.⁶ de Mello,

⁴ Kumar and Pradhan, 2002, *op cit*.

⁵ For example, see, L. Alfaro, A. Chanda, S. Kalemli and S. Sayek, "FDI and Economic Growth: The Role of Local Financial Markets", *Journal of International Economics*, 64 (1), 2004, pp. 113-134; E. Borensztein, J. de Gregorio and J-W. Lee, "How does Foreign Direct Investment affect Economic Growth?" *Journal of International Economics*, 45, 1998, pp. 115-135; J. Benhabib and M. M. Spiegel, "The Role of Human Capital in Economic Development: Evidence from Aggregate Cross-Country Data", *Journal of Monetary Economics*, 34, 1994, pp. 143-173; L. de Mello, "Foreign Direct Investment-led Growth: Evidence from Time Series and Panel Data", *Oxford Economic Papers*, 51, 1999, pp. 133-151; V.N. Balasubramanyam, M. Salisu and D. Sapsford, "Foreign Direct Investment as an Engine of Growth", *Journal of International Trade and Economic Development*, 8 (1), 1999, pp. 27-40; J. Damoeei and A. Tavakoli, "The Effects of Foreign Direct Investment and Imports on Economic Growth: A Comparative Analysis of Thailand and the Philippines (1970-1998)", *Journal of Developing Areas*, 39 (2), 2006, pp. 79-100; A. Chowdhury and G. Mavrotas, "FDI and Growth: A Causal Relationship", *WIDER Research Paper No. 2005/25*, UNU-WIDER, Helsinki; H.G. Lheem and S. Guo, "Political Economy of FDI and Economic Growth in China: A Longitudinal Test at Provincial Level", *Journal of Chinese Political Science*, 9 (1) 2004, pp. 43-62; and UNCTAD, *World Investment Report 1992*, Geneva, 1992.

⁶ C. Chen, L. Chang and Y. Zhang, "The Role of Foreign Direct Investment in China's Post-1978 Economic Development". *World Development*, 23 (4), 1995, pp. 691-703.

using bivariate vector autoregression (VAR) models, found that FDI's role in capital accumulation and therefore a growth-enhancing effect is positive in Panama and Sierra Leone.⁷ Nair-Reichert and Weinhold (2001), upon performing Holtz-Eakin causality test on panel data from 24 developing countries, found that the growth rate of FDI results in a strong positive impact on GDP growth.⁸

FDI plays a positive role in economic growth and development through increased competition between foreign and domestic firms, human resource development (HRD), research and development (R&D), and transfer of advanced technology to the recipient economies — such arguments have gained substantial empirical ground. However, studies on the role of FDI on economic growth have been mainly focusing on some specific areas.

2.1 Transfer and Spillover of Advanced Technology. Borensztein *et al* argued that FDI from multinational enterprises (MNEs) plays an important role in developing economies access to advanced technology, as MNEs are equipped with the most advanced technology due to their substantial investment in research and development (R&D). FDI plays a notable role in technological advancement in developing economies which helps attain a higher rate of growth through capital deepening in their production processes. They found that FDI has positive effects on economic growth in the host economies.⁹

Kohpaiboon tested “Bhagwati’s hypothesis” that technology spillover is more likely in export promotion (EP) than import substitution (IS) industries. In the FDI-based Thai manufacturing sector, affirmation of this hypothesis was revealed based on cross-industry regression results.¹⁰ In the case of a country in transition,

⁷ de Mello 1999, *op cit*.

⁸ U. Nair-Reichert and D. Weinhold, “Causality Tests for Cross-Country Panels: A New Look at FDI and Economic Growth in Developing Countries”, *Oxford Bulletin of Economics and Statistics*, 63 (2), 2001, pp. 153-171.

⁹ Borensztein *et al*, 1998, *op cit*.

¹⁰ A. Kohpaiboon, “Foreign Direct Investment and Technology Spillover: A Cross-Industry Analysis of Thai Manufacturing”, *World Development*, 34 (3), 2006, pp. 541-556.

Estonia, Sinai and Meyer found that technological spillover was significant, and labour- and sales-intensive FDI generated larger spillovers than equity-intensive FDI.¹¹ Liu found large and significant spillover effects of FDI on 29 manufacturing industries in the Shenzhen Special Economic Zone of China in that it increased both the levels and growth rate of firm productivity from which the domestic sector mainly benefited.¹²

2.2 Impact on Domestic Firms. In the case of developing countries like Bangladesh and Mauritius, Rhee and Belot show that entry of foreign firms led to a boom in the textile industry.¹³ Conversely, Aitken and Harrison, examining the panel data from over 4000 Venezuelan plants, found that foreign investment had a negative impact on the productivity of domestic plants.¹⁴ FDI is also believed to be associated with increased competition between domestic and foreign firms and improves the skill and efficiency among the former, thereby ultimately having a positive impact on total factor productivity (TFP) and economic growth.

2.3 Crowding in Domestic Investment. FDI is believed to be associated with augmented capital accumulation in the host countries, particularly in developing ones. In that process, increased capital-labour ratio enhances economic growth. From a panel analysis of 69 developing countries, Borensztein *et al* found that FDI increases total investment more than one-for-one.¹⁵ On the other hand, Agosin and Machado, in a panel analysis of 36 countries for 1971-2000, found that FDI left domestic investment unchanged for

¹¹ E. Sinai and K.E. Meyer, "Spillovers of Technological Transfer from FDI: The Case of Estonia", *Journal of Comparative Economics*, 32, 2004, pp. 445-466.

¹² Z. Liu, "Foreign Direct Investment and Technology Spillover: Evidence from China", *Journal of Comparative Economics*, 30, 2002, pp. 579-602.

¹³ J. W. Rhee and T. Belot, "Export Catalysts in Low Income Countries", *World Bank Working Paper*, World Bank, Washington, D. C. 1989.

¹⁴ B. J. Aitken and A .E. Harrison, "Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela". *American Economic Review*, 89 (3), 1999, pp. 605-618.

¹⁵ Borensztein *et al* 1998, *op cit*.

24 African and Asian countries, and crowded out investment in 12 Latin American countries.¹⁶

2.4 Human Capital. FDI is said to have a substantial contribution to human resource development in the host economies. Borensztein *et al* found that the magnitude of FDI's influence on growth depends on human capital stock in the recipient country.¹⁷ Using cross-country estimates of human capital stock in growth accounting regression, Benhabib and Spiegel found that human capital had a positive role in the growth rate of total factor productivity.¹⁸ Ramirez found a significant and positive effect of FDI per-worker on the growth rate of labour productivity.¹⁹

2.5 Productivity, Efficiency and Growth. Foreign firms tend to be more productive than local ones in developing countries. A recent study on Kenyan firms suggested that technology, export intensity and productivity were higher in foreign firms than domestic ones.²⁰ Higher efficiency of FDI leads to higher growth through interaction between foreign investment and human capital.²¹ Balasubramanyam *et al* also found that FDI-labour (including human capital) interactions play an important role in the process of economic growth.²²

¹⁶ M. R. Agosin and R. Machado, "Foreign Investment in Developing Countries: Does it Crowd in Domestic Investment?" *Oxford Development Studies*, 33 (2), 2005, pp. 149-162.

¹⁷ Borensztein *et al*, 1998, *op cit*.

¹⁸ Benhabib and Spiegel, 1994, *op cit*.

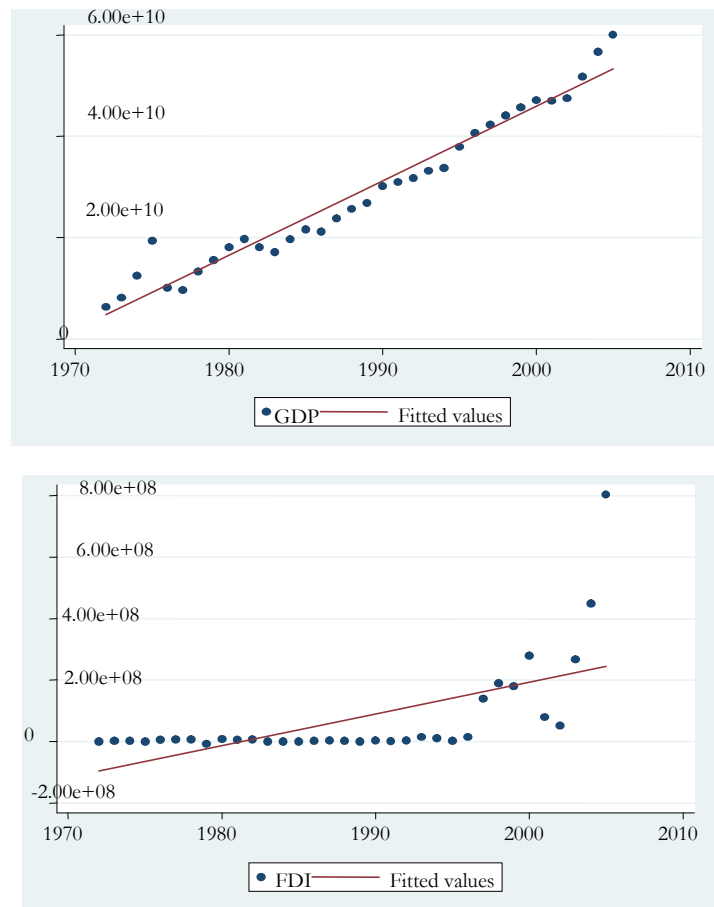
¹⁹ M.D. Ramirez, "Is Foreign Direct Investment Beneficial for Mexico? An Empirical Analysis, 1960-2001", *World Development*, 34 (5), 2006, pp. 802-817.

²⁰ R. Rasiah and G. Gachino, "Are Foreign Firms more Productive and Export and Technology-Intensive than Local Firms in Kenyan Manufacturing?" *Oxford Development Studies*, 33 (2), 2005, pp. 211-227.

²¹ Borensztein *et al*, 1998, *op cit*.

²² Balasubramanyam *et al*, 1999, *op cit*.

Figure 2: Trend of GDP (top) and FDI (bottom) inflow in Bangladesh



As aforementioned, Bangladesh has attractive policy instruments and legislations for FDI²³, and it is directed mainly in the ready-made

²³ There are also some exceptions in welcoming FDIs, which contrast with the existing favourable policies and legal instruments. For example, the policy-makers have not been very positive about the recent mega-size FDI proposals. The decision on Indian Tata group's multi-billion FDI proposal is yet to be made by the Bangladesh government. Another multi-billion

garments (RMG), natural resources (mainly gas and coal), manufacturing, and service (*e.g.* telecommunications) sectors. MNEs and joint ventures are increasingly taking part in mainly export-oriented industries. Among the Board of Investment (BOI)-registered investment proposals, during the periods 1981-1991 and 1991-2001, the share of foreign investment in total investment was 12 and 57.5 per cent respectively.²⁴ Given the documented multiple positive effects of foreign investment on economic growth in the host country, it is most likely that the effect of FDI on economic growth in Bangladesh is positive. However, using long-run data, Kumar and Pradhan found that FDI does not cause economic growth in Bangladesh.²⁵ But their paper is based on time series data for 19 years, from 1980 to 1999. They performed Granger causality test on 81 countries in order to assess whether there is causality between FDI and economic growth. Given this context, we develop econometric models in the following section in order to test whether FDI has an effect on growth in Bangladesh. The amount of net FDI flow has increased after the period. In the present paper we have taken larger dataset going beyond that period including the most recent ones, from 1972 to 2005, to examine exclusively if FDI is growth-enhancing in the country. The findings have been interpreted in section 4. Finally concluding remarks have been made.

3. Empirical Questions

3.1 Does FDI Exert Influence on Domestic Output?

In the neoclassical growth model, foreign investment enters into the production function to augment capital accumulation. In that process, the modified Cobb-Douglas production function becomes

$$Y = AL^r K^s F^x \quad (1)$$

where, Y , L , K and F are output (GDP), labour, capital and foreign capital (FDI), respectively. A represents a set of policy and control variables that affects the productivity growth. For the

recent FDI proposal of Mittal group has also not received the proper and positive attention of the government.

²⁴ See, for details, Bangladesh's Board of Investment website at <http://www.boi.gov.bd>, accessed on 25 August 2007.

²⁵ Kumar and Pradhan, 2002, *op cit.*

empirical purposes, taking logarithmic transformation and adding a stochastic error term the estimable equation becomes

$$\ln Y = w + \Gamma \ln L + S \ln K + \chi \ln F + e \quad (2)$$

In equation (2), \ln attached with each variable represents natural logarithmic transformation of the variables, and $\ln A$ and the stochastic error are denoted by ϵ and e respectively. A positive and significant coefficient on $\ln F$ will support the hypothesis that FDI has a positive effect on overall economic growth performance controlling for other factors of production.

Now assuming that F influences the efficiency of K and L and thus Y through direct and spillover effects, the aggregate impact of FDI on economic growth can be tested using the following simple regression equation

$$GDP_t = a + bFDI_t + e_t \quad (3)$$

Table 1: Regression Results (dependent GDP)

	Log-linear OLS Coefficient (standard error)	ARIMA Coefficient (standard error)
<i>a</i>	23.333*** (0.258)	2.42e+10*** (1.95e+09)
<i>b</i>	0.041** (0.017)	64.377*** (8.848)
Diagnostic		
Number of observations = 34	R ² = 0.17	Sigma = 1.03e+10
	R ² -adj = 0.14	Wald ² (1) =
	F = 6.13**	52.94***
	Heteroscedasticity Pr[² (1)] =	
	0.71	
Normality Pr[² (2)] = 0.06		
Model specification Pr [F(3,27)] =		
	0.00	

*** and ** imply significance at 1 and 5 per cent levels respectively.

The ordinary least squares (OLS) and autoregressive integrated moving average (ARIMA) regression results demonstrated in Table 1 indicates that FDI exerts statistically significant influence on

economic growth for the fitted regression on time series data from 1972 to 2005. However, the log-linear OLS coefficient of FDI and the estimated F value are significant at 5 per cent level but the goodness of fit indicators R^2 and adjusted R^2 are quite low (0.17 and 0.14 respectively). This implies that although the overall fitness of the model is good, but FDI cannot substantially explain the variation of GDP growth.

The basic assumptions of the simple econometric model are that the residuals terms have equal variance and these are normally distributed. It is also assumed that there is no omitted variable bias in the model, that is, the model is correctly specified. Cook-Weisberg test²⁶ reveals that the error terms are homoscedastic²⁷, *i.e.*, have equal variance, but Jarque-Bera²⁸ test result accepts normality at 10 percent level of significance. On the other hand, Ramsey's²⁹ RESET test accepts the hypothesis that the model has been correctly specified.

Now given the fact that the share of net FDI inflow in GDP is meagre, it is less likely that foreign investment causes economic growth in the country. In order to test the null hypothesis we here perform a popular test called Granger causality test.³⁰

3.2 Does FDI Cause Output Growth and/or Vice Versa (or none)?

As aforementioned, the existence of a positive and statistically significant relationship between FDI and GDP does not indicate

²⁶ R. D. Cook and S. Weisberg, "Diagnostics for Heteroscedasticity in Regression", *Biometrika*, 70, 1983, pp. 1-10.

²⁷ According to Gujarati, if we take log transformation of the variables, the errors terms become homoscedastic. See, D. N. Gujarati, *Basic Econometrics*, (4th edition), McGraw-Hill International Edition, 2003.

²⁸ C. M. Jarque and A. K. Bera, "A Test for Normality of Observations and Regression Residuals", *International Statistical Review*, 55, 1987, pp. 163-172.

²⁹ J. B. Ramsey, "Tests for Specification Errors in Classical Linear Least Squares Regression Analysis", *Journal of the Royal Statistical Society, Series B*, 31, 1969, pp. 350-371.

³⁰ C. W. J. Granger, "Investigating Causal Relations by Econometric Models and Cross-Spectral Methods", *Econometrica*, 37 (3), 1969, pp. 434-448.

causality or the direction of influence, *i.e.*, whether FDI causes GDP growth or vice-versa, both or none. The Granger causality test identifies the direction of such influence. The basic underlying assumption is that the test is performed on time series data. Now we use the following formula to perform the test:

$$GDP_t = \sum_{i=1}^n r_i FDI_{t-i} + \sum_{j=1}^n s_j GDP_{t-j} + e_{1t} \quad (4)$$

$$FDI_t = \sum_{i=1}^n \beta_i FDI_{t-i} + \sum_{j=1}^n u_j GDP_{t-j} + e_{2t} \quad (5)$$

where the disturbance terms e_{1t} and e_{2t} are assumed to be uncorrelated. Equation 4 postulated that current GDP is related to its past values and current value of FDI, and Equation 5 postulated the same behaviour of FDI.

Table 2: Granger Causality Test

Null Hypothesis	Computed F	Prob(F)
FDI does not cause GDP	0.357	0.70
GDP does not cause FDI	0.921	0.41

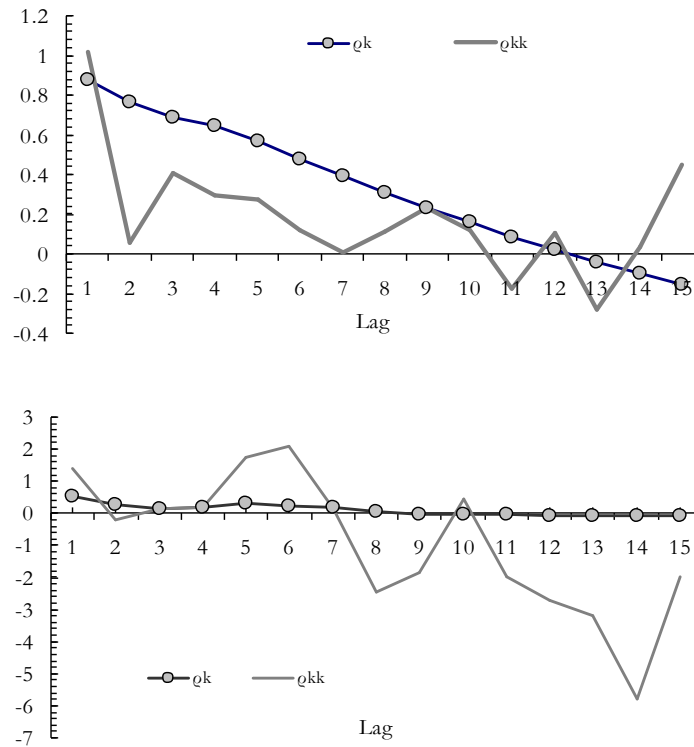
The calculated F values for Equations 4 and 5 turn out to be statistically insignificant (Table 2), which suggests that the GDP and FDI variables are independent. That is, there is no causal relationship between the two. However, the result of Equation 4 contrasts with the log-linear regression model (Table 1) where we found FDI to be significant. But since we are dealing with time series data of two macroeconomic variables which generally tend to be non-stationary, we have to confirm about the stationarity or randomness of the data series used in the present study.

3.3 Are the Two Series Stationary?

If the time series data are non-stationary, the OLS regression may result in spurious regression, and traditional diagnostic tests like

t and F become non-standard.³¹ Some of the preliminary tests for stationarity are autocorrelation ($\hat{\rho}_k$), partial autocorrelation ($\hat{\rho}_{kk}$), and Ljung-Box (LB) statistic.³²

Figure 3: Autocorrelation and Partial autocorrelation for GDP (top) and FDI (bottom), 1972-2005



The formula of autocorrelation function is $\hat{\rho}_k = \frac{\text{sample cov at lag } k}{\text{var}}$, and it is a pure number lies between ± 1 .

In the similar fashion, partial autocorrelation measures correlation between observations that are k apart after controlling for

³¹ Gujarati, 2003, *op cit*.

³² G. M. Ljung and G. P.E. Box, "On a Measure of Lack of Fit in Time Series Models", *Biometrika*, 66, 1978, pp. 66-72.

correlations at lag less than k . On the other hand, Ljung-Box (LB) statistic, defined by $LB = n(n + 2) \sum_{k=1}^m \left(\frac{\hat{\rho}_k^2}{n - k} \right) \approx \chi^2_m$, follows chi-square distribution where n = sample size and m = lag length.

For series GDP, as the Figure 3 shows, $\hat{\rho}_k$ has always been within plus and minus 1 and gradually approaching zero as the number of lags increases. From lag 2, $\hat{\rho}_{kk}$ is also within plus and minus 1 and hovering around zero. $\hat{\rho}_k$ of series FDI shows that it starts at 0.55 and then becomes significantly lower (0.14) at lag 3. Conversely, $\hat{\rho}_{kk}$ altered sign at the second lag. According to Schwarz criterion³³, the maximum number of lags is nine. In the present case, series GDP alters sign at lag 13, but at lag 9 $\hat{\rho}_k$ is much lower (0.23) compared to that of lag 1. These demonstrate that the series FDI is undoubtedly stationary, but it is uncertain from the AC and PAC whether series GDP is stationary. On the other hand, Ljung-Box statistics for GDP and FDI suggest that the hypothesis of non-stationary is rejected at 0.5 and 5 per cent levels. That is, both of the series are stationary.

A popular test for detecting stationarity is the unit root test. In the present context, the stochastic or unit root process starts as follows:

$$GDP_t = \dots_1 GDP_{t-1} + e_{1t} \tag{6}$$

$$FDI_t = \dots_2 FDI_{t-1} + e_{2t} \tag{7}$$

The difference between the variables at t and $t-1$ would provide new equations with other coefficients (α_1 and α_2 , respectively) of independent variables. If we let those equal zeros, the estimated t value of α s follows τ or Dickey-Fuller (DF) statistic.³⁴ However, the basic assumption of the DF test is that e_{it} are not correlated. But, if

³³ G. Schwarz, "Estimating the Dimension of a Model", *Annals of Statistics*, 6 (2), 1978, pp. 461-464.

³⁴ D. A. Dickey and W. A. Fuller, "Distribution of the Estimators for Autoregressive Time Series with a Unit Root", *Journal of the American Statistical Association*, 74, 1979, pp. 427-431.

e_t s are correlated, the augmented Dickey-Fuller (ADF) test can be applied using the following equations:

$$\Delta GDP_t = \alpha_1 + \alpha_2 t + \beta GDP_{t-1} + \gamma_i \sum_{i=1}^m \Delta GDP_{t-i} + e_{1t} \quad (8)$$

$$\Delta FDI_t = \beta_1 + \beta_2 t + \delta FDI_{t-1} + w_i \sum_{i=1}^m \Delta FDI_{t-i} + e_{2t} \quad (9)$$

where $\hat{\alpha}_1$ and $\hat{\alpha}_2$ provide the ADF statistic. The estimated DF and ADF statistics, from equations 6 to 9, are given in Table 3.

Table 3: Unit Root Tests for GDP and FDI

	DF		ADF	
	$\hat{\alpha}_1$	$\hat{\alpha}_2$	$\hat{\gamma}_i$	\hat{w}_i
Computed	.	2.972	0.609	1.646
Critical 1%	-3.696		-3.649	
5%	-2.978		-2.955	
10%	-2.620		-2.616	

The MacKinnon critical values³⁵ for rejecting the null hypothesis of a unit root is accepted for GDP but rejected for FDI at 10 per cent level while applying the DF test. This indicates that FDI is stationary but GDP is not. On the other hand, in the ADF test, both GDP and FDI series are observed to be non-stationary.

Against the assumption in DF and ADF that that e_t is independently and identically distributed, the Phillips-Perron (PP) unit root test³⁶ is a non-parametric test that takes care of serial correlation in e_t without adding lagged GDP and FDI. In this case, the estimated PP statistic for GDP ($\hat{\alpha}_{GDP}$) is 0.87, whereas the 10 per cent critical value for $Z(\dots)$ is -10.36 . This means series GDP is

³⁵ J. G. MacKinnon, "Critical Values of Cointegration Tests" in R. E. Engle and C. W. J. Granger (eds.), *Long-Run Economic Relationships: Readings in Cointegration*, New York: Oxford University Press, 1991.

³⁶ P. C. B. Phillips and P. Perron, "Testing for a Unit Root in Time Series Regression", *Biometrika*, 75, 1988, pp. 335-346.

non-stationary. On the other hand, $\hat{\rho}_{FDI}$ is 12.72, *i.e.*, series FDI is stationary at 10 per cent level.

3.4 Are GDP and FDI Cointegrated?

Against the caution that regression on a non-stationary time series may produce erroneous regression, various test results from above confirm that series FDI is stationary (except only ADF). In this case, since one of the two series is non-stationary, we have to identify if FDI and GDP are cointegrated, *i.e.*, whether there is a long-term or equilibrium relationship between the two variables. We follow the Johansen procedure for testing cointegration.³⁷

Table 4: Test for Cointegration

Null Hypothesis	Maximum Eigenvalue	5% critical value
$\rho = 0$	0.129	15.41
$\rho \leq 1$	0.001	3.41

Table 4 shows that estimated maximum eigenvalue rejects any cointegration between GDP and FDI. This means we do not have any spurious regression (OLS and ARIMA) while estimating the influence of FDI on GDP.

4. Interpretation of the Results

Foreign investment, through various direct impacts and spillovers, exerts influence on growth of domestic output. Despite a number of favourable policies and laws the FDI flow is very small in Bangladesh. According to the test results, it is clear that foreign investment has notable positive impact in explaining positive changes in GDP. But the diagnostic tests like R^2 and adjusted R^2 imply that there are other macroeconomic variables which we did not bring into the present analysis that might have significant impact, individually and/or jointly, on economic growth. The causal relationship between the two variables was found to be Granger-neutral, which implies that FDI does not cause economic growth and

³⁷ S. Johansen, “Statistical Analysis of Cointegrating Vectors”, *Journal of Economic Dynamics and Control*, 12, 1988, pp. 231-54.

vice versa. One reason may, of course, be the low level of the net flow of FDI compared to the size of GDP (only 1.35 per cent in 2005 and before that year it was even lower than 0.8 per cent). With this meagre magnitude, FDI is unable to exert a substantial positive effect on growth. Time series tests confirm that FDI data series is stationary but GDP is not. We also find no long-term or equilibrium relationship between the two.

There may be other reasons of such empirical evidence against foreign investment. Data suggest that FDI, whatever the amount, is directed to the sectors that either have meagre share in GDP or are not growth sectors. For example, in fiscal year 2003-04, as high as 61.46 per cent of FDI accounted for in service sector and around 16 per cent was directed to textile sector. The other important sectors that could attract foreign investment were chemical, agro-based industry, and food and allied (6.88, 6.49 and 3.29 per cent respectively). However, service sector was almost half of GDP at that time, and growth of the sector was also not very low. One of the attractive sub-sectors of FDI is telegraph and telephone (particularly booming cellular phone), of which growth rate was 14.56 per cent in 2003-04, but its share was very low in GDP, only 1.41 per cent for which it cannot significantly influence economic growth in Bangladesh.³⁸

International oil companies (IOCs) are investing substantially in gas and coal fields. Though the growth rate of natural resource and mining sector has been high (7.1 per cent in 2003-04 and around 7 per cent in the last years), this sector has very negligible share in GDP (only 1.11 in 2003-04 and not exceeding 1.19 per cent from 1996-97 onwards). There is an allegation that the IOCs are overvaluing their investment in capital good by demonstrating old machinery as new ones hiding the actual depreciation cost. If it is true, still then we cannot claim that overvaluation of capital equipment is responsible for the absence of causal flow of FDI to GDP. However, manufacturing industry has been performing well since early the 1990s, and its contribution to GDP has been around one-sixth and its growth rate is also good over the years (7.1 per cent

³⁸ Ministry of Finance, *Bangladesh Economic Review 2006*, Dhaka: Government of Bangladesh, 2007.

in 2003-04).³⁹ Greater flow of foreign investment in this sector, particularly in textile industry, has intrinsically positive influence on domestic output and its growth. Another reason of less importance of FDI in economic growth may be the full entitlement of repatriation of profit and dividend. These two areas deserve and subject to new and substantial empirical investigation. However, based on the above discussion, it may be said that meagre amount of FDI itself is responsible for the evidence of Granger-neutrality.

5. Conclusion

In this study we find that although foreign investment exerts influence on Bangladesh's domestic output, we did not find that it causes any GDP growth. However, the existence of no causal relationship does not mean the absence of the contribution of foreign investment to economic growth in the country. Kumar and Pradhan, show that FDI causes economic growth in Pakistan.⁴⁰ In order to let foreign investment play such a role the government should welcome more foreign participation in the industrial and agro-processing sectors. To attract more foreign investment there is a need for bringing about pro-FDI policy reforms so that FDI can play desirable role in the host sectors through high rate of return. Introducing and implementing competition policy would be one of the major policy instruments to foster these sectors. Special measures such as tax holiday and improvement of governance in individual sectors would be the other policy directions. However, the country should welcome FDI bearing in mind the direct and indirect effects and spillovers, and also the probable negative effects on growing local industries.

³⁹ *Ibid.*

⁴⁰ Kumar and Pradhan , 2002, *op cit.*

Annex

Table: Trend of GDP and FDI inflow in Bangladesh

Year	GDP (in US\$)	Net FDI Inflow (in US\$)	Net FDI as %age of GDP
1972	6288200000	100000	0.002
1973	8067000000	2300000	0.029
1974	12459000000	2200000	0.018
1975	19396000000	0	0.000
1976	10083000000	5400000	0.054
1977	9632500000	7000000	0.073
1978	13299000000	7700000	0.058
1979	15586000000	-8000000	-0.051
1980	18115000000	8500000	0.047
1981	19763000000	5400000	0.027
1982	18087000000	7000000	0.039
1983	17156000000	400000	0.002
1984	19670000000	-600000	-0.003
1985	21613000000	0	0.000
1986	21160000000	2400000	0.011
1987	23781000000	3200000	0.013
1988	25639000000	1800000	0.007
1989	26825000000	200000	0.001
1990	30129000000	3000000	0.010
1991	30957000000	1000000	0.003
1992	31709000000	4000000	0.013
1993	33167000000	14000000	0.042
1994	33769000000	11000000	0.033
1995	37940000000	2000000	0.005
1996	40666000000	14000000	0.034
1997	42319000000	139000000	0.328
1998	44092000000	190000000	0.431
1999	45694000000	180000000	0.394
2000	47097000000	280000000	0.595
2001	46953000000	79000000	0.168
2002	47513000000	52000000	0.109
2003	51824000000	268000000	0.517
2004	56676000000	449000000	0.792
2005	60034000000	802490000	1.337

Data Source: World Bank (2006, 2007). *World Development Indicators*, World Bank, Washington, DC (CD-ROM).

Mohammad Jasim Uddin

BANGLADESH-BHUTAN RELATIONS: CHALLENGES AND PROSPECTS

Abstract

With the establishment of diplomatic relations between Bangladesh and Bhutan, various initiatives to accelerate the bilateral relations between the two countries began. Within a few years, such initiatives resulted in a number of bilateral agreements on trade, economy, culture, air service, education and technical side. While these agreements between Bangladesh and Bhutan reflect friendliness and mutual understanding between the two, the fact remains that the push as given in the beginning for more vigorous relations has not yielded tangible results up to an expected level. In effect, the pace of relations between the two nations advanced with caution, and in few instances, with indifference. Yet, the fact remains that enormous prospects lie ahead for a more cooperative and constructive relations between them in the changed international scenario. It is in this backdrop that the paper attempts to address a set of relevant questions: What are the areas of cooperation between Bangladesh and Bhutan? What are the challenges that Bangladesh and Bhutan face in various issues of mutual interest? What are the prospects for future enrichment of Bangladesh-Bhutan relations? The purpose of the paper is to seek possible answers to these questions.

Keywords: Small State, Bilateralism, SAGQ, SAFTA, Transit, Cooperation.

Introduction

Bhutan, officially known as the Kingdom of Bhutan, has been a remote and an almost unknown country, separated from the outside

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world, until the 1960s. Since that time, the country started widening its contacts with the outside world by diversifying its diplomacy and negotiating with other countries. No sooner had the Kingdom's quest for a more open policy begun, the emergence of Bangladesh as an independent state in South Asia further gave an impulsion to such pursuit as the former too looked for building mutually beneficial relations with its proximate neighbours. Bhutan's wholehearted diplomatic and moral support to the Liberation War of Bangladesh (1971) coupled with many commonalities between the two in history, culture, geo-strategic, demographic and social conditions took very little time to set the stage for a more constructive relationship between the two countries in the future. The realisation that Bhutan and Bangladesh, both endowed with many potentialities, could gain materially from each other also acted as a catalyst in boosting up relations between the two neighbours.

It is important to note that the trajectory of Bangladesh-Bhutan relations passed through few important phases. Bhutan officially recognised Bangladesh as a sovereign state on 7 December 1971. Immediately after independence of Bangladesh, both the countries moved to set up diplomatic relations. But such relations did not take residential form until January 1980 due to political instability in Bangladesh. Setting up of diplomatic relations, however, increased official visits thereby accelerating the process of bilateral relations. As a result, a number of bilateral agreements on trade, economy, culture, air service, education and technical side were signed in the 1980s between the two countries. While these agreements between Bangladesh and Bhutan reflect friendliness and mutual understanding between the two⁴¹, the fact remains that the push as given in the beginning for more vigorous relations has not yielded tangible results up to an expected level. In effect, the pace of

⁴¹ There has been no friction since the establishment of diplomatic relations. Nonetheless, there are very few landmarks. The volume of total trade between the two countries in current time is about US\$ 14 million a year which is far ahead compared to that of the initial stage of relations. Little exchange of natural resources, smooth air link with two flights a week, and regular arrival of Bhutanese students to Bangladesh are also the landmarks. See, "Bhutan and Bangladesh could expand trade relations", available at <http://www.bhutan.gov.bt/government/newsDetail.php?id=85%20&%20cat=9> accessed on 10 October 2006.

relations between the two nations advanced with caution, and in few instances, with indifference notwithstanding the fact that enormous prospects lie ahead for a more cooperative and constructive relations between them in the changed international scenario.

It is in this backdrop that the paper attempts to address a set of relevant questions: What are the areas of cooperation between Bangladesh and Bhutan? What are the challenges that Bangladesh and Bhutan face in various issues of mutual interest? What are the prospects for future enrichment of Bangladesh-Bhutan relations? In order to address the above stated questions, the paper, barring introduction and conclusion, would consist of four successive sections which are as follows: Section I – Imperatives for Bangladesh-Bhutan Relations: An Overview, Section II – Bangladesh-Bhutan Relations: Issues Revisited, Section III – Impediments to Bangladesh-Bhutan Relations and finally Section IV – Prospects for Bangladesh-Bhutan Relations: A Future Outlook. The methodology of the paper is empirical and analytical in nature. Research materials from books, journals, newspapers, etc. constitute the research documents of the author.

Section I - Imperatives for Bangladesh-Bhutan Relations: An Overview

In international relations, inter-state behaviour may manifest itself in three types of relations - conflict, competition and cooperation. While conflictive and competitive behaviour is caused by a complex web of factors, the one of cooperation simply flows from the political commitments of the states to cooperate with each other in an atmosphere of mutual trust and understanding. The factor that catapults cooperative relations is the expectation for few tangible gains out of a constructive interaction. In case of Bangladesh-Bhutan relations, one finds such cooperative spirit as the undertone of their mutual relations. Being 'small states'⁴² and vulnerable to interference

⁴² Small states are generally characterised by small size, low per capita income, high dependence on the foreign capital and weak defence capability. However, while defining small states, such characteristics are often missing in different regions of the contemporary world. One, therefore, considers a small state, which has a very low conventional war capability (expressed in terms of GNP and military budget), not only in absolute global comparative terms...*but also vis-à-vis the large powers in*

by big powers, such relations were influenced by certain perceptions and approaches. In the initial stage, Bangladesh as part of its state-building process put emphasis on preservation and promotion of congenial relations with the neighbouring countries, and hence its attachment to the development of relations with neighbouring Bhutan. In contrast, Bhutan's psychological impulse for establishing relations with Bangladesh was based on a different calculation. The former considered that the latter in future would play an important role in the eastern zone of South Asia and, therefore, an association with Bangladesh could give Bhutan a degree of politico-diplomatic leverage to exercise as a sovereign state.⁴³ In the eyes of Bhutan, the emergence of Bangladesh increased its political manoeuvrability at the regional level; in other words, it can pursue a policy like that of Bangladesh in order to be free from all kinds of foreign domination. Perhaps, there is no gainsaying that Bangladesh's foreign policy envisaging 'friendship to all and malice to none' attracted Bhutan significantly. Then, there is the question of economic factor. If Bhutan could be friendly with Bangladesh, then it could develop its trade relations with Bangladesh. In this respect, Bangladesh could provide Bhutan with alternative source for importing and exporting

the region. But now, small states appear to be nothing but appendages of the spheres of great power influence, helpless fragments at the mercy of the giant neighbours. Because of the sheer gigantic size of India, with the power capabilities it commands in the South Asian region, both Bangladesh and Bhutan obviously appear to be small states. Power, as a function of mobilisable and deployable military force and a strategic resource base for a very specific purpose, is viewed as a quantifiable and commensurable mass, which can be measured and weighed. See, Atiur Rahman and Jaglul Haider, "Underdevelopment, Dependence and Instability in the Small States: What is the Way Out?", in M. Abdul Hafiz and Abdur Rob Khan (eds.), *Security of Small States*, University Press Limited, Dhaka, 1987, p. 62; Talukdar Maniruzzaman, "The Security of Small States in the Third World", *Canberra Papers*, 1988, p. 14; Shaheen Afroze, "Small States in Global Perspective: In Search of a Role Model in Regional Security", in Mohammad Humayun Kabir (ed.), *Small States and Regional Stability in South Asia*, University Press Limited, Dhaka, 2005, p. 12.

⁴³ Syed Serajul Islam, "Bangladesh-Bhutan Relations: From Isolation to Intimacy", in Muzaffer Ahmed and Abul Kalam (eds.), *Bangladesh Foreign Relations: Changes and Directions*, University Press Limited, Dhaka, 1989, p. 51.

necessary goods as well as serve as an outlet to the rest of the world through its two major seaports. This way, the limitations in which Bhutan is placed by its landlocked position and certain demands arising out of its special relationship with India could, to a certain extent, be reduced. However, it is important to note that the Kingdom of Bhutan, in its political and foreign policy domain, has been overtly cautious in dealing with issues that could evoke controversy. As a result, the best option for the country has been to open itself to the others economically. It is in line with this philosophy that Bhutan sought to forge a relationship with Bangladesh with the utmost economic consideration in mind. The subsequent section attempts to delve into the issue.

Section II - Bangladesh-Bhutan Relations: Issues Revisited

Although Bangladesh and Bhutan are asymmetric in terms of size, resource endowment and population, they share few significant commonalities (See Table-1).

Table 1: Bangladesh and Bhutan: Asymmetry and Symmetry

Country	Area of land (sq. km.)	Arable land	Population (million)	Population growth	GDP (real growth rate)	GDP per capita income (PPP)
Bangladesh	133910	55.39%	147.36	2.09%	6.1%	\$2200
Bhutan	47000	2.3%	2.27	2.1%	5.9%	\$1400

Source: <http://www.cia.gov/cia/publications/factbook/geos.bt.html> accessed on 27 March 2007.

The commonalities have given birth to a common set of interests that both the countries seek in pursuit of their respective socio-economic development. As indicated earlier, after the independence of Bangladesh, the leaders of both the countries met several times and expressed their desire to set up bilateral relations. It was not until the establishment of diplomatic relations between the two that their bilateral relations started intensifying in its own direction. Some of the very important issues that got priority in Bangladesh-Bhutan relations were economic in nature. A brief description of such issues is furnished below in order to determine the position of Bangladesh and Bhutan *vis-à-vis* each other.

Both the countries signed their first bilateral Agreement on Trade in early September 1980. With flexible terms⁴⁴ and limited items, the agreement was initially valid for 10 years. It kept the option for renewal for a period of another ten years. Thus, trade relations began but tangible results of such relations did not come until India signed two agreements with Bhutan and Bangladesh separately in 1983 and 1984 respectively. These agreements provided for overland transit facility, which stipulated the earlier agreement on trade and advanced both the countries to sign the Protocol on Expansion and Regulation of Trade in 1984. One of the outcomes of the protocol was the meeting of representatives of the two countries in 1985. The meeting reviewed the trade relations and agreed to increase the number of traded items. Nonetheless, trade between the two countries was very slow. The slowness, however, got a face-lift when Bangladesh waived 50% of tariff on imports from Bhutan in 1986 and India permitted most convenient Phuntsholing (Bhutan)- Changrabandha (India)-Burimari (Bangladesh) route effectively in January 1988.⁴⁵ These attempts provided a boost for trade relations although Bangladesh advanced on a declined basis.

The existing agreement on trade continued in 1990s. During that time, both the countries increased their exported items and allowed concessions on duties on a wide range of products. Products from Bangladesh were granted duty free access in Bhutan, while products from Bhutan were taxed 50% of normal duty in Bangladesh.⁴⁶ The

⁴⁴ Both will take necessary measures for developing trade and provide each other the most favoured nation's treatment with regard to custom duties, issue of licenses, storage and handling charges, and in any other fees levied on export and import of goods. All payments for goods to be exported or imported can be made in any convertible currency. See, Kamal Uddin Ahmed, "Prospects of Bangladesh-Bhutan Relations", in S. R. Chakravarty and Virendra Narain (eds.), *Bangladesh: Global Politics*, South Asian Publishers, New Delhi, 1988, p. 174.

⁴⁵ A. K. M. Abdus Sabur, "Bangladesh-Bhutan Relations: An Overview", *BISS Journal*, Vol. 19, No. 1, 1998, p. 62.

⁴⁶ "Economic and Political Relations between Bhutan and Neighbouring Countries", A Joint Research Project of the Centre for Bhutan Studies (CBS) and Institute of Developing Economics, Japan External Trade Organization (IDE/JETRO), *Monograph 12*, April 2004, pp. 68-70.

trade relations, thus, entered into a new phase. In September 2000, although the agreement on trade expired, bilateral trade continued. In 2002, the agreement on trade was again renewed under which Bhutan unilaterally began granting zero tariffs to all Bangladeshi goods.⁴⁷ In return, Bangladesh announced that they would apply only 15% of their applicable duty rates on about 18 Bhutanese goods, which were levied a 50% duty concession.⁴⁸ With such initiatives, Bangladeshi melamine and readymade garments captured the Bhutanese market, while Bhutanese agro-produce and minerals extended its domination in Bangladesh.⁴⁹ Eventually, trade relations between the two countries geared up. Exports of Bangladesh in 2005 were worth US\$ 4.8 million while imports from Bhutan amounted to US\$ 7 million (See Table-2).

Table 2: Trends in Bangladesh-Bhutan Bilateral Trade

(In million US\$)

Year	Export	Import	Volume of Total Trade
1991	0.16	4.7	4.86
2001	1.18	5.65	6.83
2002	1.67	3.92	5.59
2003	1.57	2.74	4.3
2004	2.92	5.43	8.45
2005	4.8	7	11.8

Source: Import Payments and Export Receipts, Bangladesh Bank, 2005; Bangladesh Economic Review, Ministry of Finance, 2005.

However, the volume of total trade between the two countries in current time is about US\$14 million a year.⁵⁰ While for Bhutan, it is encouraging, for Bangladesh it is insignificant. Taking this point in consideration, Bhutan has expressed its keen interest to import huge quantity of biodegradable packaging materials. It has officially

⁴⁷ “Renewal of Dhaka-Thimpu trade accord to boost economic ties”, available at <http://www.weeklyholiday.net/041002/busi.html> accessed on 6 October 2006.

⁴⁸ “Bhutan and Bangladesh could expand trade relations”, *op.cit.*

⁴⁹ “Economic and Political Relations between Bangladesh and Neighbouring Countries”, available at <http://www.ide.go.jp/English/Publish/Jrp/Pdf/jrp-132-sec1.pdf> accessed on 5 October 2006.

⁵⁰ “Bhutan and Bangladesh could expand trade relations”, *op.cit.*

informed the Bangladesh mission in Bhutan, and asked for a list of the materials.⁵¹ Meanwhile, the Bangladesh mission has urged the Export Promotion Bureau (EPB) to take necessary steps in this regard. The EPB is now communicating with the local industrialists to export their products to Bhutan. On the other hand, Bhutan has also showed its keen interest to import vehicle spare parts made in collaboration with Japan, excide car batteries, and pharmaceuticals, which are among the best in the South Asian region. Such positive attractions could be the new sign for trade and economic relations. However, the relations could be discerned not only in the pursuit of trade but also in their efforts for water, education and technical, air service and cultural development.

Although both the countries chalked out various plans to develop water resources through joint ventures in 1972, no functional initiative was taken until 1988. In 1988, through an effective initiative, Bangladesh and Bhutan formed a Joint Team of Officials (JTOs). The JTOs met three times in 1989 and finalised a report for submission to the governments of the two countries. The report recommended cooperation in flood forecasting and warning for disaster preparedness, exchange of hydro-meteorological data in time, and setting up of an institutional framework for following up of the recommendations. However, no tangible progress seems to have been made in this regard till to date.

Aside from water, both the countries took initiatives to develop relations in technical and educational fields. Even without any formal agreement, such relations were initiated by Bangladesh in 1980, when some Bhutanese students were admitted to the Universities/Medical Colleges in Bangladesh for higher studies. The Bhutanese leaders considered this matter as useful to Bhutan, which has shortage of qualified and trained personnel. In 1984, they signed an Agreement on Economic and Technical Cooperation which also provided opportunities to Bhutanese students for pursuing higher studies in Bangladesh, and creating ways of exchanging expert missions in technical side. Since then, Bangladesh has been

⁵¹ “Bhutan to import packaging materials from Bangladesh”, *United News of Bangladesh*, Dhaka, available at <http://independent-bangladesh.com/news/aug/24/24082005bs.htm#A12> accessed on 25 January 2007.

providing limited number of scholarships to the Bhutanese students in required fields. Under the agreement, the two countries also agreed to promote a programme of development cooperation providing training facilities in relevant institutions. In this way, both the countries have been benefited over the period of time in the field of human resource development.

With the objective of facilitating the movement of people from one country to the other and promoting people-to-people contact, an Agreement on Air Services was signed between the two countries in 1986. This agreement granted the Royal Bhutan Airlines to operate weekly air services to and fro between Dhaka and Thimpu. The air link between the two countries became more intensified when Bhutanese high level officials came to Dhaka in 2002. During that time, Dhaka made a decision to reduce landing fees for Druk Air, the flag carrier of Bhutan, at Zia International Airport. Dhaka also granted 50% concession on handling charges.⁵² With such initiatives, the Druk Air introduced two flights a week instead of once-a-month flight between Paro and Dhaka.

During the visit of former King Jigme Singye Wangchuck to Bangladesh in 1984, it was reaffirmed that development of relations would not be only mutually beneficial but also go a long way in fostering closer cooperation and understanding between the peoples of the two countries. In order to give a concrete shape to this policy, an Agreement on Cultural Cooperation was signed in 1986. But, cultural exchanges between the two countries took place at a level much below expectation. However, since 1972, exchange of visits at a high level and exchange of ideas on different occasions clearly indicate that the two countries intend to have close bilateral relationship to promote their national interests. Despite such mutual intention, the bilateral relationship has not yet been developed into a meaningful collaboration. The next section would try to explore the impediments, which are responsible for such a scenario.

Section III – Impediments to Bangladesh-Bhutan Relations

⁵² “Economic and Political Relations between Bhutan and Neighbouring Countries”, *op.cit.*, p. 69.

The status of relationship between Bangladesh and Bhutan is far from being satisfactory. Since the establishment of formal relationship between the two countries, several hurdles have been affecting the bilateral relations. While many of them are viewed as formidable, some can certainly be overcome. It is, thus, important to have a little discussion to find out the impediments in their relation.

First, located in the Eastern Himalayas between Tibet and India, Bhutan is a land-locked country. Similarly, Bangladesh is virtually India-locked with an outlet to the Bay of Bengal in the south. Both Bangladesh and Bhutan are smaller neighbours of India, each being detached from the other by about 30 km of Indian territory.⁵³ Geographically, they are, therefore, proximate but not contiguous, which makes India central to any joint management and development in South Asia. For example, when it is an issue on water, India's strict bilateralism⁵⁴ serves here as the most crucial factor. Experts in Bangladesh estimate that dry season flows of water may be increased by building large storage dam.⁵⁵ Therefore, Bangladesh wants to build a reservoir in the Sunkosh river of Bhutan. But India along with its centrally placed colossal position between Bangladesh and Bhutan is yet to show any positive attitude to this demand.

Second, because India has the tendency to turn its natural pre-eminence in South Asia into predominance, and that no other

⁵³ Kapileshwar Labh, "Bhutan-Bangladesh Partnership in Peace and Economic Development: Commonalities and Constraints", in S. R. Chakravarty (ed.), *Foreign Policy of Bangladesh*, Har-Anand Publications, New Delhi, 1994, p. 232.

⁵⁴ One of the facets of India's policy towards neighbours is to deal with all matters on a bilateral basis. Again, this is a general policy equally applicable towards all neighbours. India feels that all matters with neighbours should be settled bilaterally on the basis of equality and mutual benefit, i.e., without needlessly complicating them by internationalising in multilateral form, or inviting third party intervention. But this is not reciprocated sometimes by many neighbours in South Asia. See, M.S. Rajan, "India and Its Neighbours: The Policy and Problems", in S.D. Muni (ed.), *Understanding South Asia: Essays in the Memory of Late Professor (Mrs) Urmila Phadnis*, South Asian Publishers, New Delhi, 1994, pp. 10-35.

⁵⁵ Madhukar S. J. B. Rana, "Nepal-Bangladesh Relations: Retrospect and Prospects", *BISS Journal*, Vol. 24, No. 3, 2003, p. 340.

significant power other than Pakistan in the region has the potential to check Indian dominance or hegemonic aspirations, Bangladesh, in general, and Bhutan, in particular, may be considered as the smaller powers from the point of their respective vulnerability *vis-à-vis* India.⁵⁶ The vulnerability may be explained by a simple factor such as decision making capability. In the context of South Asia, Bhutan still seems not to be in a position to take independent decisions in its foreign relations since it continues to be guided by cooperative attitude and consultative mechanism of the Government of India. In addition, geo-political and geo-physical compulsions along with special relations with India under the Indo-Bhutan Friendship Treaty concluded on 8 August 1949 does not provide Bhutan with policy options to independently pursue politico-economic relations with Bangladesh and other countries of the world.⁵⁷

Third, although South Asia shares cultural affinity, this can sometimes become a threat when the smaller states face serious problems in developing their separate and distinct identities. The powerful elements of cultural affinity tend to create serious problems along borders through migration of culturally homogeneous people. This often leads to turmoil and conflict and, in turn, contributes to tension.⁵⁸ For instance, the very presence of Nepalese and Indians in Bhutan challenges its indigenous peoples' attempt to create a process of Bhutanisation.⁵⁹ Therefore, the presence of foreigners, even if they are a few thousand in number, becomes a source of serious concern and anxiety. In line with its determination to preserve national identity from harmful outside influence, the Government of Bhutan imposed strict limits on the movement of foreigners. In effect,

⁵⁶ Abul Kalam Azad, "Common Risks and Common Solutions for the Smaller States of South Asia: A Comparative Perspective", in Mohammad Humayun Kabir (ed.), *Small States and Regional Stability in South Asia*, *op.cit.*, p. 153.

⁵⁷ Parth S Ghosh, *Cooperation and Conflict in South Asia*, University Press Limited, Dhaka, 1989, p. 139.

⁵⁸ Shahnaz Karim, "Security Implications and Economic Benefits of Transit Facility: A Bangladesh Perspective", in Iftekharuzzaman (ed.), *Regional Economic Trends and South Asian Security*, Regional Centre for Strategic Studies (Colombo), Manohar, New Delhi, 1997, p. 101.

⁵⁹ Manorama Kohli, "Security Challenges Before Bhutan", *Himalayan Miscellany*, Vol. 14, 2002, p. 20.

diversified interactions between Bangladesh and Bhutan are yet to be flourished.

Fourth, Bhutan still finds itself dependent, to a certain extent, on India as a large portion of its national development budget is supported by India's economic aid and technical assistance. This assistance is provided mostly as grants and soft term loans. Because of geo-political compulsions, Bhutan has accepted such reliance, which imposes restrictions on its domestic politics as well. On the other hand, even after accepting limited economic aid from different international agencies, it has not entered into any bilateral economic agreement with any country other than India.

Fifth, although both Bangladesh and Bhutan agreed in 1986 to set up a Joint Commission to coordinate mutual cooperation, no functional initiative was taken in this regard till to date. In 1972, both the countries, for the first time, considered cooperation in the field of management and development of water resources through joint ventures as a gesture of bilateral cooperation. In 1988, they again took an initiative in identifying and implementing appropriate flood control measures. In spite of these initiatives, no significant progress has been made. In addition, there appears to be a lack of sustainable and pragmatic approach to the development of bilateral relations. This was evident when Bangladesh in early 1990s imposed tariff previously exempted on imports from Bhutan. It was a retrograde step in the context of global economy and a blow for trade relations.

Sixth, both Bangladesh and Bhutan are least developed countries, lacking adequate domestic resources. This led them to cooperate with each other at the United Nations and other international forum, where they called for greater North-South and South-South cooperation and for granting of special economic assistance.⁶⁰ However, despite having such approach, efforts to ease economic cooperation between the two countries have so far failed and thus, remained ineffective. There are a number of crucial factors, which are responsible for such ineffectiveness. Some of the factors are discussed below.

- Since the finalisation of the agreement on trade, both Bangladesh and Bhutan made diplomatic efforts to secure

⁶⁰ Kapileshwar Labh, *op.cit.*, p. 241.

transit facility from India to develop their trade relations. But the efforts have not been functionally fruitful even after formally getting Burimari-Changrabandha route because India is unlikely to compromise its economic interests in Bhutan and therefore, is not favourably disposed towards the Bangladesh-Bhutan trade agreement. The reason is that the agreement might provide some diversification for Bhutan and affect the existing Indo-Bhutanese economic relations.

- Almost 90% of Bhutanese products are exported to India while only 5% comes to Bangladesh. Similarly, Bhutan imports approximately 85% of goods from India and just 3% from Bangladesh.⁶¹ Both Bangladesh and Bhutan, even after this uneven situation of trade relations between them, are still far from initiating any serious and effective measures to increase the volume of trade between the two countries. Such reluctance along with huge amount of trade between Bhutan and India has grossly undermined the maturity of interest in bilateral trade and economic cooperation.
- Bangladesh exports some conventional and less demandable items to Bhutan such as readymade garments, melamine, tableware, kitchenware, medicine, bakery products, etc. But it imports fruits, prepared foodstuffs and beverages on a large scale. Under the South Asian Free Trade Agreement (SAFTA), the imported items are given unhindered access with the offer of conceded duties. In effect, difference to the qualitative and quantitative import and export items between Bangladesh and Bhutan and the facilitation of the SAFTA have thereby, turned the trade relations between the two countries into a one-way traffic.
- Bhutan started to increase imported items from Bangladesh in mid 1990s. But imports from Bangladesh could not be effective owing to various causes like natural calamities, inadequate supply of goods and lack of institutions such as Joint Economic Commission (JEC), Joint Business Council (JBC), Joint Chamber of Commerce (JCC), consular offices at each other's major trade or transit entry points, etc. in

⁶¹ "Bhutan and Bangladesh could expand trade relations", *op.cit.*

Bangladesh. Moreover, Bangladeshi goods by and large are not competitive in Bhutan in comparison with those from other countries. As such, the volume of imports from Bangladesh to Bhutan has been insignificant.

However, cooperation between the two countries is normally a continuing process. In the process, consideration of national interests is important. In case of Bangladesh-Bhutan relations, the aforementioned impediments hinder the process of cooperation in its various phases. But the impediments may not necessarily bring it to a halt. Given the goodwill on the part of both Bangladesh and Bhutan and with appropriate corrective measures, such scenario could be overcome.

Section IV - Prospects for Bangladesh-Bhutan Relations: A Future Outlook

In spite of many obstacles in the relationship between Bangladesh and Bhutan, there are enormous prospects for bilateral cooperation between the two countries. Amendments in some articles of the 1949 Friendship Treaty between India and Bhutan have increased this opportunity.⁶² The revised treaty significantly amends Article II and Article VI of the 1949 Treaty.⁶³ It speaks of cooperation and setting up of a consultative mechanism in conducting foreign policy of Bhutan. It also allows Bhutan to import non-lethal military equipment from other countries without India's consent and thus ends India's 57 years of direct oversight in guiding Bhutan's foreign and defence policies.⁶⁴ This means that the revised treaty, therefore, is not only just relevant to the times but is also a strong basis for the future of Bhutan's external relations. In this

⁶² India and Bhutan revised the Friendship Treaty of 1949 and signed it on 8 February 2007. See, Meeting New Times, *Kuensel*, 10 March 2007.

⁶³ Article II says that Bhutan will be guided by the advice of the Government of India regarding its external relations. Article VI declares that Bhutan would be allowed to import arms, ammunitions, machines and war materials or store for its welfare but with India's assistance and approval. See, Syed Sikander Mehdi, "Bhutan and Its Strategic Environment", *Strategic Studies*, Vol. XII, No. 2, Winter 1988, p. 80; India, Bhutan Amend Friendship Treaty, *The Daily Star*, 10 February 2007.

⁶⁴ India, Bhutan Amend Friendship Treaty, *op.cit.*

sense, Bangladesh-Bhutan relations could be discerned in a new direction. The current relationship between the two countries has vast potentials for developing mutually beneficial cooperation. Following is an attempt to shed light on some of the crucial unexplored or under-explored areas of cooperation. Discussion has been focussed on six such areas: trade and economy, education and technical, water resources, natural resources, electricity and tourism.

Trade and Economy

An important aspect of the ongoing globalisation process is the increasing integration of national economies of neighbouring countries. It can generate strong development through effective cooperation in the field of trade and economy, which is one of the existing prime prospective areas of Bangladesh-Bhutan relations. To enhance trade and economic potentialities between the two countries, some insights on trade and transit issues are given below.

With regard to the question of overland transit facilities, the elements of geographical contiguity may strongly support the trade initiatives between Bangladesh and Bhutan. It may be stated here that the existing Chilmari-Dubri IWT route is serving the Indian traffic from Kolkata to Assam via Bangladesh. Bhutan is also connected with Dubri by a motorable road. In addition, the railway track between Mogalhat and India's Gitaldah in Cooch Behar is used by goods' train from Cooch Bihar to Lalmonirhat carrying boulders and other goods for Bangladesh. Gitaldah is also connected by motorable road with Bhutan. Therefore, these two entry-exit points, i.e. Chilmari-Dubri and Mogalhat- Gitaldah could be conveniently used. By road, now central Bhutan - Dalu (India) - Nakuganj (Bangladesh) route is being considered more convenient than existing one due to shorter distance, moving traffic across the border and transshipment cost.⁶⁵ On the other hand, Bhutan wants Mongla Port for transshipment of goods to and from its territory considering shorter distance (compared to Kolkata) and lower congestion.⁶⁶ The Government of Bhutan is also thinking of opening consulates in Chittagong and Mongla to facilitate trade and business activities

⁶⁵“Economic and Political Relations between Bangladesh and Neighbouring Countries”, *op.cit.*

⁶⁶ *Ibid.*

between the two countries. With long-term policy, these requirements need to be examined. Bangladesh must take these factors into consideration and formulate its policy accordingly.

Although the volume of trade between Bangladesh and Bhutan currently stands at about US\$14 million a year, imports from Bhutan are remarkably higher than exports to Bhutan. This is a reality that needs to be taken into account and hence, an integrated institutional approach in trade expansion and facilitation, payment arrangements, tariff concessions, trade transportation, freight forwarding and customs administration needs to be considered as well as expanded. In addition, JEC, JBC and JCC, (to identify a number of sectors where joint venture projects could be set up, and to incorporate the private sectors of both the countries), and consular offices need to be established. Moreover, a bilateral Free Trade Arrangement (FTA) between the two countries could be set up considering geographical proximity, presence of trade complementarities and sound political relations to undertake a sustained trade policy for deepening and broadening the bilateral trade relations. In the process, regular interactions, at track-I and track-II level through visits, would also be a way of improving trade relations between the two countries. However, the prime response of Bangladesh, to take benefit from trade relations, is to diversify its products. One of the ways, considered by the expertise, is the continuation of the Single Country Trade Fair of Bangladeshi products in the Bhutanese capital, which tries, with enthusiastic efforts, every year to showcase a wide range of new products such as interior fittings, building materials, handloom products, educational and institutional services, cosmetics, toiletries, etc. and increase Bhutan's eagerness to import more from Bangladesh.

Education and Technical

Bhutan depends heavily on foreign expertise for educational and technical institutions. For example, in the case of its aviation industry, there is a need of a large number of technicians and airport staffs, although it has only two aircrafts in its fleet. This means that Bhutan would continue to procure substantial inputs of foreign expertise in the foreseeable future and hence, there are some opportunities for expanding educational and technical cooperation

between Bangladesh and Bhutan. The following steps need to be considered in this regard:

- Exchanging know-how and sharing knowledge for technological and technical development programmes between the institutions of the two countries;
- Setting up of joint venture institutions like schools of nursing, pharmaceuticals, hospitals, and tourism in selected areas;
- Arranging fairs in education and institutional services;
- Providing area-based expertise in Bhutan; and
- Giving permission of more Bhutanese students in Bangladesh.

Water Resources

Issues like water are so contentious that the South Asian Association for Regional Cooperation (SAARC) refuses to incorporate it as an agenda for regional cooperation. With long-standing planning, sub-regional mechanism like South Asian Growth Quadrangle (SAGQ)⁶⁷, a sub-regional grouping among the countries of the Ganges and the Brahmaputra river basins, can be substantially fruitful. It might, at least, insist on the formation of the Ganges-Brahmaputra-Meghna (GBM) River Basin Authority to be engaged in joint studies for the utilisation of these trans-boundary rivers for mutual benefit. The arrangement would, to some extent, reduce flood problem and mitigate severe shortage of water. As a member of the SAGQ, India must come with a positive attitude. Bhutan and Bangladesh should give top most priority to developing regional,

⁶⁷ The SAGQ, an idea for sub-regional cooperation, was mooted in 1996. It consists of Bangladesh, Bhutan, Nepal and India's North-eastern states and West Bengal. It has a total area of 688.6 thousand sq. km. with a population of over 247 million. It is seen as a practical solution to the socio-economic development of the sub-regional phenomenon in South Asia without forcing a major policy shift to the member states. See, Muchkund Dubey, Lok Raj Baral and Rahman Sobhan (eds.), *South Asian Growth Quadrangle: Framework for Multifaceted Cooperation*, Macmillan India Ltd., Delhi, 1999, pp. 9-11.

national and local water markets through the active participation of the private sectors. Besides, Bangladesh and Bhutan should initiate joint studies on techniques of water management and development. In this regard, the initiative of 1988 might be considered afresh.

Natural Resources

Bangladesh has mainly three types of natural resources – natural gas, arable land and timber. Besides, it possesses a well-known forest, the Sunderbans. On the other hand, Bhutan has ample natural resources – notably timber with extensive forest reserves remaining virtually unexploited, and minerals including stones, gypsum and calcium carbide.⁶⁸ There is a huge demand for those resources of Bhutan in Bangladesh. Bangladesh has a booming construction industry and would like to import more stones from Bhutan to construct roads and bridges.⁶⁹ In return, Bhutan can import cement made in collaboration with Japan, cylindered gas, and forest collections like honey, shell, crab, shrimp, fish, and fuel food from the Sunderbans. Besides, both the countries have a commonality of interest in creating community forestry, preserving natural wildlife and forest reserves. This means that enormous potentials wait for long-term collaboration between the two countries due to remarkable complementarities in supply of raw materials. To concretise such prospects and reap benefits, both the countries have to take effective measures at government as well as private sector level.

Hydroelectricity

While Bhutan has vast potentials for generating hydroelectricity, Bangladesh, in contrast, has shortage in the supply of electricity. Growing requirement and economic cost involved with the factors of production are creating a vast market for the product in Bangladesh. Therefore, electricity is a major product that Bangladesh could import from Bhutan. Bhutan has already shown keen interest in getting investment in its hydroelectric sector from Bangladesh. India too has demonstrated positive attitude at the SAARC energy ministers' meeting in New Delhi in March 2007 towards Dhaka's

⁶⁸John Bray, "Bhutan: The Dilemmas of a Small State", *Global Studies: India and South Asia*, McGraw-Hill/Dushkin Company, USA, 2002, p. 198.

⁶⁹ Bhutan and Bangladesh could expand trade relations", *op.cit.*

plan for bringing hydroelectricity from Bhutan through India by interconnecting regional power grids.⁷⁰ With this new opportunity, electricity could be an area of cooperation between the two countries.

Tourism

Tourism is a source of foreign exchange earning for both Bangladesh and Bhutan. Since the people of Bhutan are very much interested to visit the cultural and heritage sites in Bangladesh and conversely, the tourism sites in the Himalayan Kingdom can be places of attraction for Bangladeshis, there is an immense potential for the promotion of tourism between the two countries.⁷¹ It is important to note that there is no visa requirement between the two countries. Existing agreement on air services may facilitate the movement of people from one country to the other. Moreover, the introduction of bus service between the two countries is also on the cards.

Conclusion

Both Bangladesh and Bhutan are very much interested to set up a meaningful cooperation in socio-political and economic field. But their relentless efforts have not gained much as one may have expected. The Indo-Bhutan Friendship Treaty still appears to be the most outstanding obstacle to the bilateral relationship between Bangladesh and Bhutan. The other two impediments are lack of common border and Bhutan's economic dependency on India. As long as the outstanding factors exist, the prospect of a fruitful socio-economic cooperation between Bangladesh and Bhutan looks limited. In such a scenario, the expansion of the relationship between the two countries on a sustained basis needs to take the following suggestions into consideration.

- At the domestic level, it is very important to study the sector-wise challenges and then formulate ways and means for mutually beneficial cooperation considering geography, polity, security and economy. In this case, optimal

⁷⁰ India responds positively to power import plan from Bhutan and Nepal, *The Daily Star*, 12 March 2007.

⁷¹ "Renewal of Dhaka-Thimpu trade accord to boost economic ties", *op.cit.*

mobilisation of resources in terms of both men and materials is essential. But initiating meaningful efforts is difficult for any country individually. It can be rendered through cooperative endeavours with the help of not only government but also participation of a number of concerned agencies and experts in various disciplines to combat the challenges and flourish the prospects.

- Since both Bangladesh and Bhutan are members of SAGQ and SAARC, the present relationship between the two countries can also be followed up in both sub-regional and regional forum. If the two countries are engaged in a long-term relationship on such issues as hydroelectricity, water resources development and management etc. then sub-regionalism will gain rapid momentum pulling in India to cooperate trilaterally. For this to happen, the concerned countries need to assess their problems and devise policies so that a win-win situation for all the three nations can be created.
- If any initiatives like SAFTA are undertaken, regionalism in South Asia may create scopes for enhancing bilateral cooperation. Uninterrupted multi-modal transport connectivity can be established in South Asian region under the framework of SAARC involving government and non-government agencies. This would facilitate better transport communication system between Bangladesh and Bhutan.

Razia Sultana

EXPANSION OF SAARC: IMPLICATIONS FOR SOUTH ASIA

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Abstract

The inclusion of a new member (Afghanistan) and six observers (China, Japan, Republic of Korea, Iran, the USA and the EU) into SAARC has provided the regional organisation new impetus and dynamism. It has been argued in the paper that this expansion is likely to open up new avenues for cooperation for SAARC nations beyond the geographical boundaries of South Asia. The paper attempts to find out the factors that motivated the countries to be associated with SAARC. It also examines the options and challenges following the expansion of SAARC and its implications for South Asia. In the process of analysis, this paper has adopted the framework of neo-regionalism in order to explain the expansion of this regional association.

Keywords: SAARC, SAFTA, Neo-Regionalism, Observer, Regional Trade Agreements.

Introduction

The expansion of South Asian Association for Regional Cooperation (SAARC) is considered as a landmark event in the history of this organisation. The inclusion of Afghanistan as a member and China, Japan, Republic of Korea, Iran, the USA, and the European Union (EU), as observers has certainly added new strength and dynamism to SAARC itself. Consequently, the event has ushered in an era of hope for around 1.5 billion people of South Asia. Also regarded as a crucial episode, the expansion, it is hoped, would open up a new door of cooperation beyond the geographical

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boundaries of the region. However, there are some experts who opined that this expansion might bring more challenges rather than cooperation due to the uneasy relations among some members (e.g. Pakistan-Afghanistan).⁷² It is in this context, the paper makes an attempt to answer some pertinent questions: Why has SAARC expanded itself after long 22 years? Why has SAARC included Afghanistan in spite of the latter being an impoverished and war-ravaged country? What are the reasons behind this sudden rush of the powerful countries and organisation for obtaining observer status? Will the new member and observers open windows of opportunities or bring further challenges for the region? The paper argues that though the expansion would pose some challenges, it would be ultimately beneficial for knitting this regional organisation as a cohesive unit. The paper has been organised as follows: Section I of the paper tries to explain the expansion of SAARC under the framework of neo-regionalism. The motivating factors that encouraged the new member and observers to work in a common platform are presented in Section II. Section III analyses the implications of expansion of SAARC in the region. The challenges and options to overcome the problems for expanding the regional organisation are identified in Section IV and Section V respectively. Concluding remarks will be made in the last section of the paper.

I. Expansion of SAARC under the Framework of Neo-Regionalism

SAARC embraced Afghanistan as its 8th member during the 13th Summit which was held in Dhaka on 12 and 13 November of 2005. China and Japan obtained observer status. Subsequently, in the 14th SAARC Summit, Afghanistan was formally inducted in all the existing SAARC agreements, declarations, and legal documents by a Joint Declaration. In this Summit, South Korea, the USA, and the European Union were included as observers. In addition, Iran which has been actively showing its keen interest to be engaged with SAARC, submitted a formal application to the SAARC Secretariat on March 2007.

⁷²C. Raja Mohan, "Coming Full Circle at SAARC", available at <http://www.indian express.com/story/27391.html>sted, accessed 9 June 2007.

However, regarding their joining, there might have been clarifications that since the observers are included for the first time, what are the exact roles they will play? In this regard, the SAARC Charter gives the observers some defined and precise roles within SAARC. For instance, if the observers are present at a ministerial level meeting, they can make brief statements with the prior approval of the Chair.⁷³ Additionally, SAARC will invite them to open plenary and closed meetings. The observers will be allowed to make proposals on cooperation and joint venture projects with the approval of the concerned SAARC committees. But, they cannot play any role in the decision making process.

Table 1: New Member and Observers of SAARC

Country	Status	Date and Place of Joining
Afghanistan	Member	12-13 November 2005, 13 th SAARC Summit, Dhaka
China	Observer	12-13 November 2005, 13 th SAARC Summit, Dhaka
Japan	Observer	12-13 November, 2005, 13 th SAARC Summit, Dhaka
South Korea	Observer	10-11 April 2006, Standing Committee Meeting, Dhaka
The USA	Observer	10-11 April 2006 Standing Committee Meeting, Dhaka
The EU	Observer	3-4 April 2007, 14 th SAARC Summit, New Delhi
Iran	Observer	3-4 April 2007, 14 th SAARC Summit, New Delhi

Source: Compiled by the author from multiple sources

Neo-regionalism and Expansion of SAARC

Regionalism and neo-regionalism are two important phenomena of any regional integration process. Regionalism is a territoriality based autarkies, which was formed in a bipolar cold war context during the first 20-30 years after World War II. It has become a strong collective policy and a powerful tool of development in many parts of the world. There are glaring examples where regional

⁷³ “Briefing by Official Spokesperson on the Fourteenth SAARC Summit”, 21 March 2007, available at <http://meaindia.nic.in/pressbriefing/2007/03/21pb05.htm>, accessed 28 May 2007.

groupings have dealt their bilateral issues effectively to be more open, dynamic, and to achieve a win-win situation.⁷⁴

However, the concept of regionalism, generally termed as old regionalism, promotes greater integration and transaction by reducing high level of tension and conflicts.⁷⁵ This advanced form of cooperation also leads to more economic union through a sense of competition where goods and services can move freely without any constraint within the region. It believes in the specification and the separation of economic oriented issues from security issues.

In contrast, neo-regionalism took place in a multi-polar world during the 1990s. Since then onwards, it is a process of transformation from 'shallow integration' to 'deep integration'.⁷⁶ It is a more competitive, spontaneous, and open process than regionalism promoting the concept of globalisation. It is a comprehensive multi-dimensional initiative, which includes the traditional and non-traditional issues such as economic integration, environment, social policy, security, and democracy at local, national, and global level. Like old regionalism, it is not concerned about the state to state relations and its intervention. Rather, the concept of neo-regionalism indicates that market, multi-national companies (MNC), elites, and other non-state actors are active and manifest themselves at several level of global system. It emphasizes not only economic but also social and cultural networks that develop more quickly than the formal political cooperation at regional level.⁷⁷ Besides, one of its

⁷⁴ Mahendra P. Lama, "SAARC: Dynamics of Emerging Neo-Regionalism", Paper Presented at a Conference on *Regional Conference on Expansion of SAARC: Challenges and Opportunities*, Institute of Foreign Affairs (IFA) and Freidrich Ebert Stiftung (FES), Kathmandu, 29-30 June 2006 .

⁷⁵ Michal P. Sullivan, *International Relations: Theories and Evidence*, Prentice-Hall, Inc., New Jersey, 1976, p.210.

⁷⁶ Mary E. Burfisher, Sherman Robinson, and Karen Thierfelder, "International Regionalism: Old and New, Theory and Practice". Paper Presented at *The International Agricultural Trade Research Consortium (IATRC) Conference*, Capri, Italy, 23-26 June 2003, p. 2.

⁷⁷ Bjorn Hettne, "The New Regionalism: Implications for Development of Peace" in Bjorn and Hettne and Andras Inotai (eds.), *Comparing Regionalism: Implications for Global Development and International Security*, A UNU/WIDER Study, Helsinki, 1994.

important dimensions is that it includes civil societies consisting socio-cultural, political, and economic linkages that makes it different certain geographical areas from the rest of the global community.

Further to this, linking developing and developed countries through Regional Trade Agreements (RTA) is an important feature of neo-regionalism.⁷⁸ The agreement is a general term, which refers to a whole range of economic integration. The most common type of RTA is a free trade area in which members liberalise internal trade but retain their external tariffs. A regional organisation such as the EU has used RTAs as a key part of its strategy for economic development assistance. In this case, among 50 regional trade agreements, 35 took place with the developing countries.⁷⁹

The basic philosophy of regionalism is the old trade theory, which mainly focuses on commodity trade and prices. Instead, new trade theory analyses neo-regionalism and addresses a variety of other effects of trade and device other than more proficient sectoral allocation of production. In addition, it ascribes trade productivity links and dynamic changes such as new growth theory, imperfect competition, and rent seeking behaviour.

In other words, the concept of regionalism and neo-regionalism are not opposing rather the latter broadens the scope of the former by adding different aspects of globalisation. The concept of neo-regionalism includes the following dimensions:⁸⁰

- Easing the financial and Foreign Direct Investment (FDI) flows by creating investment protocols and protections;
- Liberalising labour movement within the RTA;
- Setting up institutions to assist and facilitate integration through regional funds, setting standards and, dispute resolution mechanisms;

⁷⁸ Mary E. Burfisher et al, *op.cit.*, p.6.

⁷⁹ "Regional Trade Agreements", World Trade Organization (WTO), available at http://www.wto.org/english/tratop_e/region_e/region_e.htm, accessed 17 June 2007.

⁸⁰ Mary E. Burfisher et al, *op.cit.*, p.6.

- Improvement of communications and transportation infrastructure to facilitate increased trade and factor mobility;
- Monetary union through establishing common currency integrated monetary and exchange rate policy.

Therefore, from the above discussion, it can be inferred that, under the framework of regionalism, the modernist believes that state is the single unit of analysis that promotes national interest.⁸¹ Coming out of the over statist paradigm, post modernists take the stand that state is not the key actor rather extra-regional cooperation is the engineer to expand trade beyond the geographical boundaries of a state.⁸² They also assume that state has already become irrelevant in the form of regulation due to the new wave of globalisation. However, neo-regionalism promotes certain conditions of globalisation such as free market economy, privatisation, and strong role of non-state actors. Perhaps, South Asian countries in order to cope with this paradigm change since 1990's, pursued trade liberalisation through South Asian Preferential Trading Agreements (SAPTA) and South Asian Free Trade Area (SAFTA) for enhancing economic growth like the EU and the NAFTA.

Equally important aspect is that, as Cold War is over and globalisation is the fact of life, the concept works as an intervening variable to the South Asian leaders to spawn SAARC expansion. As such, keeping the whole concept of neo-regionalism in mind, Pranab Mukherjee, the External Affairs Minister of India, said that the entry of Afghanistan is vital because it would accord fresh impetus to regional connectivity linking South Asia to Central Asia and facilitating transit and expansion of trade.⁸³ Similarly, the rationale of the SAARC members to call for increased cooperation with major powers of North East Asia, Europe, and North America is due to the

⁸¹ Robert Keohane, "Realism, New-realism and the Study of World Politics", in Robert Keohane (ed.), *Neorealism and Its Critics*, Columbia University Press, New York 1986, p.11.

⁸² Robert Keohane, and Joseph S. Nye. Jr., *Power and Interdependence*, Little, Brown and Company, Boston, 1977, pp. 24-26.

⁸³ "SAARC: India Hails Afghanistan's Entry" available at <http://www.ndtv.com/convergence/ndtv/story.aspx?id=NEWEN2007000744> 1, accessed 7 June 2007.

pace of globalisation, high growth rate, and regional development advances. Also, these big powers might further enlarge the geographical scope of SAARC and become bigger than ASEAN in the coming years. On the other hand, the new member and new observers assume that SAARC can be a ground to expand trade, investment, and people to people contact. As neo-regionalism and globalisation are interlinked, all the members and observers consider SAARC as a unified sunshade which would explore avenues of opportunities. Likewise, the state leaders have realised that they should tap the opportunities as SAARC wants to promote regional integration. Hence, it can be said that the combination of the forces of neo-regionalism encouraged SAARC to take the strategic step of enlargement in accepting Afghanistan as a full member and giving China, Japan, South Korea, Iran, the US, and the EU observer status.

II. Factors behind Associating with SAARC

There is a general perception that SAARC is a white elephant since the organisation has failed to work in a concerted way. If this is true, then the rational argument is-why is there a growing interest to become a new member or observer of SAARC? The answer perhaps lies in the various underlying forces that have driven the countries towards greater cooperation in the region. Following are some of the causes for members and observers to have joined SAARC.

a. Member

Currently, Afghanistan is not only a least developed country but also one of the poorest in the world. Its economy suffered a lot since the conflicts of 1979-80 Soviet invasion coupled with political and military unrest during the Taliban regime. During those periods, the country was isolated from the outside world for a long time. Since the collapse of the Taliban administration, it has been a great challenge for the present Afghan government to strengthen relations with rest of the world. In this situation, what seems the rational thing to do for revitalising its economy is to come out of protectionist policies and to improve relationship with its neighbours and international communities. In this connection, the country showed an overwhelming interest to join SAARC to express political and economic solidarity with the rest of the world. Besides, economic benefits are a strong driving force for the country to be included in

this organisation. After joining SAARC, Afghan President Hamid Karzai showed interest about transit rights which would give a boost to the country's war torn economy.⁸⁴ He also believes that implementing and replicating the micro finance project of Bangladesh would immensely help to alleviate poverty in Afghanistan. Similarly, Afghanistan is likely to grow at 2.7 percent since India and Pakistan are its major trading partners.⁸⁵ Even more, if Afghanistan gets SAFTA membership on February 2008, it would be able to gain as much as \$606 million out of \$2 billion trade gains from custom revenues, taxes, and other commercial ties.⁸⁶ Thus, Afghanistan's entry into SAARC is important for the country as it would be the best means to spur its war-ravaged economy to peace economy, boost trade, and fight effectively against upsurge in violence through peace initiatives.

b. Observers

China had a long term desire to be an observer of SAARC. Since the late 1980's, it has been emphasising on liberal economic policies to expand its socialist market economy. For this very reason, the country needs to get access to raw materials, commodities, and South Asian market for Chinese goods. Moreover, since 1990's onwards, China has been focusing on multilateral cooperative mechanism supporting political and economic aspects of globalisation to achieve great power status and expand its global role. At the same time, its strong economic and strategic ties with major South Asian nations paved the way for its entry into SAARC as an observer. During the 14th SAARC Summit, Li Zhaoxing, the Chinese Foreign Minister expressed that it is China's good political atmosphere, geographical proximity, and historical close rapport with South Asian countries,

⁸⁴ *Ibid.*

⁸⁵ Satyajit Mohanty, "Afghanistan in SAFTA: Issues and Implications", *South Asia*, Institute of Peace and Conflict Studies (IPCS), 28 August 2006, available at http://www.ipcs.org/South_Asia_articles2.jsp?action=showView&country, accessed 14 June 2007.

⁸⁶ G. Srinivasan, "Afghan entry to SAARC will lead to \$2-B gain for sub-continent", available at <http://www.thehindubusinessline.com/2007/03/29/stories/2007032906381000.htm>, accessed 11 June 2007.

which can play a bigger role to boost China-SAARC cooperation.⁸⁷ In this regard, the country has already taken a number of initiatives to spur its economy with the South Asian states. For example, it has recently built a naval port at the Arabian Sea Coast at Gwadar in Pakistan to connect land locked Central Asia including Afghanistan with the outside world.⁸⁸ Similarly, China signed a comprehensive agreement with Sri Lanka in 2005 for getting access to its valued sea ports as well as the Indian Ocean.⁸⁹ Thereby, China's economic, political, and strategic interests have certainly propelled the country to cooperate with the region.

Japan, on the other hand, has become an observer of SAARC despite its geographical distance from South Asia. Its main argument for being an observer is its significant contribution to the development fund in the region. Japanese Foreign Minister Taro Aso dubbed South Asia as the 'central pillar' of the Asian arc of prosperity.⁹⁰ Therefore, to derive mutual benefits, he offered Japan's support to work with SAARC for improving regional connectivity and increasing trade with his country.

The economic ties with South Asian countries perhaps encouraged Korea to join SAARC. Foreign Minister of South Korea, Song Min-Soon, said that since its trade with SAARC nations has been growing significantly, the country is ready to share its experience in ICT, government innovation, human resources development, and other concrete programmes with the South Asian members.⁹¹ Also, the security issues might prompt Korea to be associated with SAARC. Its Foreign Minister said that North Korean

⁸⁷ "SAARC has a bright future through cooperation says Li", cited in <http://www.hindu.com/2007/04/04/stories/2007040408811200.htm>, accessed 3 June 2007.

⁸⁸ Tarique Niazi, "Asia between China and India" *Japan Focus*, available at <http://japanfocus.org/products/topdf/1756>, accessed 26 June 2007

⁸⁹ Tarique Niazi, "Sino-Indian Rivalry for Pan Asian Leadership." *China Brief*, Vol. 6 (14), 15 February 2006, available at http://jamestown.org/china_brief/article.php?articleid=2373170, accessed 22 June 2007.

⁹⁰ "Afghanistan inducted as 8th member: 14th SAARC Summit begins" available at <http://www.dawn.com/2007/04/04/top13.htm>, accessed 12 June 2007.

⁹¹ *The Daily Star*, 4 April 2007.

nuclear issue can be resolved with the continued support of the international community including the SAARC members.

Robert B. Zoellick, Special Trade Representative of the USA (now President, World Bank), analysed his country's pursuit of 'regionalism' as strategy to acquire short term economic goals and achieve long term strategic objectives that can be fostered by trade liberalisation.⁹² Accordingly, Richard Boucher, the US Assistant Secretary of State for South and Central Asia stated that South Asian free trade is an opportunity for all the countries of the region to establish links with Central Asian organisations which perhaps inspired the USA to join SAARC.⁹³ Furthermore, the signing of SAFTA has raised hope that SAARC might take off as a trading bloc. As a leading super power, the USA always wants to play a vital role in world affairs. Therefore, such regional grouping like SAARC is an important ground to increase political and economic interactions. However, the USA wants to join a group which includes emerging economic power like India and another Asian giant such as China. Apart from these, it is the calculations of security issues which drive the country to be involved with the region. For instance, since the 9/11 terrorist attack, the USA has given more attention to the war against terror. Therefore, SAARC can be a ground for combating the extremists and terrorists who are detrimental to its national security.

As a successful regional organisation, the EU values mutual aid through regional integration process as a means of encouraging investment and competition, including preferential trading agreements between the countries, which are not geographically contiguous or even nearby. Thereafter, Benita Ferrero-Waldner, the European Commissioner for External Relations takes the view that the EU can assist to consolidate the existing integration process with South Asian countries through reinforcing regional cooperation, people-to-people contacts and trade liberalisation in the region.⁹⁴ In

⁹² Mary E. Burfisher et al, *op.cit.*, p.1.

⁹³ Anand Kumar, "Making a Beeline for SAARC", available at <http://www.saag.org/%5Cpapers18%5Cpaper1770.html>, accessed 27 May 2007.

⁹⁴ *The Daily Star*, *op.cit.*

addition, its own historical experience of trade cooperation, diversified transactions, and its interest in crisis prevention for world peace has consistently encouraged involving with another regional organisation.

In the recent 14th SAARC Summit, Iran showed its keen interest to be engaged with SAARC to promote its 'Look East Policy' perspective. The Iranian envoy, Rasool Islami, noted that Iran's inclusion in this organisation would be beneficial for both Iran and SAARC because of the country's geographic and economic strength.⁹⁵ On the one hand, its geographical position is important as it is a neighbour of two other SAARC members, namely Pakistan and Afghanistan, while on the other, the country has economic strength mainly based on its energy resources. Besides, Iran's link with this region is long-standing and deep-seated in terms of its history and culture. Thus, all these factors likely to have motivated Iran to build a closer relation with the South Asian countries.

III. Implications for South Asia

Needless to say, the entry of a new member and observers can bring new dynamism and a chain of opportunities for South Asian countries. Moreover, the regional association can gain a lot by expanding its horizons and forging cooperation for regional prosperity. In addition, it might bring far reaching political, social, and economic implications in South Asia as a whole. In this section, an attempt has been made to highlight how South Asian members could gain immensely if the region integrates in a framework for intra and extra-regional cooperation in the probable areas such as energy, infrastructure connectivity, tourism, trade as well as security issues.

⁹⁵ "Iran Requests for Observer Status in SAARC" available at http://english.people.com.cn/200703/05/eng20070305_354236.html, accessed 29 May 2007.

a. *Trans-regional Trading Arrangement and Investment*

The participation of Afghanistan as an active member is likely to provide a much larger scope in terms of economic gains for South Asian countries. In this connection, it is estimated that if the country participates in SAFTA, the region will gain \$2 billion through trade.⁹⁶ In case of China, it has substantial economic and financial investments in India, Pakistan, Bangladesh, Sri Lanka and Nepal. Due to the troubled relations with India, China's positive investment strategy will further help the small South Asian states to open up its trade and services. Similarly, Japan's assistance through Overseas Development Assistance (ODA) in different projects in South Asia might add new strength and open up new avenues of cooperation. Regarding South Korea, its trade with SAARC nations has been increasing at 23 percent yearly and is likely to grow more in future as it has already showed interest to invest in the region.⁹⁷ As an important initiative, the country signed a Memorandum of Understanding (MoU) with Bangladesh on 4 June 2007 to take manpower under Employment Permit System (EPS).⁹⁸ Similarly, being one of the largest exporters, the EU expressed its desire to share its expertise, experience, and market access in all areas of interest with the region. As the EU has agreements with all SAARC members except Maldives and Nepal, the organisation sees itself as a natural partner in all its efforts aimed at reinforcing regional cooperation, people-to-people contact, and trade liberalization in South Asia.

b. *Energy Cooperation*

Energy is one of the priority areas among the SAARC member countries. To meet the energy demand of the growing population of the region, trans-border energy cooperation is an important option. Observing the future energy crisis, Manmohan Singh, the Prime Minister of India, proposed in the 14th SAARC Summit to launch a South Asian energy community and back up of appropriate local technologies for harnessing renewable energy (hydropower, bio-fuel, solar and wind power) as areas of consideration for further

⁹⁶ G. Srinivasan, *op.cit.*

⁹⁷ *The Hindu*, Vol. 22, No. 25, 3-16 December 2005.

⁹⁸ *The Financial Express*, 5 June 2005.

cooperation.⁹⁹ The Indian Premier further proposed to share energy markets through harmonising systems and grid structures to meet the crisis. In this regard, the inclusion of Afghanistan probably will help to fuel the economies of other countries. At present, Afghanistan has significant amount of natural gas, oil, and coal which can resolve the regional energy crisis.¹⁰⁰ Moreover, with proper coordination, South Asia can be connected by land with Central Asia to increase energy trade and investment. Besides, Afghan President Hamid Karzai's proposal to open corridors through Turkmenistan-Afghanistan-Pakistan-India is a good sign for further energy cooperation in this area.¹⁰¹ Previously, a study on the gas pipeline was prepared but it was not implemented due to the unwillingness of Pakistan to involve Afghanistan in the project. As Afghanistan is now a member of SAARC, India and Pakistan can consider the venture with a concerted effort. In addition, Iran can cooperate through exporting energy products especially gas and oil which can facilitate the member countries to create a secured energy market.

c. Geographical Connectivity

Physical connectivity, most importantly, transport and communications is the basis of economic cooperation and integration efforts through the movement of goods, services, capital, people, and information across the countries. Therefore, transit and transport facilities under the regional multi-modal transportation system are the key priority for South Asian members. Over the last five years, India has been demanding transit facilities through Pakistan to allow its goods and services to reach Afghanistan and Central Asia. Therefore, Afghanistan's accession to SAARC has given a new multilateral dimension to India's quest for an overland transit facility through Pakistan for trade and investment with Afghanistan and Central Asia. Meanwhile, in the 14th SAARC Summit, a Regional

⁹⁹ Nazrul Islam, "Call to Turn SAARC into an Economic Powerhouse" available at <http://www.bangladesh-web.com/view.php?hidDate=2007-04-05&hidType=TOP & hid Record =0000000000000000156231>, accessed 23 May 2007.

¹⁰⁰ Presently, Afghanistan has 1.6 Trillion Cubic Feet (CFT) of natural gas, 95 million barrels of oil and 400 million tonnes (MT) of coal; See for details, Satyajit Mohanty, *op.cit.*

¹⁰¹ *The Daily Star, op.cit.*

Multimodal Transport Study (RMTS)¹⁰² was proposed outlining Dhaka-Kabul corridor which might enhance transport connectivity among SAARC countries. Furthermore, Iran's inclusion to SAARC can promote the East-West connectivity. Few years back, the country proposed to create a West Asian Cooperation Bloc including India and Pakistan.¹⁰³ As it is very difficult for India to set up a direct road access to Afghanistan and Central Asia, Iran can be helpful to reduce these problems allowing Indian goods and services to Afghanistan and Central Asian countries. Recently, Bangladesh, India, China, Iran, Nepal, South Korea, and Sri Lanka's participation in Trans-Asian railway with other 13 countries¹⁰⁴ of Central, Europe, and South Asia might enhance the regional connectivity process in this regard.

d. Poverty Alleviation

It is fairly evident that South Asian members have a common problem of poverty and lower per capita income. In the 14th SAARC Summit, both Nepal and Bangladesh stressed the need for effective and equitable utilisation of human potential to free the chain of poverty. In addition to this, China's willingness to discuss cooperative mechanism and carry out a comparative study on poverty reduction model might give a strong flip to alleviate poverty. On the other hand, Japan's desire to assist Afghanistan for rebuilding the country will immensely help the nation to come out from the chronic poverty. Seemingly, India's proposal to activate SAARC Development Fund (SDF)¹⁰⁵ and a possible "soft wing" might be an

¹⁰² RMTS has been identified with road, rail, and air links to the region that would be extended to Afghanistan.

¹⁰³ V. Sundaram, "Iran in SAARC: In India's interest but what about Pakistan?", available at <http://www.boloji.com/analysis2/0200.htm>, accessed 19 June 2007.

¹⁰⁴ Armenia, Azerbaijan, Cambodia, Indonesia, Kazakhstan, Laos, Mongolia, Russia, Tajikistan, Thailand, Turkey, Uzbekistan and Vietnam.

¹⁰⁵ SDF is a project of \$100 million on poverty alleviation. It will cover mainly three windows- social, economic, and infrastructure. The poverty alleviation issue would come under social window; See for details, "Briefing by Official Spokesperson on the Fourteenth SAARC Summit", *op.cit.*

important and visionary step for poverty mitigation. Also, the decision of SAARC leaders to set up a food bank in the 14th SAARC Summit can help to provide emergency food requirements as most of the countries are the regular victim of food shortage due to the periodic natural disasters like floods, droughts, earthquake, tsunami etc.

e. Counter Terrorism Measures

As a security issue, terrorism is one of the prime concerns of South Asian countries. Due to the massive terrorist attacks at New York, Karachi, Qandahar, and Mumbai, SAARC members and observers are now united to provide a common support against terrorism. Recently, all the SAARC leaders decided to work out the modalities to implement the provisions of the existing SAARC Conventions to combat terrorism, narcotics, psychotropic substances, trafficking in women and children and trans-national crime. In this regard, in October 2007, Sri Lanka's proposal to host a Legal Expert meeting in India on "Mutual Legal Assistance on Criminal Matters" would intensify cooperation on crimes with multiple sources.¹⁰⁶ Besides, all the SAARC members expressed their will to work together by taking possible steps to prevent the linkages between trade in narcotics and terrorism. As most of the countries have this common problem, SAARC can be a platform to combat terrorism with the external powers such as the USA, Iran, and China.

f. Change in Power Politics?

In South Asia, India and China are the two major players. The presence of the latter, however, is a problem for the former. Although Pakistan accepted China readily, India was the only country who opposed China's presence strongly to join the regional grouping. India believes that, China's presence in this organisation might reduce its own importance to the small neighbouring countries.¹⁰⁷ Another concern is that as an emerging global power, it

¹⁰⁶ Ashfaq Wares Khan, "SAARC Summits starts today with high hopes on trade", *The Daily Star*, 3 April 2007.

¹⁰⁷ Qudssia Akhlaque, "Afghanistan Inducted as 8th Member: 14th SAARC Summit Begins" available at <http://www.dawn.com/2007/04/04/top13.htm>, accessed 17 June 2007.

might harm India's monopoly business. Therefore, to meet its existing asymmetry in power, the country strongly supports the USA and Japan to contain China in the region.¹⁰⁸ Though in the power competition game, China is visibly far ahead of India in terms of its economic and military capabilities. At present, the country deftly is increasing its strategic ties with Pakistan, Bangladesh, and Sri Lanka under defence and strategic cooperation agreements. In addition, bilateral trade between China and SAARC rose yearly to \$20 billion.¹⁰⁹ Therefore, China might act as a regional power and dominate SAARC to counterbalance India's design.

g. Social, Cultural, and Technical Advancements

The intensification of globalisation can bring more crossbreeding of cultural exchanges.¹¹⁰ In South Asia, cooperation in this sector might enhance intra-SAARC flow of tourists. With a view to highlighting the importance of this sector, India's announcement to relax the visa regime and Bangladesh's call for uniform fee at the heritage site in the 14th SAARC Summit would obviously encourage tourism within the region. In terms of social and technological development, the new member and observers can support significantly for overall development of the region. Already, Pakistan has initiated a program of establishing engineering, science, and technology universities based on probable Japan's technical assistance.¹¹¹ Besides investing in Pakistan, the latter contributed additional \$7 million to the SAARC-Japan special fund for strengthening social and cultural exchanges for the entire region.¹¹² As recently as in the 14th SAARC Summit, one of the major decisions was taken to set up a South Asia University with main campus in India and other campuses in member states. This step

¹⁰⁸ Tarique Niazi, "Sino-Indian Rivalry for Pan Asian Leadership", *op.cit.*

¹⁰⁹ *Ibid.*

¹¹⁰ Zaki Laidi, "Neo-Regionalism-A Response to Globalization?" Paper presented at Seventh ASEF University in Barcelona, Spain, *Regionalism in Asia and Europe and implications for Asia-Europe Relations*, 10-24 November 2002.

¹¹¹ Shaukat Aziz, "Japan as Observer to Add Strength to SAARC", *The News*, cited in

<http://www.thenews.com.pk/print.asp?id=20424>, accessed 14 June 2007.

¹¹² Qudssia Akhlaque, *op.cit.*

would noticeably facilitate sharing of knowledge and ideas of experts, academics, and policy makers of new member and observers in the region. Besides, the proposals of Bangladesh government to host a SAARC youth camp in 2007, and more elaboration of SAARC scholarship programme in the ICT and Bio-science can thereby bring significant gains in the region.

IV. Challenges

There is also a well-built supporting argument that the inclusion of new member and observers would empower SAARC by jointly projecting them on multilateral forums. However, like other organisations, SAARC also faces different challenges. The region, unfortunately, has many unresolved conflicts and outstanding issues which are major threats against greater cooperation. Therefore, it is necessary to indicate those factors that may be regarded as general impediments to cooperation.

a. Intra-SAARC Relationship

Major countries like India and Pakistan are the real threats to greater integration in the entire region. Owing to their deep rooted rivalry attitudes, South Asia has already become one of the poorest areas and most dangerous places in the world.¹¹³ As a result, intra-regional trade in South Asia is very low compared to other regions.¹¹⁴ In addition, South Asian Free Trade Area (SAFTA) which is the main driving force of new regionalism concept in the region has slowed down because of the reluctance of India and Pakistan to open up trade. As intra-SAARC trade will determine the degree of regional cooperation and ultimate promotion of extra-regional trade, the question arises whether these two member countries can put their political differences aside or not.

¹¹³ Mahmud Ali Durrani, *The Cost of Conflicts and Benefits of Peace*, Oxford University Press, 2002, p. 72.

¹¹⁴ At present, intra-regional trade amongst the SAARC members accounts for less than 5 percent of global and intra regional trade while it is 38 percent share by ASEAN, 65 percent by the EU and 37 percent by NAFTA. See, *The Financial Express*, 4 March 2007.

b. Uneven Comparative Advantages in the Market

Market, one of the significant components of neo-regionalism, has a significant role to determine the level of cooperation. A market, among other things, is considered to be not politically neutral as economics is everywhere in politics.¹¹⁵ The existence of markets leads to economic power, which a country uses against another one and *vice versa*. Thus, politics cannot be isolated from economics and this is very much true in South Asia. Regarding the question of equal benefit, the liberal argues that even if cooperation occurs despite differences on the point of distributive gains, markets can bring mutual gain.¹¹⁶ But in this region, India has more comparative advantages than the small countries of SAARC in term of expanding its market with new member and observers for the presence of its strong economic structure. To some extent, small countries are offered certain privileges (zero duty access, non tariff barrier, reduction of sensitive list etc.) though benefits may not be necessarily equal. As India dominates the economic sector (77 percent) in regional market, the limited market potential of the small countries and similarity of the exportable commodities (such as export of readymade garments of Pakistan, India, China, and Bangladesh, tea market by India and Sri Lanka) have become the main contending issues to compete with one another. Due to these certain conditions, is it really possible for the small countries to be a part of economic regionalism? Will the economic benefits be trickle down to the lower strata of the region?

c. Emerging Conflicts in Energy Sector

Energy, on the other hand, is an important area of economic cooperation. Also it cannot be isolated from security issues. If a gas pipeline is installed along Afghanistan-Pakistan-India, it will have spill over impacts on the security affairs of these countries. If India includes only Afghanistan deducting Pakistan in the gas pipeline project, it might only trigger further uprising of conflicts rather than cohesion in the region. Furthermore, if the gas pipeline takes place

¹¹⁵ Robert Gilpin, *"The Political Economy of International Relations"*, Princeton University Press, Princeton, New Jersey, 1987, Chapter Two, pp.41-51.

¹¹⁶ *Ibid.*

bilaterally¹¹⁷ (e.g. between India and Afghanistan), will it be called regional cooperation? Does this type of bilateral cooperation necessarily enhance regional process? Will it be beneficial for all the members of the region?

d. *Spread of Narcotics Trade and Terrorism*

Another issue pertaining to security is the spread of narcotics and terrorism in the region due to the inclusion of Afghanistan. Cultivation of morphine (about 90 percent) is one of the main earning sources of the Talibans.¹¹⁸ Besides, the recent attacks of NATO on the Talibans especially at Qandahar and Helmand-the two main drug producing provinces, have made the country unstable. At the same time, the re-emergence of Taliban coupled with their terrorist activities including sanctuary, training, and financial support in part of Afghanistan and Pakistan border (i.e. South Waziristan) has escalated further volatility in the region. Under these circumstances, to what extent a new India-Pakistan-Afghanistan cooperation is possible for the regional prosperity?

e. *Insufficient Infrastructural Development*

Regional connectivity is very important to foster economic integration in South Asia. Generally, successful integration takes place in a 'core area' which usually has administrative skills, military power, economic resources, and techniques.¹¹⁹ But, limited success owing to the absence of infrastructure and very limited level of industrialization in turn limit the scope of regional connectivity. In this connection, is it really possible to accelerate trade beyond the region with the new member and observers?

V. The Prospects

The more optimistic prognosis, however, holds that the enlargement of SAARC will widen the areas of cooperation, while

¹¹⁷ As such leaders of India term their South Asia policy as one of "beneficial bilateralism"; See for details, S. D. Muni, "SARC: Building Regionalism from below", *Asian Survey*, Vol. 25, No. 4. April 1985, p.393.

¹¹⁸ Reported in *The Manob Jomin*, (a Bengali Daily), 6 May 2007.

¹¹⁹ Ernst B. Hass, "The Challenge of Regionalism" *International Organization*, Vol. 12, No.4, Autumn 1958, p.443.

the pessimists tend to ignore the possibilities of opening up in the emerging cooperative regional framework due to the conflicts and original problems of the members and observers. Generally, in South Asia, it may be more realistic to analyse that conflict resolution has a positive impact on economic cooperation such as expansion of trade.¹²⁰ However, using the factor analysis as a tool and correlating the behaviour of 82 nation states, no relationship (positive or negative) between trade and conflict variables has been found.¹²¹ Thus, it cannot be said that commercial expansion eventually gives rise to conflicting behaviour between nation-states as asserted by traditionalist school of International Relations. Probably, this is not the ideal time to analyse that this expansion would bring full fruit to the region as a whole ignoring the problems of the member states. The paper might not be able to answer or to solve all the problems but, certain initiatives of the members as well as observers might strengthen further cooperation among the members and observer countries.

a. *Positive Role of India*

Resolution of problems is an urgent need for the entire region. Though India is a major power in South Asia, unfortunately, it is involved in almost all the problems. Thus, it is India who can resolve the problems on bilateral basis building the alchemy of trust for the success of the regional cooperation. Besides, SAARC can make no headway through the policy of non interference to lower down the major conflicts such as the Tamil's assault in Sri Lanka, Maoist movement in Nepal, and Kashmir issue between India and Pakistan like ASEAN members. Similarly, strengthening Track II diplomacy and involving the observers for solving these intractable conflicts can bring the prospects of peace in the region.

¹²⁰ Imtiaz H. Bokhari, "South Asian Regional Cooperation: Progress, Problems, Potential, and Prospects", *Asian Survey*, Vol.25, No.4, April 1985, pp. 389-390

¹²¹ "The Dimensionality of Nations Project" in *Comparing Nations*, Richard L Merritt and Stein Rokkan (eds.), Yale University Press, New Haven, 1966, pp. 109-129.

b. *Greater Cooperation on Security Issues*

Unmistakably, it is terrorism that poses big threat to South Asia's peace and security and thereby creates obstacle to regional integration. Currently, Nepal's blaming of India for harbouring Maoist guerrillas and Taliban insurgency along the Pakistan-Afghanistan border are great threats to greater South Asian integration. Through SAARC, India can play a vital role by initiating a new India-Pakistan-Afghanistan-Nepal conversation to combat trans-border terrorist groups and to work jointly on counter terrorism. In addition, necessary initiatives should be taken by the members for implementing the provisions of SAARC Convention on Terrorism along with its additional protocol and a regional extradition treaty.

c. *Rapid Implementation of SAFTA*

Besides trade liberalisation programme, implementation of SAFTA by giving a specific timeline is necessary to achieve the overall benefits. For getting full payback, Afghanistan should develop its fiscal and tariff structure since Pakistan opposed the inclusion of the former due to this structural problem. On the contrary, regarding transit rights, Pakistan is very sensitive to allow Indian goods imported to Afghanistan under SAFTA. Thus, progress on these issues can only be possible if India takes a measure of trust between India and Pakistan on the one hand, and Pakistan and Afghanistan on the other. Besides, decisions in the 14th SAARC Summit about signing of regional investment treaty and introducing a single currency, like the one introduced by the EU, as proposed by the Sri Lankan President, Mahinda Rajapakse to enhance productivity in the region should be seriously taken into consideration.

d. *Trade Harmonisation and Exchange of Cooperation*

There is no doubt that South Asia has huge potentials for trade expansion because of its geographical, cultural, and historical proximity. Table 2 shows the possibilities of trade harmonisation and exchange of cooperation with SAARC members and observers in certain areas to derive mutual benefits. For instance, Bangladesh can

cooperate with Afghanistan in energy sector while the latter can import manpower from the former to enhance its economy.

Table 2: South Asian Members' Possible Cooperation with the New Member and Observers

Members	Commodities/Areas	Observers	Commodities/Areas
Afghanistan	Raw materials such as fruits, nuts, carpets, wool, cotton, hides, pelts & precious gems, and energy sector such as gas, petroleum, coal, copper, iron ore & precious stones	China	Infrastructure, textile, energy, poverty alleviation, mitigation of disaster relief, & human resource development
Bangladesh	Textile, jute, cotton, shrimp, leather and leather manufactures & manpower	Japan	Technology, foreign aid & investment
Bhutan	Water resource, tourism, wood products, gypsum, & calcium carbide	Iran	Nuts, carpet, ceramics & energy
India	Raw materials, iron ore, steel, chemicals, dyes, agricultural products like wheat, tea & spices	South Korea	ICT, government innovation, footwear, electronics & steel products
Maldives	Coconut & fish	The EU	Infrastructure & textile service facilities
Nepal	Water resource, tourism, woollen carpet, & ready made garments	The USA	Technology, soft ware & clothing
Pakistan	Energy, cotton, yarn, textile, fabrics, leather products, & electronics	-	-
Sri Lanka	Coconut, tea, wooden items, stones and gems, ceramics, rubber, & tourism	-	-

Source: Compiled by the author

It is fair to mention that to overcome the limited export supply capability of most of the SAARC members, the trade-investment linkages through infrastructural development, customs clearance, and other facilitation measures including multi-modal transport operations must be reinforced. Besides, members and observers can

work through joint ventures to produce specific goods at the most reasonable price, considering the region as a single market. In this regard, the bigger countries of South Asia might give their smaller neighbours some concessions and trade facilities.

Conclusion

Undoubtedly, the inclusion of new member and observers is a decisive breakthrough for SAARC. Needless to say, it has now become a wider platform in a complete sense. The SAARC members welcomed the expansion, as they have opted for greater cooperation beyond the region. The new member and observers have shown their keen interest to enhance cooperative initiatives in the region. Their presence can bring positive impact on various sectors such as poverty alleviation, diffusion of political conflicts, people's connectivity, energy security, and other security issues in the region. Also, the presence of the big powers (China, the USA, Japan, and South Korea) in SAARC might have positive effect in terms of improving relations among the member countries. There is optimism that the expansion of SAARC could enhance intra-regional trade among South Asian nations and it would further expand cheaper imports as well as provide a greater market for regional exports. However, at the same time, there is a concern too about how much it would be beneficial for the entire region. As SAARC has huge potentials, the countries should look beyond their bilateral disputes, overcome the limitations in various sectors and work together for making the organisation more dynamic and vibrant. Otherwise, the expansion of SAARC for greater cooperation beyond the region might be a futile initiative.

Sharif M. Hossain
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REGIONAL COOPERATION IN SOUTH ASIA: FUTURE OF SAFTA

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Abstract

The creation of South Asian Free Trade Area (SAFTA) is a widely discussed policy issue in this region. Recently, there has been an increased interest in regional economic integration in the South Asia region. The SAFTA is a parallel initiative to the multilateral trade liberalisation commitments of SAARC member countries. There have been some strong arguments for regional economic integration in South Asia, as this integration is thought to generate significant intra-regional trade and welfare gains for the South Asian countries. However, critics have pointed out that the potential benefits from the SAFTA and other regional trading arrangements in South Asia are modest because of limited complementarities in the region and location of major trading partners of the individual South Asian countries outside the region. Mindless politics over people's concerns, mistrust and hegemonic attitude of the bigger towards the smaller countries would also prohibit deriving full benefits out of an excellent free trade agreement. Given this backdrop, the paper is intended to examine mainly the features, prospects and challenges of SAFTA.

Key Words: SAFTA, FTA, GTAP Model, Regional Cooperation, Trade Liberalisation.

1. Introduction

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In recent years, one important policy concern regarding trade relations among South Asian countries is whether the creation of South Asian Free Trade Area (SAFTA) would ensure gains for its member countries or not. In December 1985, seven countries of South Asia, *i.e.*, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka formed the South Asian Association for Regional Cooperation (SAARC) to promote economic, social and cultural cooperation. In 1993, the South Asian Preferential Trade Agreement (SAPTA) was initiated by SAARC to promote greater regional economic cooperation, which came into effect from December 1995. Subsequently, the member countries of SAARC transformed SAPTA into SAFTA, which is expected to be in place (in a complete form) by 2016. The key motivation behind the creation of SAFTA is to enhance intra-regional trade among SAARC members through the removal of tariff and non-tariff barriers and thereby to enjoy the gains of regional integration and at the same time to become more competitive in the global market.

The literature on South Asian regional grouping has expressed divergent views about the possible impact of SAFTA on its members. While some have expressed optimism about the impact, others remained skeptical. There have been some strong arguments for the regional economic integration in South Asia towards generating significant intraregional trade and welfare gains for the regional countries. However, critics have pointed out that the potential benefits from SAFTA and other regional trading arrangements in South Asia are little because there are limited complementarities in the region. Major trading partners of the individual South Asian countries are located in the West.¹²²

Given this backdrop, the main objective of this paper is to assess the prospects of SAFTA. To reach a conclusion regarding the prospect of SAFTA and its impacts on member countries, a quantitative assessment is needed. In doing this, we used a popular applied general equilibrium (AGE) model called Global Trade Analysis Project (GTAP) model. The paper is organised as follows.

¹²² Selim Raihan and M. A. Razzaque, "Welfare Effects of South Asian Free Trade Area (SAFTA), Regional Trading Arrangements (RTAs) in South Asia: Implications for Bangladesh Economy", Paper Presented in a Conference on *Trade Liberalization and SAFTA: Opportunities, Concerns and Challenges*, Rawalpindi, Pakistan, January 2007, p.2.

Section 1 is the introduction, while Section 2 provides the salient features of SAFTA. Section 3 presents the criteria for a successful Free Trade Area (FTA). Section 4 discusses the future of SAFTA based on GTAP simulation results. Section 5 sketches a brief picture of the political environment and free trade Agreement in South Asia. Challenges of SAFTA are presented in Section 6, while Section 7 provides the conclusion.

2. Salient Features of SAFTA

The origin of SAFTA could be traced back to the Malé Summit of SAARC held in 1997. During the Summit, the SAARC countries initiated the regional approach of FTA in South Asia. They intended to establish SAFTA by 2001. But the political instability in South Asian region delayed SAFTA's enforcement within the stipulated time frame. However, to draw up a comprehensive treaty regime for creating a free trade area in South Asia, a 'committee of experts' was set up at the Colombo Summit in 1998. The framework of the proposed SAFTA was prepared by this committee and the member nations agreed in principle to it. During the Islamabad Summit held in 2004, the Foreign Ministers signed the framework agreement to launch SAFTA in order to attain better economic cooperation among the South Asian nations. Following the SAFTA Agreement, the member countries agreed to reduce tariff according to the following schedule:

Table 1: Schedule of Tariff Reduction under SAFTA

<i>Countries</i>	<i>Existing Tariff Rates</i>	<i>Tariff Rates Under SAFTA Agreement</i>	<i>Time Schedule</i>
SAFTA First Phase			
India, Pakistan and Sri Lanka	More than 20%	Reduce to 20%	2 Years
	Less than 20%	Annual reduction of 10%	2 Years
Bangladesh, Bhutan, Maldives and Nepal	More than 30%	Reduce to 30%	2 Years
	Less than 30%	Annual reduction of 5%	2 Years
SAFTA Second Phase			
Pakistan and India	20% or below	0-5%	5 Years
Sri Lanka	20% or below	0-5%	6 Years
Bangladesh, Bhutan, Maldives and Nepal	30% or below	0-5%	8 Years

Source: Hossain (2005).

It is evident from Table 1 that in the first phase, the developing countries i.e., India, Pakistan and Sri Lanka, will reduce tariff to 20 percent while the least developed countries in the region namely, Bangladesh, Bhutan, Maldives and Nepal, will reduce to 30 percent if the actual tariff rates are higher than this limit. However, there will be a 10 percent annual reduction on a Margin of Preference basis for developing countries and 5 percent for least developed countries (LDCs)¹²³ on actual tariff rates for each of the two years if the actual tariff rates are below this limit. In the second phase, it will take 5 years for the developed countries to reduce tariff to 0-5 percent whereas Sri Lanka will take an additional year to decrease tariff to 0-5 percent. The least developed countries will reduce tariff within 8 years. However, the member states are encouraged to adopt reductions in equal annual instalment, but not less than 15 percent annually.¹²⁴

The Agreement on SAFTA has seven core elements:¹²⁵

- Trade Liberalisation Programme
- Rules of Origin
- Institutional Arrangements
- Revenue Compensation Mechanism
- Technical Assistance for LDCs
- Safeguard Measures
- Consultations and Dispute Settlement Procedures

2.1. Trade Liberalisation Programme

2.1.1. Tariff reduction

As per Article 7 of the Agreement, tariffs on all products except the products under sensitive lists would be reduced to 0-5 percent within time frames agreed for LDCs and non-LDCs. The Agreement stipulates that SAFTA Committee of Experts would review non-

¹²³ India, Pakistan and Sri Lanka are developed countries, and the rest are LDCs in SAARC.

¹²⁴ Sharif M. Hossain, "Bangladesh and the Free Trade Area: Regional and Bilateral Routes", *BIISS Journal*, Vol. 26, No.3, July 2005, pp. 396-397.

¹²⁵ Raihan and Razzaque, *op. cit.*, pp.4 -7.

tariff barriers in its regular meeting with a view to eliminating them or making them non-restrictive.

The Agreement provides different timeframe for tariff reduction by LDCs and non-LDCs. Moreover, non-LDCs are required to reduce their tariffs for the products of LDCs within shorter period. Non-LDCs are required to reduce their tariffs applied on 1 January 2006 to 0-5 percent among themselves within seven years, with one extra year for Sri Lanka (Table 1).

2.1.2. Sensitive lists

SAFTA sets up a sensitive list where products are exempted from the Trade Liberalisation Programme. This list is negotiated by the contracting states and incorporated in the Agreement as an integral part. However, the number of products in the sensitive lists is subject to maximum ceiling, which are mutually agreed among the contracting states, with flexibility to least developed contracting states to seek derogation in respect of the products of their export interest. Furthermore, the Agreement stipulates that the sensitive list shall be reviewed every four years or sooner, as may be decided by SAFTA Ministerial Council, with a view to reducing the number of items in the sensitive list.¹²⁶

Table 2: Sensitive Lists Among the SAFTA Members

Country	Total Number of Sensitive List		Coverage of Sensitive List as % of Total HS Lines	
	For LDCs	For Non-LDCs	For Non-LDCs	For LDCs
Bangladesh	1254	1249	24.0	23.9
Bhutan	157	157	3.0	3.0
India	865	744	16.6	14.2
Maldives	671	671	12.8	12.8
Nepal	1335	1299	25.6	24.9
Pakistan	1191	1191	22.8	22.8
Sri Lanka	1079	1079	20.7	20.7

Source: Raihan and Razzaque (2007).

¹²⁶ Ahmed Sheikh, "SAFTA: An Evaluation of Framework Agreement", Paper Presented at the Commonwealth Business Council SAFTA Roundtable, India, 2004, p. 6.

2.1.3. Non-tariff and para-tariff barriers

The Agreement requires that all quantitative restrictions, if not permitted under GATT 1994, shall be eliminated. With respect to other non-tariff and para-tariff measures, the Agreement requires that the countries notify the measures to SAARC Secretariat on an annual basis. The SAFTA Committee of Experts will then review the non-tariff and para-tariff barriers in its regular meeting with a view to making recommendation for their elimination or making them non-restrictive. The Agreement also requires that “The initial notification shall be made within three months from the date of coming into force of the Agreement and the Committee of Experts shall review the notifications in its first meeting and take appropriate decisions”.¹²⁷ In order to implement commitment to this provisions, a sub-group on non-tariff measures has already been established, which is engaged in addressing the non-tariff barriers.

2.2. Rules of Origin

Rules of origin is one of the most important aspects of any free trade area. The rules of origin agreed under SAFTA are general in nature (*i.e.*, one criterion for all products) barring 1991 products for which product specific rules are applied. Thus, SAFTA rules of origin requires that in order to enjoy the preference under SAFTA, a product must undergo sufficient processing for changing the tariff heading from the non-originating inputs and for having value at least 40 percent value addition measures as percentage of fob (free on board) value. However, value addition requirement is lower for Sri Lanka and LDCs, which is 35 percent and 30 percent respectively. In order to avoid fraudulent practices, detailed operational certification procedures have been adopted.

2.3. Institutional Arrangement

In order to monitor the implementation of SAFTA, two bodies namely SAFTA Ministerial Council and Committee of Experts have been established. SAFTA Ministerial Council comprising of

¹²⁷ SAFTA Agreement, available at: www.saarc-sec.org/data/agenda/economic/safta/SAFTA%20AGREEMENT.pdf, accessed on 10 June 2007.

Commerce/Trade Minister of member countries is the highest decision making body of SAFTA. The Council shall meet once a year or more often. It will be supported by the SAFTA Committee of Experts comprising senior trade officials of member countries, which will meet once in every six months.

2.4. Mechanism for Compensation of Revenue Loss

A mechanism has been established to compensate the revenue loss to be incurred by the LDCs due to reduction of tariffs. The compensation will be in cash and partial: maximum 5 percent of the customs duty collected from SAARC import in 2005. Compensation will be available for 4 years only (for Maldives compensation will be available for six years).

2.5. Technical Assistance for LDCs

There are provisions for technical assistance for LDCs at their request. Areas of technical assistance as agreed upon are as follows:

- Trade related capacity building;
- Development and improvement of tax policy and instruments;
- Customs procedures related measures;
- Legislative and policy related measures, assistance for improvement of national capacity; and
- Studies on trade related physical infrastructure development, improvement of banking sector and development of export financing.

2.6. Safeguard Measures

In order to protect domestic industry from potential damage due to increased preferential import, the Agreement provided scope for partial or full withdrawal of preference granted under SAFTA for a period of maximum 3 years. Safeguard measures cannot be applied against the product of LDCs if share of import from an LDC of the product concerned in total import of importing country is less than 5 percent.

2.7. Consultations and Dispute Settlement Procedures

There is a specific article on dispute settlement mechanism with specific time table. Bilateral consultation shall be held within 30 days upon a request made by any member. If dispute cannot be settled through bilateral consultation, the matter will be referred to the Committee of Experts for its recommendation within 60 days. The Committee of Experts may consult with a panel of experts for peer review. Any decision of the Committee of Experts can be appealed to SAFTA Ministerial Council for its decision within 60 days. The decision of the SAFTA Ministerial Council will be final.

3. Criteria for a Successful FTA

Theoretically, success of an FTA depends on fulfilment of some criteria. If those have been fulfilled, then the probability is higher for an economically viable FTA. In trade related theories and literatures, the economists agreed to set up some common necessary conditions. The common set of conditions is described below.

3.1. Geographical Proximity

Geographical proximity had always been a key issue for trade between the two countries. Around the world, one of the major determinants of bilateral trade is transport cost. Evidently, for reduced transport and communication cost neighbouring countries could get advantage while countries far away get disadvantaged. Regional trading arrangements should be undertaken on the basis that it is natural for neighbours to indulge in trade with each other. Goods from neighbouring countries may also be more compatible with local factors of production than those from farther away. While regional trading arrangements follow this pattern, bilateral trading arrangements may take place between distant partners. Although these FTAs do not benefit from transport cost savings, they benefit on other counts, as they would have traded in any case. In case of SAFTA, all the member countries enjoy lower transport cost compared to other trading partners.

3.2. High Pre-FTA Tariff Rates

High pre-FTA tariff rates increase the probability of trade creation among members, rather than diverted from non-members to

members. South Asian countries have long maintained high tariff rates and other protection measures despite their recent efforts to liberalise trade.¹²⁸ The average tariff rate in South Asia is still higher compared to other regions in the world. It shows that high pre-FTA tariffs as a precondition for forming an FTA does indeed exist in South Asia.

3.3. Intra-regional Trade

High degree of intra-regional trade is an encouraging sign for establishing an FTA. Benefits from regional FTA would be higher among the countries having high degree of intra-regional trade while trade agreement with little prior trade would be unsuccessful. Intra-regional trade may depend more on the existence of product complementarities and comparative advantage and other characteristics such as the degree of concentration and diversification of trade profiles amongst the regional partners. The share of intra-regional trade in South Asia is very low compared to other trading blocs. Tables 3 and 4 show the share of bilateral and regional export and import as percentage of world exports and imports. The bilateral export and import shares of all SAFTA members are below 1 percent except India in most of the cases. India's trade share is relatively higher within SAFTA bloc.

¹²⁸ Jayatilleke S Bandara and Wusheng Yu, "How Desirable is the South Asian Free Trade Area? A Quantitative Assessment", available at: <http://www.foi.life.ku.dk/upload/foi/docs/publikationer/working%20papers/2001/16.pdf>, accessed on 14 July, 2007, p. 9.

Table 3: Share of Bilateral/Regional Export as a Percentage of World Export in 2005

	<i>Bangla desh</i>	<i>Bhutan</i>	<i>India</i>	<i>Maldi ves</i>	<i>Nepal</i>	<i>Pakista n</i>	<i>Sri Lank a</i>	<i>SAARC</i>
Banglade sh		0.00	1.25	0.00	0.00	0.67	0.09	2.00
Bhutan	0.00		75.31	0.00	0.00	0.48	0.00	75.79
India	1.62	0.10		0.07	0.83	0.67	1.97	5.39
Maldives	0.00	0.00	0.72		0.00	0.00	12.24	12.96
Nepal	0.00	0.00	56.34	0.00		0.53	0.02	56.88
Pakistan	1.46	0.00	2.10	0.02	0.02		0.96	11.19
Sri Lanka	0.25	0.00	9.07	0.40	0.00	0.70		10.46
SAARC	1.40	0.07	1.13	0.07	0.63	0.63	1.62	

Source: Based on Trade Map Data, International Trade Centre, available at <http://www.trademap.org/>, accessed on 26 April 2007.

Table 4: Share of Bilateral/Regional Import as a Percentage of World Import in 2005

	<i>Bangla desh</i>	<i>Bhut an</i>	<i>India</i>	<i>Maldiv es</i>	<i>Nep al</i>	<i>Pakist an</i>	<i>Sri Lank a</i>	<i>SAAR C</i>
Banglad esh		0.00	15.24	0.00	0.00	2.14	0.14	17.52
Bhutan	0.00		69.08	0.00	0.00	0.17	0.01	69.26
India	0.09	0.06		0.00	0.25	0.12	0.39	0.95
Maldives	0.00	0.00	11.26		0.00	0.39	5.72	17.36
Nepal	0.00	0.00	64.39	0.00		0.27	0.02	64.68
Pakistan	0.27	0.00	2.30	0.01	0.01		0.24	3.05
Sri Lanka	0.11	0.00	17.33	0.25	0.00	1.39		19.08
SAARC	0.10	0.04	2.45	0.01	0.19	0.80	0.35	

Source: Based on Trade Map Data, International Trade Centre, available at <http://www.trademap.org/>, accessed on 26 April 2007.

3.4. Trade Complementarities

FTAs are likely to succeed in strengthening bilateral trade if the trade structures of member countries exhibit strong complementarities. When the commodities of one country have a considerable demand to another, the potential benefits of trade are higher. If the commodities of FTA member countries are same in nature, member countries would not be able to touch the envisaged levels of trade due to low level of trade complementarities. Trade complementarity between a pair of countries is traditionally measured by the Trade Complementarity Index (TCI). It can provide useful information on prospects for intraregional trade in that it shows how well the structures of a country's imports and exports match. The index is a measure of similarities between the export basket of one country and the import basket of another. TCI is defined as follows:¹²⁹

$$TCI_{ij} = 100 - \sum_k \frac{|M_{jk} - X_{ik}|}{2}$$

where X_{ik} is country i 's total exports of product k , and M_{jk} is country j 's total imports of product k . The index ranges from zero to 100. The index is zero when none of the goods exported by one country is imported by the other and 100 when the export-import shares perfectly correspond. According to a World Bank study, SAFTA would not be able to touch the envisaged levels of trade due to a very low level of TCI of 1.3, as compared to 56.3 for NAFTA, 53.4 for the European Union, and 28.6 for Mercosur (Table 5).

¹²⁹ International Monetary Fund, "Central American Economics and Monetary Community: Selected Issues", *IMF Country Report No. 06/309*, August 2006, p. 9.

Table 5: Trade Complementarity Index of Major Trading Blocs

<i>Trading Blocs</i>	<i>Trade Complementarity Index (TCI)</i>
South Asian Free Trade Area (SAFTA)	1.3
North American Free Trade Area (NAFTA)	56.3
European Union (EU)	53.4
Andean Pact	7.4
Mercosur	28.6
Canada - USA FTA	64.3
Latin American Free Trade Area (LAFTA)	22.3

Source: Pitigala (2005).

3.5. Comparative Advantage

The central characteristics of international trade based on efficiency are governed by the concept of comparative advantage and specialisation.¹³⁰ Countries having different specialisation among different commodity groups would be able to establish a successful FTA. Prospects of trade expansion are likely to be weak for countries that have comparative advantage in similar products. To analyse the specialisation, policymakers frequently used the International Revealed Comparative Advantage (IRCA) index. IRCA index is a ratio of the share of a given product in a country's exports to its share in world exports. IRCA is defined as follows:¹³¹

$$IRCA_{ij} = \frac{X_{ij} / X_{wj}}{\sum X_{ij} / \sum X_{wj}}$$

where $IRCA_{ij}$ is the index of revealed comparative advantage of country i in commodity j ; X_{ij} is country i 's export of commodity j ; X_{wj} is world exports of commodity j ; $\sum X_i$ is total exports of country i ; and $\sum X_w$ is total world exports. A country is said to have a revealed comparative advantage in product if the index exceeds unity. According to IRCA index, the South Asian countries enjoy comparative advantage in a relatively narrow range of products with

¹³⁰ Nihal Pitigala, "What Does Regional Trade in South Asia Reveal about Future Trade Integration? Some Empirical Evidence", *World Bank Policy Research Working Paper 3497*, February 2005, p. 28.

¹³¹ *Ibid.*

the exception of India and Sri Lanka.¹³² Bangladesh, Nepal and Pakistan out of 71 commodity groups have revealed comparative advantage in only 7, 5 and 12 commodity groups while India and Sri Lanka have comparative advantage in 26 and 21 product categories; and none of the countries has comparative advantage in capital intensive and high value-added products.

3.6. Insignificant Political Tensions

Political tensions have also undermined efforts to foster trading arrangements. Political conflicts hamper the negotiation and implementation of any trading arrangement. As long as political tension is insignificant, it does not create much hindrance towards a friendly environment among the member countries to reach the final decision smoothly. But political tensions existing between Pakistan and India, and to some extent between Bangladesh and India are always a problem for creating a congenial environment for cooperation.

It is thus clear that member countries of SAFTA do not meet all the preconditions which are required to create a successful free trade area in this region. But it is not mandatory to satisfy all the criteria in all the cases. Because following the formation of an FTA the demand of products would change and the member countries may be able to diversify their products. The same situation could be expected in case of comparative advantage. With increased demand of goods and large scale of production, countries might not have identical comparative advantages. However, obtaining such trade complementarity is not easy for nations of South Asia, which is still far away from making an economic breakthrough to achieve a sustainable cycle of rapid growth¹³³. Thus, the South Asian countries need to move up in their respective growth trajectories.

¹³² A. R. Kemal, "SAFTA and Economic Cooperation", Paper Presented at SAFMA Regional Conference, 20-21 August 2004, Dhaka, available at: http://www.southasianmedia.net/conference/Regional_Cooperation/safta.htm, accessed on 12 July 2005.

¹³³ Moudud Ahmed, *South Asia, Crisis of Development: The Case of Bangladesh*, The University Press Limited, Dhaka, 2002, p. 229.

4. Future of SAFTA: A GTAP Analysis

The present study has used the data and the modelling framework given under GTAP which captures various aspects of world economic activity. Currently, the GTAP model has become a useful tool for analysing the effects of Preferential Trading Arrangements (PTAs).¹³⁴ Since the main objective of this paper is to assess the impact of SAFTA on its member countries, a multi-regional AGE model is an appropriate analytical tool.

The GTAP database covers all the bilateral trade, transport and protection data that link 87 country/regional economic databases. The latest version (Version 6) of the GTAP database represents the world economy in 2001.¹³⁵ This version has 87 regions, 57 commodities and 5 factors of production. Each member of SAFTA has been separated as much as possible such as – Bangladesh, India, Pakistan and Sri Lanka.¹³⁶ In case of commodity aggregation, 57 commodities are aggregated as 8 commodities. There are 5 factors of production – land, unskilled labour, skilled labour, capital and natural resources. There is also a change in the closure in the present study. In the default setting of the GTAP modelling framework, labour is assumed to be employed fully. However, in reality, large scale unemployment of unskilled labour is a major feature in the SAARC region. Therefore, this study has assumed that supply of unskilled labour for the SAARC member countries is perfectly elastic. Thus, in this case the wage is fixed for the unskilled labour of the SAARC region. With the aim of estimating the various effects of SAFTA, all tariff and non-tariff barriers have been eliminated among

¹³⁴ For details about the GTAP modelling framework and the sources and characteristics of the data, see Thomas W. Hertel, *Global Trade Analysis: Modeling and Applications*, Cambridge University Press, USA, 1997.

¹³⁵ The regional data bases have been derived from individual country domestic data bases or input-output tables. The individual country input-output tables then have been reconstructed in a form of sectoral disaggregation.

¹³⁶ The version 6 of GTAP database did not separate Pakistan, Nepal and Maldives. They are considered jointly as rest of South Asia. In the rest of South Asia group, Pakistan is dominating and in this study rest of South Asia is considered as Pakistan.

the member countries in the GTAP simulation. But they keep their tariff with the rest of the world unaffected.

4.1. GTAP Simulation Results

In this section, the results of the SAFTA simulations are presented and analysed. The welfare results of different countries are shown as Equivalent Variation (EV) and presented in Table 6. To get an immediate picture of the outcome of any policy option, it is plausible to look at the welfare impact of such policy. In GTAP, welfare effects are determined mainly by three factors, *i.e.*, changes in allocative efficiency, changes in country's terms of trade (ToT) and changes in endowment. allocative efficiency refers to the efficient sector-wise allocation of scarce resources to produce the optimal combination of output. In the open economy context, it also refers to efficiency in resource use in purchasing imported products. ToT effect refers to relative movement in prices of countries exports and imports. It increases with relative increase in the price of exports as compared to imports. Endowment effect is a measure of how much the countries gain due to increase in employment of factors of production such as land, labour or capital. The table shows that all the member countries experience a sufficient welfare gain from SAFTA.

Table 6: Decomposition of Equivalent Variation (\$ US million)

	<i>Allocative Efficiency</i>	<i>Endowment Effect</i>	<i>ToT Effect</i>	<i>I-S Effect</i>	<i>Total</i>
Bangladesh	-18.1	217.7	-135.2	-17.7	46.6
India	134.2	521.7	250.7	-3.6	902.9
Pakistan	110.5	183	374.3	11.7	679.5
Sri Lanka	38.3	128.3	52.3	0.8	219.6

Source: GTAP simulation result.

From the welfare impacts, we observe that India is the biggest gainer from SAFTA and experiences a welfare gain of US\$ 902.9 million.¹³⁷ Pakistan and Sri Lanka also experience a sufficient welfare gain of US\$ 679.5 million and US\$ 219 million respectively.

¹³⁷ In GTAP, welfare is measured by equivalent variations (EV) using base year price and consumption for each type of household.

In case of Bangladesh, SAFTA generates only a small welfare gain. However, this is not an efficient solution as it leads to losses in allocative efficiency and terms of trade loss despite some marginal gain in the endowment effect due to a slight expansion in the export industries.

Table 7: Commodity Decomposition of Allocative Efficiency (\$US million)

	<i>Bangladesh</i>	<i>India</i>	<i>Pakistan</i>	<i>Sri Lanka</i>
Rice	0.1	1.3	1.8	5.8
Other Agri.	7.1	-6.2	34.5	7.6
Textile	-48	-4.3	-44.6	0.9
Garments	7.4	-11.4	-16.3	-0.6
Leather	0.4	-1.2	-0.1	-0.5
Chemical	-4.8	-15.8	52.9	4
Other Mfg.	-33.5	145.4	65.5	13.3
Services	-0.5	9	4.8	4

Source: GTAP simulation result.

Table 7 represents the commodity decomposition of allocative efficiency. The gain from the resource reallocation in agricultural sector is positive for all the countries except India. It loses slightly in some agricultural products. India's gain from manufacturing sector is the biggest, which is near US\$ 145 million. Pakistan experiences positive gain in chemical and other manufacturing sectors and loses in textile and garments sectors. In Bangladesh, among the manufacturing sectors only garments sector has efficiently reallocated the scarce resources. Sri Lanka experiences positive gain in most of the products with the highest gain in the manufacturing sector.

Table 8: Effects on GDP, Trade and Employment

	<i>Value of GDP (%)</i>	<i>Balance of Trade (US\$ million)</i>	<i>Volume of Export (%)</i>	<i>Volume of Import (%)</i>	<i>Employment (%)</i>
Bangladesh	-0.64	-161.8	11.81	9.28	1.54
India	0.63	-394.57	2.57	3.65	0.35
Pakistan	3.5	-415.62	5.95	11.03	0.66
Sri Lanka	1.87	-132.92	1.95	4.67	2.27

Source: GTAP simulation result.

Table 8 shows the effects on GDP, trade and employment. After arranging SAFTA, all the member countries experience sufficient increase in volume of export and import. But net increase of import is higher than net increase of export which results in a deterioration of balance of trade. With the higher demand of exportable commodities, industry output and economic activities are increased and generates additional employment as shown in Table 8.

It is important to note that the benefits of SAFTA cannot be fully captured by a perfectly competitive static model. The GTAP model assumes constant returns to scale and perfect competition in all sectors. The GTAP model also cannot capture dynamic effects of trade liberalisation. Any trade liberalisation under such models will always be welfare increasing. In that sense the result depicting welfare increase is not surprising. What is important, however, is the source of the gain. As South Asia is in general a labour-surplus region with high unemployment, the conventional model has been modified to reflect this ground reality. Much of the welfare gain occurs due to increased employment of labour. While the changes in output are not substantial, the total unemployment pool is so large that even a small increase in labour employment may have resulted in large aggregate welfare gains.

5. Political Environment and Free Trade Agreement in South Asia

It is the historical relationship among the South Asian nations and the complexities evolved during the process of their independence which still dictate inter-state relations in this region. Regional cooperation is heavily influenced by such political relationship. The most important reason for least effective regional integration in South Asia has been the intense hostility between Pakistan and India over Kashmir since 1947 when the two countries gained independence from colonial rule.¹³⁸ The Kashmir issue usually rules any Indo-Pak talk. Therefore, the Indo-Pak relationship has become one of the most crucial issues for regional cooperation in South Asia. Rivalry between these two South Asian giants has even

¹³⁸ Shahid Javed Burki, "Potential of the South Asian Free Trade Area", in *South Asian Free Trade Area: Opportunities and Challenges*, Nathan Associates Inc, USA, October 2005, p.11.

hindered the progress of SAARC. As a result, this regional organisation, since its inception, has remained mostly ineffective and has achieved very little in tangible terms. Also, some other political tensions among its member states have led to the underachievement of SAARC. There are a number of severe problems that the organisation faces. Other than the issue of Kashmir, the conflicting issues, which have plagued the region for years are water distribution in the east, and internal power sharing in the north (Nepal) and south (Sri Lanka).¹³⁹ For Bangladesh, the lifeline for the country is water that flows through India. However, the latter's unilateral diversion of water in the upstream during the dry season has created great problem in the former. And this adversely affects the cooperation between the two countries. In addition, the northern and southern parts of both Nepal and Sri Lanka have been bogged down for years by their infighting over internal power sharing, which is having a serious impact on their attitude to and cooperation with others. All these political tensions and conflicts in South Asia have posed a question of uncertainty and challenge the implementation of SAFTA.

India, with its largest and fastest growing economy, has the upper hand for resolving the major issues that have afflicted the region. Hence, the country has a great responsibility to steer SAARC nations in the direction of economic integration. By doing so, India will expedite its own growth and ensure its stability as well. Experts suggest that India can assist most of the other South Asian states in their developmental efforts by virtue of its diversified industrial base and relatively skilled manpower. For instance, Nepal and Bangladesh could benefit in textiles and plastic products, while Bangladesh and Pakistan could substantially improve iron and steel production with cooperation from India.¹⁴⁰ India as a leading power in the region has an enormous obligation to lead by setting a good example for other member states. Another important missing ingredient is a shared perception of common benefits. All the members must feel they are sharing the costs and benefits of the cooperation equitably. The recent developments in relations between Pakistan and India have

¹³⁹ Mahfuz R. Chowdhury, "Free Trade", *The Daily Star*, 7 August 2007.

¹⁴⁰ CUTS-CITEE, "Economic Cooperation in South Asia: Current States and Prospects", *Briefing Paper No. 2/2005*, CUTS Centre for International Trade, Economics and Environment, India, 2005, p.4.

enkindled hopes for acceleration of such regional cooperation. Trade between two nations accrues gains to both while the loss of existing trade ties, resulting from political conflict between them, implies a loss of economic benefits for both. Two countries trading with each other, therefore, should make an effort to avoid conflicts in order not to suffer such a loss.¹⁴¹

6. Challenges to Successful Implementation

Political instability, high transportation cost, low level of intra-regional trade among members, similar pattern of comparative advantage, and absence of trade complementarities pose threat to inception of any FTA. Apart from these, there are some other factors that challenge successful implementation of SAFTA. On the economic front, the main inhibiting factor has been the competitive rather than complementary nature of products.¹⁴² There are several areas where South Asian countries compete for the same market, thereby making it harder to cooperate among themselves. Due to competing nature of the product, there is mutual distrust among the member states that one country might outmanoeuvre the other.¹⁴³ Another impediment is the tendency of SAFTA member countries to enter into free trade agreements with other member countries or to become associated with other parallel economic bloc like Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). In such a case, SAFTA might become marginal to trade interests of its members.¹⁴⁴ Though there is nothing

¹⁴¹ Saroj Bishoyi, "India-Pakistan Relations and SAFTA", Article No. 2102, August 2007, available at: http://ipcs.org/India_Pak_articles2.jsp?action=showView&kValue=2117&country=1016&status=article&mod=a&portal=pakistan, accessed on 25 August 2007.

¹⁴² For details, see A. R. Kemal, *op. cit.*

¹⁴³ Asadul Islam, "South Asian Free Trade Agreement: Perspectives of the Private Sector and Government of Bangladesh", *mimeograph*, Bangladesh Institute of Development Studies, (undated), p.17.

¹⁴⁴ Saman Kelegama, "Impediments to Regional Economic Cooperation in South Asia", FES Publication No 49, Institute of Policy Studies of Sri Lanka and Coalition for Action on South Asian Cooperation, available at: www.fessrilanka.org/pdf/pub/Impediments/i-1.pdf, accessed on 26 August, 2007.

wrong with the bilateral agreements, in the current situation it is desirable that every member country invest their time in making SAFTA successful. Lack of physical infrastructure like linkages through road, railway and waterway increases the transportation cost in this region and thus becomes another challenge to SAFTA. In a highly competitive world economy, transport cost is a significant determinant of competitiveness, which makes an integrated and efficient surface transport network an essential element of the enabling environment for economic integration at any level.¹⁴⁵ It would be essential to have adequate facilitation measures to ensure that goods and vehicles can move freely across borders and through countries. SAFTA will facilitate optimum trade flow among member countries when a forward looking approach is undertaken towards integrating the transit network in the whole region. It should also be noted that to derive gain from SAFTA, some other meaningful issues like removal of non- tariff barriers, solving the problem of illegal border trade and expanding tariff liberalisation span have to be considered. Unfortunately, while everybody agrees to removal of tariff, actual trade has often crossed much tougher non-tariff barriers which under no stretch of imagination can be touted as free trade. As long as such a situation of unfettered movement of goods and services occurs, the gain from SAFTA will not be realised.

7. Conclusion

SAFTA was launched in the poverty-ridden South Asia with the aim to liberalise trade, gain economic welfare and to pursue a higher economic growth for the people. But, the region still remains the least integrated zone in the world.¹⁴⁶ However, South Asia could be

¹⁴⁵ M. Rahmatullah, “Improving Transport Connectivity and Facilitation Measures”, Paper Presented at the Fourth International Forum on Regional Economic Cooperation among Bangladesh, China, India, Myanmar, March 2003.

¹⁴⁶ Asif Maqbool, Muhammad Waqas Alam Chattha and Masood Azeem, “Challenges and Opportunities for Pakistan under SAFTA””, Paper Presented in a Conference on Trade Liberalization and SAFTA: Opportunities, Concerns and Challenges, Rawalpindi, Pakistan, January 2007, available at: <https://www.gtap.agecon.purdue.edu/resources/download/2977.pdf>, accessed on 15 July 2007.

benefited if it implements SAFTA successfully as quantitative analysis clearly depicts a net welfare gain even for least developed countries of the region. Thus, countries like Bangladesh and Nepal can remain hopeful to accrue dividends of SAFTA. On the other hand, from realistic point of view, a number of multifaceted challenges have encircled this regional economic bloc. Low volume of intra regional trade coupled with poor infrastructure and a few other problems which are mentioned earlier have already posed a question mark to the future of SAFTA. On the political front, eternal rivalry between Pakistan and India over Kashmir has become a stumbling block to the success of SAFTA. Moreover, some other South Asian countries' disputed relations with India may not provide SAFTA the conducive environment. Nevertheless, by setting aside the disputed affairs the countries should explore the possible opportunities which arise from operating under integrated economic bloc. Interestingly, it is India which improved its trade and economic links with China despite having a soured relationship with the latter. Also, past animosity has not hampered the Japan-South Korea or China-Japan economic ties. Therefore, countries from South Asia should maintain meaningful trade links among themselves, while continue to discuss on the sticky political matters. Such policy might brighten prospects for SAFTA to contribute positively to the wellbeing of the South Asian population.

*M. Jashim Uddin**

**THE ROLE OF A STATE AS A THIRD PARTY IN
MANAGING CONFLICTS: A CONCEPTUAL ANALYSIS**

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Abstract

Conflict is an inseparable part of all human social relations. Today, the world is literally covered with ethnic, religious and ideological conflicts. Although resolving a conflict is desirable and should be the aim of any negotiation, due to mutual distrust very often disputants fail to bring any peaceful and permanent solution of the conflict. Hence, scholars emphasize conflict management, a process that reduces the level of intensity of a conflict, and uses channels of communication for gradual solution of the problem. This article examines the criteria, motives and strategies of a mediator in managing a conflict. It brings in a debate on the importance of impartiality and leverage as the most important criteria when choosing a mediator. Finally, this study argues that a state in particular a major power, which is impartial in a conflict and has leverage on the disputants, can be an acceptable and affective mediator. As a diplomatic strategy, the major power can simultaneously employ its Track I and Track II diplomacy for conflict management.

Keywords: Mediation, Conflict and Conflict Management, State, Diplomacy, Third party, Track I, Track II.

Introduction

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Conflict is a natural and inseparable part of human social relations. Conflicts occur at all levels of society ranging from interpersonal to international level. Conflict may be defined as escalated, natural competition between two or more parties about scarce resources, power and prestige.¹⁴⁷ Conflict can also be described as a struggle or clash between two opposing forces about values, ideologies, interests, desires and perceptions. A conflict could take place when one wants to gain its interests at the cost of other's interests. In other words, when a group or a state cannot go beyond their narrow interests, then a conflict becomes inevitable.

After the end of the Cold War, there was a widespread expectation that the world would be a safer and peaceful place. Nevertheless, the record of the last one and half decades is mixed. Although the number of states involved in serious conflicts has dropped by almost half in the post-Cold War period,¹⁴⁸ the wars (both intra-state and inter-state) that have been going on for many years in places like Kashmir, Sri Lanka, Sudan, Afghanistan and Iraq have been responsible for several millions killed, most of them civilian.¹⁴⁹ The bipolar system of the Cold War period was changed to unipolar, multipolar or uni-multipolar, which altered the power distribution in the international politics. However, the new international system is as conflict-prone as any previous system.¹⁵⁰ Therefore, conflicts are going to remain with us, and as long as conflicts are with us the possibility of serious damage exists, as does the need to resolve such conflicts.

Although resolving a conflict is desirable and should be the aim of any negotiation, very often it is difficult to have a concrete resolution that can satisfy both parties in conflict. Therefore, scholars emphasize the study of conflict management. Conflict

¹⁴⁷ James Laue, "The Emergence and Institutionalization of Third Party Roles in Conflict," in Dennis J. D. Sandole and Ingrid Sandole-Staroste, (eds.), *Conflict Management and Problem Solving: Interpersonal to International Application*, Frances Publishers, London, 1987, pp. 17-29.

¹⁴⁸ John Davies and Edy Kaufman, "Second Track/ Citizen's Diplomacy: An Overview," in John Davies and Edy Kaufman, (eds.), *Second Track/Citizen Diplomacy: Concepts and Techniques for Conflict Transformation*, Rowman and Littlefield, New York, 2003, p. 1.

¹⁴⁹ *Ibid.*

¹⁵⁰ Jacob Bercovitch, "Introduction: Thinking about Mediation," in Jacob Bercovitch (ed.), *Resolving International Conflicts: The Theory and Practice of Mediation*, Lynne Rienner Publishers, Inc, London, 1996, p. 1.

management is a process that reduces the level of intensity of a conflict and save human lives and prevent damage of resources, and uses channels of communication for gradual solution of the problem. The primary mission of conflict management is to terminate the immediate crisis before it escalates or spreads.¹⁵¹

There are different methods for conflict management and resolution: cultural conciliation, economic cooperation, political commitment, conflict avoidance, negotiation, and third party intervention.¹⁵² Third party intervention has various forms: good office, facilitation, arbitration, military intervention and mediation. However, mediation has been one of the most significant devices for conflict management throughout the human history.¹⁵³ Although mediation is a complex process and the number of the successful mediation of conflicts is low, it has been applied more than other conflict management methods. Hence the study attempts to search the answers to the following questions: Why third party mediation is important for conflict management? What are the criteria to be an effective mediator? What are the motives and strategies of a mediator in managing a conflict? And who is the ideal mediator?

This article consists of four sections. *The first section* attempts to provide significance and definition of third party mediation. *The second section* focuses on the criteria of a third party mediator. *The third section* focuses on various actors involved in mediation and their motives in managing conflicts. *The final section* argues that state, especially a major power which has leverage on the disputants, and has been impartial in the conflict could be an effective mediator in managing conflict. As a mediation strategy,

¹⁵¹ During the high tense period in May-June 2003, when India and Pakistan were very close to a nuclear war, the international community gave diplomatic pressure to both India and Pakistan to withdraw the troops on the Line of Control in Kashmir. The decision to withdraw troops constituted a change to India and Pakistan's behaviour. This can be cited as an instance of conflict management. See, Harun ur Rashid, *An Introduction to Peace and Conflict Studies*, The University Press Limited, Dhaka, 2005, p. 65.

¹⁵² Jacob Bercovitch and Allison Houston, "The Study of International Mediation: Theoretical Issues and Empirical Evidence," in Jacob Bercovitch, *op. cit.*, p. 11. ; See also, Harun ur Rashid, *ibid.*, pp. 66-68.

¹⁵³ Jacob Bercovitch, "The Structure and Diversity of Mediation in International Relations," in Jacob Bercovitch and Jeffrey Z. Rubin, (eds.), *Mediation in International Relations: Multiple Approaches to Conflict Management*, Macmillan Press Limited, London, 1992, pp. 1-2.

the major power can simultaneously employ its Track I and Track II diplomacy for conflict management.

1. Third Party Mediation in Managing Conflicts

1.1 Why Third Party Mediation is Important?

Mediation has been practiced for as long as two people have fought while a third party tried to bring their fight to an end. Jeffrey Rubin noted that “Mediation in international relations has not only been practiced frequently, but has emerged as an important instrument of international diplomacy.”¹⁵⁴ Zartman and Touval argued that international conflicts are frequently the subject of third party mediation. It has been a frequent occurrence for at least last 200 years.¹⁵⁵ Bercovitch noted that in the present international system, where conflicts are multiplied and manifold, and where there is no central authority with the power to regulate international behavior, mediation can be seen as an ideal way of dealing with differences and setting conflicts between hostile states.¹⁵⁶

If one compares mediation with the other forms of third party intervention, one can find that a third party, acting as a ‘facilitator’ or providing ‘good offices’, has a more limited role than a mediator, usually involving no more than helping to bring the parties in conflict into direct negotiations. Like a mediator, a facilitator or good officer cannot analyse the conflict and propose agenda and directions for negotiation. Arbitration, another form of third party intervention, is a quasi-judicial mode of settlement among states in which the parties agree to one or more arbitrators to make a decision on a conflict. Usually disputants are reluctant to accept this method for conflict management. On the other hand, military intervention is the aggressive method of resolving a conflict. The second Gulf War on Iraq in 2003 is a case in point. However, the application of military forces does not necessarily root out the seeds of the conflict. Therefore, compared to the

¹⁵⁴ Jeffrey Z. Rubin, “Conclusion: International Mediation in Context”, *ibid*, p. 249.

¹⁵⁵ William Zartman and Saadia Touval, “International Mediation in the Post-Cold War Era,” in Chester A. Crocker & Fen Osler Hampson with Pamela Aall, (eds.), *Managing Global Chaos: Sources of and Responses to International Conflict*, United States Institute of Peace, Washington D. C, 1997, p. 445.

¹⁵⁶ Bercovitch, *op. cit.*, p. 2.

other mechanisms, mediation, a non-coercive mechanism, has more scope for and can be effective in managing a conflict.

In addition, if one examines the prevalence of mediation *vis-à-vis* other conflict management activities, one gets a fairly clear picture of how widespread is the choice to mediation as a form of international conflict management. Bercovitch and Houston identified total 241 disputes from 1945 to 1990, and 137 of that were actually mediated. Some disputes were mediated once, others experienced multiple mediations.¹⁵⁷ The statistic reveals the distribution of mediation outcomes from 1945 to 1990. It shows that 55 percent of mediation were unsuccessful, compared to 45 percent of successful cases. Full settlement outcomes were low.¹⁵⁸ Nonetheless, the following figure clearly reveals that during the same period third party mediation was applied more than other conflict management methods.

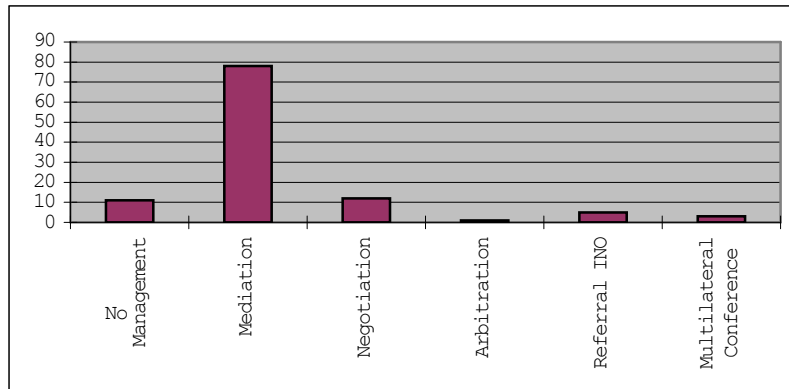


Figure 1: Conflict Management Types used in Different Conflicts from

1945 to 1990¹⁵⁹

From personal relations to international relations, whenever conflicts occur, very often adversaries cannot solve a dispute. Therefore, they request a third party to mediate the conflict, or sometimes a third party willingly wants to mediate the dispute.

¹⁵⁷ Bercovitch and Houston, *op. cit.*, pp. 16-17.

¹⁵⁸ *Ibid.*, p. 19.

¹⁵⁹ *Ibid.*, p. 18.

The third party may want to mediate the conflict just for humanitarian cause or be motivated by its own interests. However, whatever the motives behind the mediation, if the mechanism helps the parties to resolve, then the mediation should be welcomed. Bercovitch and Houston noted that as a form of conflict management, mediation is important when *First*, a conflict has gone on for some time and is ripe for mediation and solution. *Second*, the efforts of the adversaries have reached a mutual hurting stalemate. *Third*, the cost of the war (in terms of death toll, damage of resources) is high, and neither actor is prepared to countenance further costs or escalation of the dispute. *Fourth*, both parties welcome some form of mediation and are ready to engage in direct or indirect dialogue.¹⁶⁰ To add to their views the author argues that when a conflict directly or indirectly affects the international stability or the interests of a third country, then mediation also occurs.

1.2 Definition of Third Party Mediation

Mediation is a kind of negotiation designed to promote the settlement of a conflict. In this negotiation a distinctive role is played by a third party, which is not directly involved in the dispute. There are various definitions of third party mediation in the existing literatures. Bercovitch defines mediation as, “A process of conflict management, related to but distinct from the parties’ own efforts, where the disputing parties or their representatives seek the assistance, or accept an offer of help, from an individual, group, state or organization to change, affect or influence their perceptions or behavior, without resorting to physical force or invoking the authority of the law.”¹⁶¹ Berridge argues, “Mediation is the active search for a negotiated settlement to an international or intrastate conflict by an impartial third party.”¹⁶² Young defines mediation as “Any action taken by an actor that is not a direct party to the crisis, that is designed to reduce or remove one or more of the problems of the bargaining relationship, and therefore, to facilitate the termination of the

¹⁶⁰ Bercovitch, p. 12.

¹⁶¹ Bercovitch in Bercovitch and Jeffrey Z. Rubin, *op. cit.*, p. 7.

¹⁶² G. R. Berridge, *Diplomacy: Theory and Practice*, (Second Edition), Palgrave, New York, 2002, p. 188.

crisis.”¹⁶³ Ronald Fisher defines mediation as the intervention of a skilled and impartial third party working to facilitate a mutually acceptable settlement for both disputants.¹⁶⁴ Zartman and Touval noted that mediation is a form of third-party intervention in a conflict and it is not based on the direct use of force and is not aimed at helping one of the participants to win. Its purpose is to bring the conflict to a settlement that is acceptable to both parties.¹⁶⁵

Third party mediation is a process that helps the disputants to terminate their conflicts. The aim of the mediation is to bring about a win win situation for the parties in conflict. It is noted that most of the definitions focus on the activities and the quality of a third party mediator. A great number of definitions stress the importance of one particular attribute; namely, impartiality. Finally, the author defines that *Third Party mediation is a dynamic search of negotiation in which an impartial third party motivated by its self interest and/or to establish justice can exercise its leverage on the disputants to settle a conflict for a mutually acceptable solution.* Moreover, the third party provides a guarantee of the agreement to both parties during the settlement.

2. The Criteria of a Third Party in Managing Conflicts

Successful management of a conflict largely depends on the quality of a mediator. The identity and characteristics of a mediator have been cited by some scholars as predictors of success.¹⁶⁶ There are several criteria to become a third party mediator in managing a conflict: a state or organisation, which 1) is not involved in the conflict and free from dependence on either political entity that has a stake in the outcome of the conflict at hand; 2) has been impartial in the conflict; 3) has leverage on parties in conflict; 4) has skilled individual and experts on mediation and negotiation; and finally, 5) has self-interest in resolving the conflict. The self-interest drives the country or organisation to see a resolution of the conflict. The author

¹⁶³ Oran Young, *The Intermediaries: Third Parties in International Crisis*, Princeton University Press, New Jersey, 1967, p. 34.

¹⁶⁴ Ronald J. Fisher, *Methods of Third Party Intervention*, Berghof Research Center for Constructive Conflict Management, Berlin, 2001, p. 4.

¹⁶⁵ Zartman and Touval, *op. cit.*

¹⁶⁶ Bercovitch and Houston, *op. cit.*, p. 25.

analyses the two most important criteria of a mediator in more detail below.

2.1 Impartiality

A number of scholars underline impartiality as one of the most important criteria for becoming a third party mediator. Berridge argues that the third party must be substantially *impartial* in the dispute, at least once the negotiation has started.¹⁶⁷ This study also argues that when the adversaries fail to resolve a conflict and seek a third party, usually they search a third party, which has been impartial in the conflict. Young noted that in most cases a meaningful role for a third party mediator will depend on the party's impartial participation in the conflict. He claims that "a high score in such areas as impartiality would seem to be at the heart of successful interventions in many situations."¹⁶⁸ If the third party is perceived as partial to one side or other, it loses its status as a true third party mediator. In order to play an impartial mediatory role, the third party must be independent from any disputants.

2.2 Leverage

Having "leverage" on the antagonists is another important requirement for a third party mediator. Some even argue that it is the most important criteria for effective mediation. Touval and Zartman observed that the mediation process succeeds not when a mediator is unbiased or impartial, but when he or she possesses resources and leverage that either disputant values.¹⁶⁹ Touval observed that mediators require leverage in order to be successful in managing a conflict. Leverage comes, *first*, from the parties' need for a solution that the mediator can provide; *second*, from the parties' vulnerability to the shifting weight that the mediator can apply; and *third*, from the parties' interests in side payments that the mediator can either offer (carrots) or withhold (sticks).¹⁷⁰ Leverage is the source of power, influence, and capability of a

¹⁶⁷ G.R. Berridge, *op. cit.*, p. 188.

¹⁶⁸ Young, *op. cit.*, p. 81.

¹⁶⁹ Touval and Zartman, *op. cit.* p. 81.

¹⁷⁰ Touval, "The Superpowers as Mediators," in Bercovitch and Jeffery Z. Rubin, (eds.), *op. cit.*, p. 233.

state (third party), which can be political, economic, or military, or a combination of them, to persuade the adversaries for accepting third party mediation or a peaceful solution in a dispute. Leverage of a third party, carrots and sticks, is used either to make the present situation more unpleasant for the conflicting parties or to make the future situation of mediated peace more pleasant.

2.3 A Debate on the Importance of Impartiality and Leverage

There is a debate on the importance of impartiality and leverage when choosing a mediator. Some scholars, for instance, Touval and Zartman suggest that impartiality is not necessary for successful mediation.¹⁷¹ They argue, “If the acceptance of mediation is based on a cost-benefit calculation, then assumption that mediators must be perceived as impartial needs to be revised.”¹⁷² They also argue, “Good relationship with one of the parties may be an aid to communicating, to developing creative proposals, and to converging the two parties’ position.”¹⁷³ Touval and Zartman considered the capability of a third party to bring about acceptable outcomes rather than mediator’s impartiality should be the determinant for choosing a third party. Related to this, they provided several examples such as American mediation between Arab-Israeli conflict and Soviet mediation between India and Pakistan in Tashkent.¹⁷⁴ In these cases mediators were not impartial.

However, this study argues that a third party that has the ability but lacks impartiality is probably not the first or best choice. Related to this, Welton and Pruitt noted that if both parties come to believe that the mediator is hostile or biased against them, then the disfavoured party will be less likely to pay attention to the

¹⁷¹ Saadia Touval and William Zartman, “Introduction: Mediation in Theory,” in Saadia Touval and William Zartman, (eds.), *International Mediation in Theory and Practice*, School of Advanced International Studies, Boulder, 1985, p. 15.

¹⁷² Zartman and Touval, “International Mediation in the Post-Cold War Era,” in Chester A. Crocker & others, *op. cit.*, p. 450.

¹⁷³ *Ibid.*

¹⁷⁴ For more details, see, Zartman and Touval, *ibid.*, p. 451.

mediator's suggestions for a settlement, and less likely to accept the mediator as a mediator in the first place.¹⁷⁵

A further look at the above two cases, U.S. mediation in Arab-Israel, and Soviet mediation in India-Pakistan conflict, indicates that only the weak parties (Arab and Pakistan) accepted both the U.S. and Soviet Union respectively as third party mediators as they had no better choice. Touval and Zartman noted that in case of several mediations between Arabs and Israel, the Arabs' belief that the close American-Israel ties would enable the U.S. to deliver Israeli concessions, made American mediation attractive to them. On the other hand, in the case of India-Pakistan conflict, Pakistan perceived that the Soviet Union wanted to improve relations with it, and as a friend of India, the Soviet Union could help bring about an agreement.

Touval and Zartman were correct in their arguments. Nonetheless, from a different perspective, in the case of Israel-Palestine conflict, if the UN or any other impartial and capable third party were available to mediate the conflict, Palestine (the weak party) probably would have chosen them rather than the U.S. Although the Arab has accepted the West, particularly US mediation, they have always been in fear whether they will be given the justice or not. In the case of the India and Pakistan conflict, Pakistan (weak party) accepted the Soviet Union, because only the Soviet Union was willing to mediate at that time. Pakistan, which had been looking for international mediation in the Kashmir problem, took it as a positive step for face saving and for improving relations with the Soviet Union.

Cosmetic and superficial measures to manage or resolve a conflict cannot bring a permanent and peaceful solution as it is evident especially in case of Palestine. There is a need to seek resolution of the Kashmir and Palestine conflicts by taking the will of the suppressed people. Since these conflicts have resulted in large scale violence and the excessive use of force by the Israeli and Indian security forces, the outcome is the emergence

¹⁷⁵ G. L. Welton and D.G. Pruitt, "The Effects of Mediator Bias and Disputant Power Over the Mediator on the Mediation Process," *Personality and Social Psychology Bulletin* 13, 1987, pp. 123-133; Also see Peter J. Carnevale and Sharon Arad, "Bias and Impartiality in International Mediation," in Bercovitch *op. cit.*, p. 41.

of extremist religious groups which often resort to terrorist activities.¹⁷⁶

Therefore, based on the above arguments it is not too much to say that for making a real peace, impartiality is and should be the first criteria that a mediator should meet. Sometimes, it is said that the more ties the mediator has with a party, the greater the possibility of pressing that party by suspending ties. However, from another perspective, suspended ties also mean reduced influence on the party. Moreover, a big stick can make the parties in conflict decide that it can do just well without carrots in its diet.

3. Different Actors in Mediation and Motivating Factors

Due to distrust, antagonism and lack of political will, when two rivals fail to manage or resolve their dispute, a third party very often tries to mediate between them for a peaceful resolution. The third party provides the context in which disputants are able to come together for peaceful solution of a conflict.¹⁷⁷ However, now the questions are: Who are the mediators? What motivates them to mediate a conflict? And why do parties in conflict accept their mediation? This section attempts to answer these questions.

Mediation is carried out by different actors. State (big or small), the UN, regional organisations, non state actors, and individuals like the former U.S. President Carter have played mediation role in various conflicts in various parts of the world. Here, actors involved in mediation are sorted out into three categories. *First*, Individual mediator; *Second*, Institutions (International, regional and non-governmental); *Third*, State (major power, small power, and multiparty major powers). Although apparently it is seen that the aim of mediation is to manage a dispute, many hidden and declared factors are associated with the process of mediation. It is a mechanism that brings mutual benefit, a win-win situation for adversaries, and also benefits for the mediator. Touval noted that “mediators, like brokers, are in it for profit.”¹⁷⁸ Therefore,

¹⁷⁶ Moonis Ahmar, “Why Rethink the Paradigms of Conflict Resolution?,” in Moonis Ahmar (ed.), *Paradigms of Conflict Resolution in South Asia*, The University Press Limited, Dhaka, 2003, p. 25.

¹⁷⁷ Herbert Kelman, “Interactive Problem Solving as a Tool for Second Track Diplomacy,” in John Davies and Edy Kaufman, *op. cit.*, p. 91.

¹⁷⁸ Cited in G. R. Berridge, *op. cit.*, p. 190.

motives of a third party mediator are important for an effective mediation. There are a variety of motives behind third party mediation. These motives differ from actor to actor. For examples, states' motives for mediation may differ from the motives of international or regional organisation. However, generally the following motives may drive an actor to be a mediator. *First*, dispute resolution and global peace; *Second*, self interests; *Third*, international political power game; *Fourth*, to become prominent in the international arena; *Fifth*, improving relations with adversaries; *Sixth*, to establish justice. This section sheds some light on different mediators and their motives separately.

3.1 Mediation by Individuals

An individual actor can mediate national or international conflict. Usually, former political leaders, diplomats, scholars, practitioners can be the mediator. For instance, the former U.S. President Jimmy Carter has mediated many domestic and international disputes. One of the good examples of his mediation role is the Nairobi Agreement between Sudan and Uganda in December 1999.¹⁷⁹

It is noted that there is confusion on the identity of the individual mediator. For example, the individual mediator who is normally an official representative of his/her government in formal interactions with high level officials from the disputing countries cannot be described as individual mediator. The individual just represents the view of his /her state or formal organisation. Individual mediation means mediation that is carried out by individuals who are not government officials or political incumbents. However, Bercovitch divided individual mediation into formal and informal mediation. Formal mediation takes place when a government representative acts in his/her "private capacity" to mediate a conflict between the official representatives of other states (e.g., Dennis Ross in his role as the U.S. State Department's special Middle East coordinator, and Richard Holbrooke in Bosnia).¹⁸⁰ Informal mediation, on the

¹⁷⁹ For more detailed see "Peace Program," in *The Carter Center*, available at <http://www.cartercenter.org/peaceprograms/program12.htm>, accessed on 20 August, 2007.

¹⁸⁰ Bercovitch, *op. cit.*

other hand, refers to the efforts of mediators who have a long-standing experience and a deep commitment to international conflict resolution, or to the efforts of scholars whose professional experience give them the opportunity to engage in mediation with real conflict parties (e.g., the efforts of scholars such as Burton, Doob, and Kelman). The motives behind individual mediation are as follows:

I) Scholars and practitioners desire to use their scholarly ideas and experience on mediation for conflict management. The new ideas they create encourage them to contribute in resolving a crisis.

II) They do it mostly for establishing global and local peace. A desire to be instrumental in changing the pattern of a long-standing conflict also motivates them.

III) The individual mediators may do it for their self interest too. They sell their skill, knowledge, and expertise on mediation. The organisations the individuals work for want to increase their image as peace maker.

3.2 Mediation by International, Regional, and Non Governmental Organisations

The political, economic, and security situations in the contemporary world have become more complicated than ever before. It is argued that state alone is not enough to face the manifold and multi-type conflicts of this world. Consequently, we have witnessed a phenomenal growth in the number of international, regional, and other non-state actors.”¹⁸¹ The role and motives of international organisations are discussed below.

International Organisations (The United Nations)

Since its birth on October 24, 1945, the UN has been involved in mediating many international and intra-state conflicts. Anthony Baird noted, “Transnational organizations, of which the UN is the most eminent, have, in the last 50 years, taken a prominent role in

¹⁸¹ *Ibid*, p. 13.

third-party mediation of conflict negotiations.”¹⁸² The list of UN Security Council resolutions indicates that compared to the Cold War days of the 1950s or 1960s, today the organization is facing double or triple disputes to resolve.¹⁸³ However, the UN has experienced both success and failure in managing or resolving conflicts in different parts of the world over the last six decades. The UN has contributed to the cease-fire between Iran and Iraq, the withdrawal of Soviet forces from Afghanistan, the peace process in Cambodia, and so on.¹⁸⁴ On the other hand, the UN experiences in Kashmir and Israel have shown its failure or lack of ability in managing the two oldest conflicts.

Concerning the merit and demerit of the UN as a mediator, Baird observed, “The main advantage to institutional mediation is its impartiality, which also gives its authority more legitimacy than power-based mediation, whose strongest guiding principle is the interests of the mediating state.”¹⁸⁵ Nevertheless, many practitioners and scholars argue that such mediation is like a lion without teeth. They argue that because of the lack of military peacekeepers or its passive mandate, institutional mediation has no power to mediate a conflict. From a different perspective, as an intergovernmental organisation the UN is often unable to engage in mediating activities when one or more of the adversary parties are not a state, as it is better equipped and oriented to deal with state.¹⁸⁶ Although peacemaking is the aim of the UN, however, the organisation is also subject to the particular policies and interests of its member-states. It is evident that the UN was frequently paralysed by the Cold War and engaged in peacemaking much less than its Charter suggested it should.¹⁸⁷ The motives of the UN to mediate a conflict are:

¹⁸² Anthony Baird, “An Atmosphere of Reconciliation: A Theory of Resolving Ethnic Conflicts Based on the Trans-Caucasian Conflicts,” *The Online Journal of Peace and Conflict Resolution*, November 1999, available at http://www.trinstitute.org/ojpcr/2_4baird.htm, accessed on 15 October, 2006.

¹⁸³ See, UNSC Resolutions, UN Document Center, available at <http://www.un.org/documents/>, accessed on 12 June, 2006.

¹⁸⁴ Kjell Skjelsbaek and Gunnar Fermann, “The UN Secretary-General and the Mediation of International Disputes,” in Bercovitch, *op. cit.*, p. 75.

¹⁸⁵ Anthony Baird, *op. cit.*

¹⁸⁶ Louis Kriesberg, “Verities of Mediating Activities and Mediators in International Relations,” in Bercovitch, *op. cit.*, p. 277.

¹⁸⁷ *Ibid.*

- I) The UN wants to resolve or manage a conflict in a peaceful way. It wants to resolve the issue mainly for humanitarian cause. Upholding the international law and norms also motivates it to manage and resolve a dispute.
- II) The UN seeks the mediator's mantle in order to defuse crises that threaten the global stability, including global economic stability, in which the organisations have such an important stake.¹⁸⁸
- III) The UN would like to mediate a dispute for its self interests. It wants to promote its influence in the international political arena.

Regional Organisations

Since the demise of the Cold War, American and Russian interest in regional conflict management has declined. However, the post-Cold War period has experienced increasing religious, ethnic, clan, even sub-clan conflicts in various regions around the world. Due to this situation, regional organisations freed from bipolar constraints have rushed into mediation and conflict management. Related to this, the name of the Organization of African Unity (OAU), currently known as African Union (AU), has been frequently mentioned in the previous literature. The Charter of the OAU allows it to mediate inter-state and intra-state conflicts in Africa. The Economic Community of West African States (ECOWAS) mediated conflicts in their midst. The complementary roles of OAU and the UN in managing conflicts have been notable. For instance, the collective efforts of the United Nations Secretary-General's Special Representative and the Executive Secretary of ECOWAS helped in the signing of a Peace Agreement for Liberia, in Cotonou, Benin on July 25, 1993. With regards to Somalia, OAU has fully cooperated with the UN in the efforts to bring about an end to the conflict.

Some other regional organisations like the Arab League in the Middle East and ASEAN Regional Forum (ARF) in East Asia have played their respective roles in regional conflict

¹⁸⁸ G. R. Berridge, *op. cit.*, p. 190.

management. However, these organisations could bring a little change in conflict management. On the other hand, South Asian Association for Regional Cooperation (SAARC) has failed to play any role in managing conflicts in South Asia.¹⁸⁹ Regarding regional organisation, Touval and Zartman noted that regional organisations have limitation in managing a conflict between its members, because mediation requires agreement among the organisations' most influential members, as well as acceptance by the other parties directly involved.¹⁹⁰ The primary motives of regional organisations are:

- I) Regional organisations want to resolve a dispute for the regional integration.
- II) Regional organisations seek to reduce the interference of outside powers' in regional political issues.

Non Governmental Organisations (NGOs)

Non Governmental Organisations (NGOs) have been considered important actors in post-Cold War diplomacy for conflict management and resolution. The former U.S. President Jimmy Carter noted, "NGOs can lessen tensions between parties and facilitate the peaceful negotiating process. Central to the effectiveness of any NGO in mediating a conflict, however, is its credibility and neutrality with warring parties."¹⁹¹ Andrew S. Natsios mentioned that NGOs can help in a variety of peacemaking scenarios. They are a unique instrument of conflict resolution.¹⁹²

¹⁸⁹ It can be said that according to the SAARC Charter, SAARC does not have the mandate to negotiate or mediate any security issues in South Asia. Although, it is observed that India and Pakistani leaders sometimes use the forum to address their bilateral disputes or sometimes indirectly pose claims towards each other in their speeches, the forum cannot take any measures in managing conflicts. However, the 13th SAARC summit announced a holistic united effort to combat terrorism, a security issue, in this region. Therefore, the author argues that time is ripe for South Asian people either to amend the SAARC Charter or build a separate regional security forum to discuss and manage the security issues.

¹⁹⁰ Zartman and Touval, *op. cit.*

¹⁹¹ Jimmy Carter, "Foreword," in Bercovitch, *op. cit.*, p. ix.

¹⁹² Andrew S. Natsios, "An NGO Perspective," in Zartman and J. Lewis Rasmussen, (eds.), *op. cit.*, pp. 338-339.

There are numerous NGOs working for conflict prevention, management and resolution. Berridge mentioned that “as for NGOs, the current edition of the *Directory of Conflict Prevention Organization* published by the European Centre for Conflict Prevention now lists 475 organizations active in this area.”¹⁹³ The Japan Center for Conflict Prevention (JCCP), an important NGO for conflict prevention and resolution, recently published the *Asia Pacific Conflict Prevention Directory in 2004* in which there is a list of total 491 NGOs and Research Centers dealing with conflict and development issues in the Asia-Pacific region.¹⁹⁴ The JCCP has played an important role in peace building in Cambodia and in the current peace process in Sri Lanka.

Among the other NGOs, some religious/secular NGOs have dedicated themselves to conflict prevention and resolution. The Quaker’s American Friends Service Committee (AFS) is one example in this regard.¹⁹⁵ NGOs have many limitations in managing conflicts. The key limitation is lack of resources and leverage on the conflicting parties. Sometimes NGOs are influenced by the interests of the state it originates. The main reasons that motivate NGOs to play mediatory role are:

- I) NGOs want to promote humanitarian situation in the conflict area and to establish peace; and
- II) NGOs want to increase their self interest and influence by playing mediatory role and get more funds.

3.3 States as Mediator

States are the key player in managing domestic and international conflict. States use mediation as a foreign policy or diplomatic instrument. Berridge argued, “The most important mediators, in international relations, are states, whether acting singly or collectively, or via the international organizations such as the United Nations that are largely their creatures.”¹⁹⁶ Bercovitch noted that as a political actor the state is one of the most successful and enduring forms of social and political

¹⁹³ G. R. Berridge, *op. cit.*, pp. 193-194.

¹⁹⁴ *The Asia Pacific Conflict Prevention Directory in 2004* is available at <http://www.jccp.gr.jp/>, accessed on 25 November, 2006.

¹⁹⁵ Andrew S. Natsios, *op. cit.*

¹⁹⁶ G. R. Berridge, *op. cit.*, p. 190.

organisation. Most mediation is carried on by states or by their representatives. Although the number of the various organisations has increased in the last few decades, states are still widely regarded as the most significant actors in international politics.¹⁹⁷ States pursue resources, markets, and leverage for conflict management. States role and motives can be categorised into major power state and small power state.

States' status can be sorted out into major power states and small power states. Bercovitch mentioned that "By using the term "major power" state and "small power" state, we do not mean the "size" of the state, but its "weight" in the international system."¹⁹⁸ Five factors can be identified as affecting the "weight" of a state; *First*, population and territory; *Second*, military strength; *Third*, economic development; *Fourth*, level of industrialisation; and *Fifth*, GNP per capita.¹⁹⁹ The author considers that all of these criteria are important to determine a country's status in the international political arena, nonetheless the second, third, and fourth criteria (with technological power) are more important criteria in contemporary world.

Many states, regardless of their weight and status, have contributed in mediation of various conflicts in different parts of the world. However, it is argued that mainly major powers have been involved in most of the international conflicts since 1945.²⁰⁰ Major powers can employ their leverage and influence on the parties to find a peaceful solution to the conflict. Touval noted that the political influence and the vast material capabilities enable the major powers to apply "sticks" and "carrots" policy on disputants. By using the stick and carrot policy, they can change disputant's motives.

During the Cold War, the U.S. and the Soviet Union mediated many international conflicts.²⁰¹ Among the various conflicts that are currently mediated by major powers, the U.S. mediation in Israel-Palestine conflicts, and Japan's mediation or facilitation role between the government of Sri Lanka and Tamil Tigers can

¹⁹⁷ Bercovitch, *op. cit.*, p. 12.

¹⁹⁸ *Ibid.*, p. 13

¹⁹⁹ Bercovitch in Bercovitch and Rubin, *op. cit.*, p. 28.

²⁰⁰ Touval, "The Superpowers as Mediators," *op. cit.*, p. 232.

²⁰¹ *Ibid.*

be noted.²⁰² In these mediations or facilitations, the major powers have used their political and economic leverage on the disputants.

Small states, on the other hand, have also mediated in different disputes. Algerian mediation between the U.S. and Iran on the issue of American hostage crisis in 1980, is one of the good examples.²⁰³ A small country normally waits for an invitation to mediate. When they do intervene, their strategies tend to be mostly low-profile strategies of dialogue and communication. Norway's mediation effort between the government of Sri Lanka and Tamil Tigers is such an example. However, compared to major powers, small states have few alternative foreign policy instruments at their disposal. They lack resources, influence and strategies to mediate a conflict.

On the other hand, multi party major powers mediation can be found in the case of Bosnia and Kosovo conflicts. The U.S., Russia, the EU, and NATO were involved in managing the conflicts. In the post-Cold War era, in case of Bosnia and Kosovo crisis in 1999, major powers such as the U.S., Russia, France, Germany and Britain played mediatory role to resolve the disputes, increasing their respective political influence.²⁰⁴

Some Specific Motives of State for Mediation

The motives of the states are very important for a successful mediation. States have different motivations in the mediation of a conflict. Some important motives are noted below:

I) Dispute Resolution: Conflict management or resolution is the declared motive of all major or small power states. States desire to mediate when conflicts (e.g. Israel-Palestine and India-Pakistan conflict) seriously threaten the global peace and security.

II) Self Interest: Mediators often seek to gain political, economic, and strategic benefits by involving in conflict management.

²⁰² "Japan Envoy Upbeat over Salvaging Sri Lanka Peace Process," *South Asia Monitor*, available at <http://www.southasiamonitor.org/diplomacy/2004/nov/2dip1.shtml>, accessed on 20 July, 2006.

²⁰³ Randa M. Slim, "Small States Mediation in International Relations: Mediation of the Iranian Hostage Crisis," in Bercovitch and Jeffery Z. Rubin, *op. cit.*, p. 206.

²⁰⁴ G. R. Berridge, *op. cit.*

Mediators have interests and incentives that motivate their involvement in conflict. Nevertheless, the desire to make peace is intertwined with other motives best described within the context of power politics. To understand these motives, it is useful to use cost-benefit approach. Mediators are interested in outcomes of the conflict, otherwise they would not mediate.

As a mediator major powers' goals can be divided into "defensive goal" and "offensive goal." Mediators act defensively when a continuing conflict between others threatens the mediator's interests. If two of the mediator's allies engage in a conflict, it can disrupt and weaken the alliance or damage the parties' relations with the third party.²⁰⁵ For example, a conflict between two U.S. allies, Japan and South Korea, can damage U.S. interests and relationships with these countries. On the other hand, offensive motive is the desire to extend major powers' influence. In this case, the solution of the conflict has no direct importance for the mediator and is only a vehicle for improving relations with one or both parties. Soviet mediation between India and Pakistan in 1966 was inspired by an offensive motive.

III) International Political Power Game: One of the important motives of the major powers for mediation is the desire to expand influence in the international arena. In the era of the Cold War, countries, in particular, the U.S. and the Soviet Union, often mediated in international conflicts simply to increase their own power and limit its rival's opportunity to enlarge its influence through a mediation role. As mentioned earlier, in case of Bosnia and Kosovo crisis in 1999, major powers such as the U.S., Russia, France, Germany and Britain, played mediation role to increase their respective political influence.

IV) Humanitarian Cause and Improving Relationship: States wish to mediate between two enemies for humanitarian cause, and save lives and assets. Sometimes states want to build good relations with disputed countries through mediation. For instance, although the primary motives of Algeria in mediating between the U.S. and Iran on the issue of American hostage release in 1980 was humanitarian,²⁰⁶ it was also motivated by a desire to improve its relationship with the U.S.²⁰⁷ One of main motives of Japan's and

²⁰⁵ Zartman and Touval, *op. cit.*, p. 446.

²⁰⁶ Randa M. Slim, *op. cit.*, p. 224.

²⁰⁷ *Ibid.*

Norway's efforts in managing the Sri Lankan long civil war is humanitarian. Gaining respect and gratitude from the disputants also motivate the states to play the mediatory role.

3.4 Parties' Motives for Accepting Mediation

One of the important tasks of a third party is to precisely evaluate the motives of the parties as well as the legitimacy of their desire to reach a mutually acceptable settlement."²⁰⁸ Therefore, it is important to know the parties' motives. Although parties do not have same assessment, they accept mediation and cooperate with the mediator if it feels that rejection of mediation proposal might cause even greater harm. Adversaries in a conflict have several motives for accepting mediation: 1) parties consider that mediation may actually help them reduce the risks of an escalating conflict and get them closer to a settlement; 2) each party may embrace mediation expecting that the mediator will actually influence the other party; 3) both parties may see mediation as public expression of their commitment to an international norm of peaceful conflict management; 4) parties in conflict may desire mediation because a mediator can observe, verify, and guarantee any eventual agreement²⁰⁹; and 5) mediator's offer for economic assistance in reconstructing the conflict zone and parties' over all economic development also encourages them to accept third party mediation.

3.5 Who is the Ideal Mediator?

It is difficult to identify an ideal mediator because the necessity and merit of a mediator depend on the nature of conflicts and disputant's attitude to the mediator. In this regard, Berridge noted, "Obviously the attributes of the ideal mediator will vary according to the nature of the conflict with which it is called upon or aspires to deal."²¹⁰ It has been observed that most of the time, individual mediator, organisations and small states may be impartial to mediate a conflict. Nonetheless, these actors lack leverage and resources that are very important for an effective

²⁰⁸ Ronald Fisher, *op. cit.*, p. 7.

²⁰⁹ *Ibid.*, p. 450.

²¹⁰ G. R. Berridge, *op. cit.*, p. 196.

mediation. Concerning individual mediators Paul Hare noted that “private individuals acting as mediators may possess freedom of movement and latitude of decision that is often denied to their official counterparts, but lack resources or leverage”.²¹¹ In case of the U.S. hostage crisis in Iran from 1979 to 1980, for example, individual and non-state actors failed to play any role as the Iranian side was not interested in individual or non-governmental mediation. When the Algerian government offered mediation to resolve it, the Iranian government accepted the mediation. This case indicated the limitation of individual or other non-state actors’ diplomacy.²¹²

On the other hand, the UN and regional organisations also lack direct leverage and influence on disputants. In addition, due to involvement of many states, the UN and regional organisation complicate the decision making process for conflict resolution. The UN is often hampered by disagreements between Security Council members because of the need to reach consensus on any Security Council resolution. For example, in the Kosovo crisis, the UN was completely neutralised and sidelined by the initiative of one single member, Russia, who is entirely opposed to NATO actions in the region.²¹³ The UN has too few resources to deal with the many global crises. At the same time, regional organisations cannot mediate a dispute if rivalry exists between two strong countries in a region. For example, due to India and Pakistan’s rivalry in South Asia, SAARC, the only regional organisation in South Asia, has been unable to play any conflict management role between them.

States, particularly major powers are the main and most significant actor in international politics. A major power has leverage (carrot and stick), strategy, and incentives in mediating a conflict. For conflict management, the decision making process of a major power is simple compared to the UN or regional organisations. At the same time, since a major power is not only driven by humanitarian interests but also self interests, it may seek a quick solution of the conflict. In contrast, individuals, NGOs, and international organisations lack resources, influence

²¹¹ A. Paul Hare, “Informal Mediation by Private Individuals,” in Bercovitch *op. cit.*, p. 61.

²¹² Randa M. Slim, *op. cit.*

²¹³ Shalini Chawla, “NATO’s Response to Kosovo Crisis,” *Strategic Analyses*, Vol. XXIV, September 2000.

and direct interests in a conflict. Finally, based on the above discussion, it can be argued that a major power which has both impartiality and leverage (at least to a certain level where a major power can use its carrot and stick policy) and employ diplomatic strategies for conflict management can be an effective mediator.

To make the above argument more reasonable to the reader, as an example here, this study argues that considering the mediation of the Kashmir conflict, which has been a grave concern for the international community for six decades, if one examines the role of the major powers like the US, Russia, China and Japan, one can clearly find that Japan, the top donor to both India and Pakistan, is in a strong position to be a good candidate for mediation. It has a friendly relationship with both India and Pakistan and has always been impartial in India-Pakistan conflict. On the other hand, China and Russia have sided with Pakistan and India respectively for a long time. China lacks credibility regarding India while Russia faces the same problem with regard to Pakistan. Besides, these countries do not have much economic or political leverage on disputants. On the other hand, although the U.S. has much leverage on India and Pakistan, it lacks credibility as it has changed its strategy and priority several times since the Cold War. Both India and Pakistan have been skeptical of U.S. motives in this region. Japan has impartiality, credibility and it can use its aid as leverage on both India and Pakistan. If Japan can promote its diplomatic strategies through various channels, it can play a significant role in the Kashmir conflict. Japan should ask and convincingly pursue both India and Pakistan to accept the benefits of its role as a third party mediator for the management of the Kashmir dispute. Both Japan and other South Asian countries will mutually benefit from a peaceful resolution of the Kashmir dispute.

4. The Role of a State as a Mediator in Managing Conflicts through Track I and Track II Diplomacy

In this section the study raises the questions: How does a major power mediate a conflict? What is the strategy of a major power in managing a conflict? In the previous literature, the state's role mainly focused on Track I or governmental role for third party mediation. However, this author suggests that a major power's strategy for mediation-and this is a key argument of the article-

should include both its official Track I and unofficial Track II diplomatic channels. Cooperation and coordination between Track I and Track II diplomatic channels, in other words, can bring a more fruitful outcome for conflict management.

Track I Diplomacy is a term used to describe government-to-government negotiations among designated representatives of sovereign states. This form of diplomacy is conducted by official representatives of a state or state-like authority. Government official or Track I diplomats are responsible for negotiating, signing, and ratifying treaties and other agreements. In reality, however, it is well understood that Track I diplomacy has various limits that tend to hamper the confidence-building and conflict-management processes. The people in the official diplomacy have some kind of obligations to their respective governments or people that usually restrain them from openness and transparency in dialogue. Very often, they cannot advance beyond narrow national interests. Due to mutual suspicions, they usually fear to accept any new formal proposal made by the opposite party. One example of the limitation or failure of the official diplomacy, especially in South Asia is the Agra Summit in 2001 where Indian Prime Minister and Pakistani President failed to make even a joint statement on the Kashmir dispute.²¹⁴ From another perspective, governments are often reluctant to negotiate openly with armed groups, believing it would confer upon them legitimacy or encourage other such armed movements. Yet, peace requires discussions with such groups. Such talks can be carried on in unofficial or “Track II” ways which the government can deny later if need be.

4.1 Definition and Significance of Track II Diplomacy

In contrast to the official Track I diplomacy, Track II diplomacy is commonly known as ‘unofficial diplomacy’ or ‘citizen diplomacy.’²¹⁵ Joseph Montville, an American diplomat, coined the term “Track II diplomacy” for the first time in 1981, which covers a wide range of unofficial contact and interaction aimed at resolving conflicts between the parties. He defined Track II diplomacy as “Unofficial, informal interaction between members of adversary groups or nations which aims to develop strategies,

²¹⁴ *The Daily Star*, 25 October, 2001.

²¹⁵ Davies and Kaufman, *op. cit.*, p. 5.

influence public opinion, and organize human and material resources in ways that might help resolve their conflict.”²¹⁶

It is important to note here that Track II diplomacy is not a substitute for Track I diplomacy, but a supplemental or parallel operation to help improve relationships at various levels and among different individuals.”²¹⁷ Track II diplomats can facilitate the successful conduct of Track I diplomacy – as witnessed in the Oslo components of the Middle East Peace Process. Herbert Kelman argued that Track II diplomacy is an integral component of the larger diplomatic process, and is often the only means through which members of opposing parties can safely meet.²¹⁸ Berridge noted that Track II diplomacy has a potential in managing a conflict especially in a context where one of the disputants considers that Track I diplomacy can give too much legitimacy to its rival, or where the major powers are reluctant to involve themselves directly but would sincerely like to see a peaceful resolution of the conflict.²¹⁹

Track II diplomacy engages influential citizens such as civil society leaders, individual experts, academic and NGOs professionals, former diplomats and politicians, religious leaders, and others who have access to their governments, and can influence mass media and public opinion.²²⁰ This study argues that as a Track II institution, the Council for Security Cooperation in the Asia Pacific (CSCAP) has been widely recognised for its activities in pursuing security cooperation in the Asia Pacific region.²²¹ However, it should be noted that Track II diplomacy has limitations too. Sometimes, Track II diplomats are biased and

²¹⁶ Joseph V. Montville, “The Arrow and the Olive Branch: A Case for Track Two Diplomacy,” in John W. Mc Donald and Diane B. Bendahmane, (eds.), *Conflict Resolution: Track Two Diplomacy*, Institute for Multi-Track Diplomacy, Washington D.C., 1995, p. 9.

²¹⁷ J. Lewis Rasmussen, “Peacemaking in the Twenty-First Century,” in Zartman and J. Lewis Rasmussen, (eds.), *Peacemaking in International Conflict: Methods & Techniques*, United States Institute of Peace, Washington D. C., 1997, p. 43.

²¹⁸ Herbert Kelman, “Interactive Problem Solving as a Tool for Second Track Diplomacy,” in Davis and Kaufman, *op. cit.*, pp. 81-106.

²¹⁹ G. R. Berridge, *op. cit.*, p. 196.

²²⁰ Davis and Kaufman, *op. cit.*, p. 6.

²²¹ Joseph A. Camilleri, “Regionalism and Globalism in Asia Pacific,” in Majid Tehrani (ed.), *Asian Peace: Security and Governance in the Asia Pacific Region*, I.B. Tauris, London: 1999, pp. 61-62.

influenced by the Track I politics, and cannot advance beyond their narrow national interests.

4.2 State's Mediation Strategy: Cooperation and Coordination between Diplomatic Channels

Based on the above discussion, it can be said that when conflicts are manifold and complicated in today's world, state's official diplomacy alone is not enough to resolve a difficult problem. Therefore, state should emphasize on cooperation and coordination between official Track I and unofficial Track II actors for the mediation of a conflict. No single actor or activity can create sustainable peace and security. Both Track I and Track II diplomats need cooperation from each other. Cooperation among official and unofficial actors can enhance the potential for achieving shared and complementary goals. Cooperation between Track I and Track II is an issue of increasing attention within both governmental and non-governmental circles in the U.S. and many other parts of the world. Both Track I and Track II diplomats increasingly recognise that the prevention and resolution of complex conflicts depend on a wide range of activities by diverse actors, and that coordination and cooperation maximise the opportunities for complementarity and synergy.²²² The study argues that track I and track II should: 1) share information; 2) plan together; 3) share resources; and finally 4) work in collaboration.

One good example of Track I and Track II cooperation was "The International Workshop on Kashmir" in Yokohama, Japan on July 2, 2005. The most significant aspect of the workshop was the presence of the two representatives from the two parts of disputed Kashmir. It was organised by the Keiko Research International (KRI) and Centre for Pacific Asia Studies (CPAS), and supported by Japan International Cooperation Agency (JICA), an organization of the Japanese government. Hence, like JICA's role in Yokohama, Track I can provide resources, funds, venue, and information to the Track II process and in exchange, Track II can articulate new ideas and policy recommendations as a testing ground. The study provides a model for third party mediation in

²²² Louis Kriesberg, "Coordinating Intermediary Peace Efforts," *Negotiation Journal*, Vol. 12, 1996.

Track I and Track II diplomatic channels for conflict management.

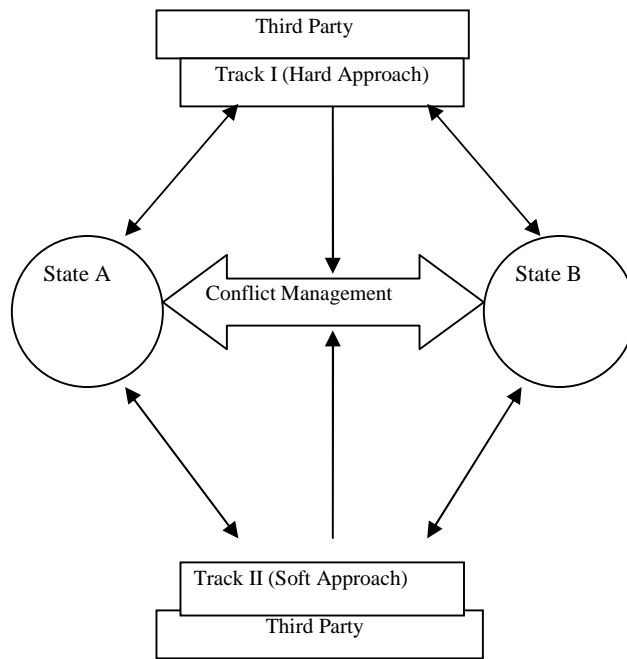


Figure 2: State's Role as a Third Party in Managing Conflict through Track I and Track II Diplomatic Channels

Figure 2 shows that State A and State B have been involved in a conflict and have failed to manage or resolve the conflict by themselves. A third party major power which has leverage on both disputants, and has been impartial in the conflict attempts to mediate between them. The major power simultaneously exercises its Track I and Track II diplomatic channels to resolve the disputes between State A and State B.

It has been already mentioned that formal diplomacy has limitations and most of the time it is refused by the disputants. Therefore, if State A and State B or any of them is suspicious

about the motives of the major power, they could refuse the formal mediation offered by the third party. To avoid the risk, at the beginning the major power should and can propose informal diplomacy for mediation instead of direct or Track I diplomacy. Disputants usually accept the Track II or informal dialogue as it does not have any legitimacy. Of course, the third party can officially address their concern about the dispute and its implication on both disputants and international peace and security. When new agendas and policy recommendations are discussed at the Track II level, if the disputants find their mutual benefit or a “win-win situation,” then the third party and the disputants can start dialogue at the Track I or official level. However, Track II without having resources and feedback by Track I cannot go far to reach their target. As Figure 2 shows Track I and Track II function at the top level and bottom level. Even though dialogue for mediation gets set back in Track I level, dialogues can always continue at Track II level.

Figure 2 also explains Track I and Track II diplomacy of a third party major power as “Hard Approach” and “Soft Approach” respectively. As a “Hard Approach” Track I can utilise its leverage and resources to press the disputants for a peaceful solution. If the disputants, State A and State B, listen to the third party to solve the dispute through peaceful ways, they will be awarded, but if they choose war to solve the problem then they will be punished. It should be noted that even though the author use the word Hard Approach for Track I diplomacy, it is mainly to distinguish from the Track II diplomacy which is always “Soft Approach” or non-coercive diplomacy. The mediator takes the Hard Approach as a last resort to press the disputants. Of course, it should be noted that taking the Hard Approach does not mean that a mediator can impose a solution on the disputants. As an example, Japan’s potential role to mediate between two arch rival India and Pakistan is already mentioned in this paper. As a diplomatic strategy, Japan can simultaneously employ its Track I and Track II diplomatic channels in managing the Kashmir conflict as it is shown in the Figure 2.

Conclusion

This article argues that compared to the other actors, a state in particular a major power has more leverage, incentives and

strategies for a successful mediation of a conflict. If the major power, which is impartial in a conflict and seriously wants to mediate, can convince the disputants for accepting its mediation by utilising its carrot and stick policy, and, on the other hand, if the disputants consider that the major power has been impartial in their conflict, and also feel pressure for its carrot and stick policy, then mediation could take place.

Concerning diplomatic strategy of a major power in managing a conflict, this study recommends that a major power state can and should include unofficial Track II diplomacy with official Track I diplomacy in its mediation strategy. Track I diplomacy has inherent limitations while Track II diplomacy has more scope to discuss and articulate new ideas for management of the conflict. As a second line of communication, Track II could be only a test ground for new proposals in the mediation or negotiation between the adversaries. However, it is Track I which will eventually implement the agreement and provide the guarantee of the agreement. Therefore, the cooperation and coordination between official Track I and unofficial Track II diplomacy should be given priority for mediating a conflict.

The hidden and declared motives of a major power in mediating a conflict have been discussed earlier. The self interests motivate a major power to mediate a conflict. If the self interests overlap with the humanitarian interests then the outcome of the mediation process can be better. Finally, it is argued that mediation process can and should address the “human needs” and “justice” for the people who are the victims of the conflict. If there is no guarantee that conflict management will lead to justice, and the seeds of the conflict are not uprooted, conflict must revive even after a long time. There are examples of reviving conflicts in history. Major powers playing the role of mediator and the conflicting parties should not ignore the suggested strategies elucidated in this article.