Regionalization Process and the Economic Integration in South Asia

Raquib Ahmed

Keywords: Regionalization, trade, foreign direct investment, textile industry, garments

Introduction

All the South Asian countries have independent economic approaches based on their own natural resources, social and political set up, foreign relations influenced by dynamic global power polarization pattern and economic system. Post-colonial economic growth expanded parallel to occasional global economic fluctuations. South Asia is currently one of the least integrated regions in terms of trade, infrastructure, water, and energy cooperation despite it has a strong potential of growing GDP, a large internal market and access to free-market economic system.

The South Asian Association for Regional Cooperation (SAARC), the agreement on the South Asian Free Trade Area (SAFTA), South Asian Preferential Trade Agreement (SAPTA) and several bilateral agreements are some existing intra-regional agreements. Despite that economic connectivity is below the region's potential for prosperity (Shaheen et al. 2007). SAARC shares only about 5% of total trade of the region today which was about 3 % in 1990. Comparing these developments to other Asian economic blocs, others did better during the same period; e.g. ASEAN grew from 17 to 25 % and ASEAN+ 3 grew from 38 to 45 %. Intra-regional trade contributed about 20% to its GDP for ASEAN whereas it was only 2% for SAARC countries (Rahman et al, 2012, p. 168).

Tariff and non-tariff barriers, weak infrastructure, poor awareness among stakeholders, a lack of political will, and low levels of investment are few constrains. Despite newly adopted regional liberalized trade policy, the non-tariff barriers (NTBs) have appeared as challenge in economic partnership which originated most likely from colonial legacy. The NTBs act sometimes as formal restrictions in other ways on trade that range from quotas to sanctions, or they can be administrative bottlenecks, inefficient customs procedures, and in the name of "standard", finally include almost everything. In the region, about 28% import cost (about USD 4.6 billion) of intra-regional trade could be reduced through removing NTBs (Rahman, S.H. et al 2012).

Status of economic partnership

Two aspects are linked to future possibilities: (1) the status of the regional integration facilitation and (2) basic tariff and non-tariff barriers functioning behind.

Potential driving forces behind regional integration are essentially; regional integration in trade and regional integration of industries. Though main thrust of regional integration lies in economic integration. The SAARC Charter focuses on mutual assistance in economic, social, cultural, technical and scientific fields. South Asian leaders recognize that opening their economies, trade and investment, especially with neighboring countries, could lay the groundwork for reducing conflicts in the region. But intra-regional trade remained very low despite the creation of SAPTA in 1995. Regional trade imbalances continued between neighboring countries. India prefers trade through bilateral policy that follows a general trend of benefit that goes to the bigger country linked to the traditional Ricardian and Hecksher–Ohlin trade theory, which refers to differences in factor endowment between countries. So, the intra-regional trade could not improve even there exist comparative advantages in the production of similar products such as garments, light manufacturing and agricultural products (Leamer 1995). Thus, smaller countries get less benefits in exporting goods, while for importing goods they pay more. New trade theory suggests effective interaction between trade liberalization and foreign direct investment (FDI) is potential for a greater intra- regional trade (Leamer 1995).

The first possibility is embedded in trade and FDI. This substitutes as trade liberalization lead to factor price equalization between countries. This may be considered as a vertical approach of trade incentives helping regional countries to achieve a more balanced growth. The second possibility exists through increased incentives for vertical integration of production between firms of the different trading partners, such as firms from India, Bangladesh, Sri Lanka and Pakistan. Trade liberalization can result in greater investment flows and vice versa. This could be a horizontal approach of economic growth. EU and ASEAN have shown that reduction of barriers and trade costs, in conjunction with climate of conducive investment, may boost both intra-regional trade and investment as a result of firms' backward and forward linkages. It is important to take into account the nexus between trade liberalization and FDI through horizontal integration. However, with trade liberalization, the costs of exports fall.

Garments and textile industries show how economic benefits could help a balanced growth of the regional economy. It is observed that trade liberalization policies in South Asia appear to be partly non-functional due to non-tariff factors. Through this weakness FDI reaches individual countries through different international linkages and foreign policies. Figure 1 indicates higher FDI inputs in Bangladesh in sectors other than garments, where garments stand for the most potential in Bangladesh's economic growth. A basic mechanism is ignored - benefit of product fragmentation. This may give advantage to all the segments in the production chain and, thus, finally adds value to the product at consumers' level. Table 1 indicates factors which create competitive advantages in different countries for product fragmentation. A better link between FDI based on local advantages might be the potential general economic growth and regional integration.

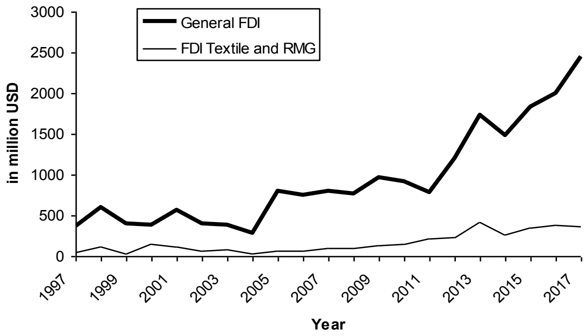

Figure 1: Flow pattern of FDI to Bangladesh. Data source: Bangladesh Bank, 2017

India and Pakistan produce quality cotton and fabrics. Bangladesh produces garments of general/regular use and Sri Lanka produces specialized garments such as swim wear. Sri Lanka has superior technology and availability of skilled labor with experience. India produces women's fashion and high-end apparels. Trade liberalization can offer benefits for the movement of raw and partly finished products in the region to be fed into the segmented industries. FDI can facilitate industries in different locations, by facilitating flow of raw materials for the industries as well as trading of the product. This kind of fragmentation is an important part of contemporary globalization (Curran & Nadvi 2015). Currently raw product and resource move within the region's liberalized policies under the augments of regional forum of SAARC but heavily affected by non-tariff barriers. These include;

- Bureaucracy inherited from colonial legacy,
- Social conflicts,
- Poor transportation infrastructure,
- Insufficient and unlinked government policies,
- Poor communication such as telecommunication and internet use, and
- Poor visa system affecting easy movement of civil population.

SAARC has formulated SAFTA to smoothen intra-regional trade. It is expected that removal of barriers might (i) reduce differences in trade balance, (ii) increase economic growth for all stakeholders, and (iii) instrumentalize regional integration for achieving success. Several other sectors function complimentary to economic growth under an integrated region are such as, (i) security, (ii) illegal trans-border trade, (iii) human trafficking and illegal migration and, (iv) develop growth infrastructure. When SAARC was formed in 1985 by political choice, it avoided cooperation in the core economic areas of money, finance, trade and manufacturing. Thus, trade liberalization and removing NTB has always remained a question.

Ready-made garments (RMG) provide faster growth in Bangladesh's rapidly developing economy. In 1972, the World Bank approximated the gross domestic product (GDP) of Bangladesh at USD 6.29 billion that grew to USD 173.82 billion by 2014, with USD 31.2 billion of that generated by exports, 82% of which was ready-made garments (in 1977 it was 77 %). As of 2016, Bangladesh was the world's second-largest apparel exporter of western (fast) fashion brands. 60 % of the export contracts of western brands are with European buyers and about 40 % with American buyers. Only 5 % of textile factories are owned by foreign investors. In 2016-2017, the RMG generated US$28.14 billion, which was 80.7 % of the total export earnings and 12.36 % of the GDP. The industry was also taking on green manufacturing practices.

	1	2	3	4	5	6	7	8	9	10	11	12	**Overall GCI**
Bangladesh	3.1	2.8	4.8	5.2	3.0	4.1	3.6	3.5	2.7	4.6	3.5	2.8	**3.80**
India	4.4	4.0	4.5	5.5	4.1	4.4	4.4	4.4	3.0	6.4	4.4	4.0	**4.52**
Nepal	3.5	2.2	5.5	5.6	3.3	3.9	3.9	3.9	2.6	3.2	3.3	2.6	**3.89**
Bhutan	4.7	3.4	3.8	5.3	3.8	4.0	4.7	3.9	3.2	1.8	3.7	3.1	**3.87**
Pakistan	3.3	2.7	3.8	4.0	2.9	3.9	3.3	3.4	2.7	3.9	3.7	3.3	**3.49**
Sri Lanka	4.1	3.9	4.2	6.2	4.4	4.3	3.4	4.0	3.2	4.1	4.1	3.7	**4.19**

1. Institutions, 2. Infrastructure, 3. Macro economic environment, 4. Primary and health education, 5. Higher education and training, 6. Goods market efficiency, 7. Labor market efficiency, 8. Financial market development, 9. Technological readiness, 10. Market size, 11. Business sophistication, 12. Innovation.

Table 1: Global Competitive Index of South Asian countries. Data source: Global Competitive Report, 2017

In sum, it is observed that Bangladesh fell between Pakistan and India in regards to comparative advantages in textiles, but held the highest RCA (Revealed Comparative Advantage). Despite rating highly, Bangladesh's textile and clothing industries face several challenges. Weak government and political turmoil makes access to their textile and clothing products unstable. Private actors have speculated that Bangladesh will be one of the top sourcing spots during next 5 years. The clothing sector has seen a positive growth in terms of RCA and the country has a low cost of labor. Procuring machinery and technology, computerized cutting and spread machinery, sewing machines, and barcode-enable inventory management systems are adding values locally. Bangladesh's foreign policy is playing a role in the growth of the Bangladeshi garment industry, as the exports are mainly concentrated in the United States and the European Union. However, the Multi-Fibre Arrangement (MFA) period showed that only 21 out of 52 firms export to a third market, while 66 out of 69 have exported to at least a third market, which indicates a diversification in the Bangladeshi garment industry and a potential to grow.

Conclusion

It is observed that the region as a factor does not impact on benefits in economic advantages. Countries can benefit from adjusting individual advantages shown in global competitive index. A combination of Bangladesh's macroeconomic environment and labor market efficiency, India's goods market efficiency and financial development, and Sri Lanka's higher education/training and technological readiness may pave way for effective product fragmentation and complimentary economic gain. Weakness in governance and political system in the region created wide-spread non-tariff barriers that have incapacitated potentialities in product fragmentation and flow of FDI.

It is observed that Bangladesh fell between Pakistan and India in regards to comparative advantages in textiles, but held the highest RCA (Revealed Comparative Advantage). Despite rating highly, Bangladesh's textile and clothing industries face several challenges. Weak government and political turmoil make access to their textile and clothing products unstable. It may be speculated that Bangladesh will be one of the top sourcing spots during the next 5 years. The clothing sector has seen a positive growth in terms of RCA and the country has a low cost of labor. Procuring machinery and technology, computerized cutting and spread machinery, sewing machines, and barcode-enable inventory management systems are adding values locally. Bangladesh's foreign policy is playing a role in the growth of the Bangladeshi garment industry, as the exports are mainly concentrated in the United States and the European Union.

References

Bangladesh Bank (2017): Foreign Direct Investment in Bangladesh, Survey Report, 2017, Bangladesh Bank: 15–19.

Chowdhury, M. et al. (2014): Prospects and Problems of RMG Industry: A study on Bangladesh. In: Research Journal of Finance and Accounting, (5)7.

Hasan, J. (2013): The Competitiveness of Ready Made Garments Industry of Bangladesh in Post MFA Era: How Does the Industry Behave to Face the Competitive Challenge? In: British Journal of Economics, Management & Trade 3(3): 296–306.

Kurran, L. & Nadvi, K. (2015): Shifting trade preferences and value chain impacts in the Bangladesh textiles and garment industry. In: Cambridge Journal of Regions, Economy and Society, (8)3: 459–474.

Leamer, E. (1995): The Hecksher–Ohlin Model Theory and Practice. In: Princeton Studies in International Finance, 19: 5.

Schwab, K. (2017): Global Competitiveness Report, 2016-17. World Economic Forum, Geneva, 101-111.

Shaheen, R. K., Faisal H. S., Moeed Y., & Aska T. (2007): Regional Integration, Trade and Conflict in South Asia. In: International Institute for Sustainable Development: 8.

Sultan, H. R., Sridhar, K. and Hans-Peter B. (2012): Regional Integration and Economic Development in South Asia, Asian Development Bank: 168.

World Economic Outlook (2015): South Asia Regional Updates, International Monitory Fund.

Contact

Raquib Ahmed (Professor Dr.)
Department of Geography and Environmental Studies, Rajshahi University, Rajshahi, Bangladesh
raquib_ahmed@yahoo.com