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Bilateral FTAs in South Asia: Recasting the Regionalism Debate

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Abstract

The slow pace of progress of the South Asian regional trade integration process under SAARC has prompted many countries to seek bilateral agreements. Sri Lanka is a case in point with bilateral agreements with both India and Pakistan. While the former is acknowledged to have yielded positive results, the latter has remained of limited interest. Given that India remains the single most important trading partner for almost all other South Asian countries, regionalism in South Asia essentially entails bilateral market access to India. The current evidence suggests that India has attempted to do so via a host of bilateral and regional arrangements, but that the emerging nature of that integration process is unlikely to be an 'inclusive' South Asian regional grouping.

JEL Classification: F10, F15, R10.

Keywords: Economic integration, South Asia, trade liberalization.

1. Introduction

Economic integration initiatives in South Asia have taken varying shapes since the inception of the South Asian Preferential Trade Agreement (SAPTA) in December 1995 under the general framework of the South Asian Association for Regional Cooperation (SAARC). Not only has the region witnessed the emergence of bilateral free trade agreements (FTAs) between member countries of SAARC, but also efforts to form subregional preferential trade initiatives that carry only select members of the grouping. Such initiatives have continued to gather momentum despite the transition to a more liberal South Asian Free Trade Agreement (SAFTA) in July 2006. While it can be argued that alternative arrangements outside the SAARC process offer the prospect of 'fast-track' liberalization in view of the slow progress under SAPTA/SAFTA, the implied fragmentation of the South Asian integration process is of some concern.

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The evolving role of India in shaping the South Asian economic integration process is critical. Not only is India the region's largest economy by far, it is also the single most important trading partner for almost all other South Asian countries. For the smaller South Asian economies, strategic bilateral trade interests with India have taken precedence over wider regional economic imperatives. Sri Lanka provides perhaps the best example of pursuing a more beneficial bilateral liberalization process vis-à-vis India while continuing to engage in regional negotiations. The implementation of the India-Sri Lanka FTA (ISFTA) since March 2000 has been of particular economic benefit to Sri Lanka, leading to a significant increase in the volume of trade almost from the outset. However, the implementation of a similar bilateral agreement with Pakistan under the Pakistan-Sri Lanka FTA (PSFTA) since June 2005 has, to date, yielded hardly any results. The particular experiences bring to the forefront once again the central role of India in furthering economic integration in the region. This paper examines this in some detail, offering a comparative perspective of Sri Lanka's bilateral engagements with India and Pakistan in the context of the wider South Asian regional integration process.

2. Sri Lanka's Experience with Bilateral Trade Relations in South Asia

Having liberalized its economy well ahead of most other South Asian countries, Sri Lanka has been at the forefront of pushing forward the agenda on preferential trade liberalization in South Asia. By the early 1990s, it had already begun to explore the possibility of a bilateral arrangement with India[1] while proposing–along with Nepal—that South Asia adopt a regional initiative under the SAARC framework. Sri Lanka's interest in a bilateral arrangement with India was not received with much enthusiasm by the latter, and the idea was shelved with the formation of SAPTA and subsequent discussions with regard to the transition to a region-wide FTA.[2]

For Sri Lanka, the attractions of a 'fast-track' bilateral process with India were clear. Bilateral trade between the two countries had been expanding rapidly in the 1990s, driven primarily by unilateral liberalization efforts. Although trade flows were largely in favor of India—allowing it to emerge as Sri Lanka's primary source of imports in 1996—the key factors prompting Sri Lanka's interests were the prospect of 'early-mover' access to

[1] See Jayawardena *et al* (1993).

[2] In 1996, SAARC member countries agreed in principle to enact SAFTA by 2000, but not later than 2005. In 1998, it was proposed that the date be brought forward to 2001. However, political tensions between India and Pakistan led to the postponement of SAARC summits during 1999-2001 and negotiations on a Framework Agreement (FA) commenced only in 2002. The FA was finalized in 2004 and outstanding issues finalized in 2006.

a large market. It was hoped that a trade agreement would help Sri Lanka diversify its industrial base and raise its profile as a destination for foreign direct investment (FDI) on the basis of preferential access to a still relatively 'protected' Indian market. Sri Lanka's preference for a bilateral agreement was all the more so owing to the slow pace of regional negotiations under SAPTA (World Bank 2004, Mukherji 2000).

The breakdown of the SAARC official process in 1998 set the seal for a bilateral deal between India and Sri Lanka in the same year with very limited prior discussion on the deal. In fact, the ISFTA was signed peremptorily in December 1998, with both countries agreeing to negotiate and finalize the finer points—in particular, the composition of the negative list of items—to allow full implementation to begin in February 1999.[3] Opposition to the agreement was voiced from within Sri Lanka's domestic industrial sector (as well as from particular sectors within India) with regard to potential adverse implications from heightened competition from cheaper imports. Nevertheless, the agreement came into effect in March 2000 (with negotiations delayed as both governments attempted to address domestic interest pressure concerns) and has since continued to be implemented according to the schedules that were agreed on.

For Sri Lanka, the ISFTA has conferred significant benefits in terms of closing the bilateral trade gap as well as encouraging a higher inflow of Indian FDI in subsequent years. By contrast, Sri Lanka's subsequent FTAs—a bilateral agreement with Pakistan and the regional SAFTA treaty—do not promise similar outcomes. In the case of the SAFTA agreement, there are significant limitations in view of the very restrictive nature of trade liberalization that has been agreed on where nearly 53% of intra-regional imports have been protected under the negative list provisions (Weerakoon and Thennakoon 2008). Sri Lanka, for instance, faces an Indian negative list of 884 tariff lines under SAFTA, whereas under the bilateral agreement the Indian negative list stands at only 419 tariff lines (Table-1).

As far as the PSFTA is concerned, there is hardly any difference with the ISFTA in terms of the terms, scope and depth of preferential liberalization that was negotiated (Table-1). However, the constraining factor remains the very limited nature of bilateral trade between the two countries. Not only is the volume of trade low, there is also high concentration among a handful of items. Exports from Sri Lanka to Pakistan in particular tend to be

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[3] The ISFTA was also a mark of renewed political confidence between the two countries. Political tensions between India and Sri Lanka heightened with the outbreak of civil conflict in Sri Lanka in the mid-1980s that culminated with direct military involvement of India during 1987-1990.

concentrated in agricultural products which are more sensitive to liberalization. As such, an analysis of bilateral trade data at the time of implementation of the ISFTA and PSFTA suggests that the former offered a higher depth of market access for Sri Lanka's exports. For instance, only 13% of Sri Lankan exports to India fell within the Indian negative list whilst close on 25% of Sri Lanka's total exports to Pakistan were restricted via negative list treatment (Table-2). Conversely, Sri Lanka ensured that nearly 44% of Indian exports to Sri Lanka would not enjoy any preferential treatment, while the percentage for Pakistan was lower at just over 15%.

Table-1: Terms of Comparative FTAs in South Asia

		SAFTA	ISFTA	PSFTA
Negative List	India	884 tariff lines	419 tariff lines	
	Pakistan	1,183 tariff lines	1,180 tariff lines	540 tariff lines
	Sri Lanka	1,065 tariff lines		697 tariff lines
Immediate 0% duty	India		1,351 tariff lines	
	Pakistan			206 tariff lines
	Sri Lanka		319 tariff lines	102 tariff lines
TLP for other items	India	Reduce tariffs to 20% over 2 yrs	Duty on balance items to be phased out over 3 yrs	Duty on balance items to be phased out over 3 yrs
	Pakistan	Reduce tariffs to 20% over 2 yrs		
	Sri Lanka	Reduce tariffs to 20% over 3 yrs	Duty on balance items to be phased out over 8 yrs	Duty on balance items to be phased out over 5 yrs
Rules of Origin	India	40% VA/4-digit CTH	35% VA/4-digit CTH	
	Pakistan	40% VA/4-digit CTH		35% VA/6-digit CTH
	Sri Lanka	35% VA/4-digit CTH	35% VA/4-digit CTH	35% VA/6-digit CTH
Completed		2016	2008	2010

Source: Respective agreements.

Table-2: Partner Country Negative Lists Under ISFTA and PSFTA

		ISFTA		PSFTA	
		% of Indian Exports Subject to Sri Lankan NL	% of Sri Lankan Exports Subject to Indian NL	% of Pakistan Exports Subject to Sri Lankan NL	% of Sri Lankan Exports Subject to Pakistan NL
01-05	Live animals, animal products	17.5		98.9	
06-14	Vegetable products	99.2		72.5	23.6
15	Animal or vegetable fats and oils	84.9		2.3	100.0
16-24	Prepared foodstuffs	35.4		81.6	
25-27	Mineral products	74.4		14.1	
28-38	Chemical products	5.9		2.0	
39-40	Plastics and rubber	52.6	91.4	43.5	
41-43	Leather products	61.5		25.4	
44-46	Wood products	35.3			
47-49	Paper products	74.3	9.3	60.0	
50-63	Textile articles	1.9	21.5	...	
64-67	Footwear	93.5		18.8	
68-70	Stone, plaster, cement	75.0		19.4	
71	Pearls				
72-83	Base metal	25.4		0.7	
84-85	Machinery and mechanical goods	18.0		10.7	
86-89	Transport equipment	76.8		9.0	
90-92	Optical, photographic equip.	4.8			
93	Arms and ammunition				
94-96	Misc. manufactured articles	56.0		12.6	
97-99	Works of art				
Total	Total	44.1	13.6	15.4	24.5

Notes: NL=negative list.

Source: Estimated using data from Department of Customs, *External Trade Statistics*, Sri Lanka; Weerakoon and Wijayasiri (2001) for ISFTA estimates.

Indeed, the pace of growth of Sri Lanka's trade with Pakistan has hardly changed since the implementation of the PSFTA in 2005 (Table-3). By contrast, Sri Lanka's exports to India increased sharply—rising to nearly 8% of total exports by 2008 compared to 1% in 2000. There has also been a sharp increase in the import share, rising from 8.2% in 2000 to over 22% by 2008.

Table-3: Sri Lanka's Bilateral Trade with India and Pakistan

	Unit	2000	2002	2004	2006	2007
Exports to India	$ mn	55	169	392	489	515
Exports to Pakistan	$ mn	28	29	29	58	55
Export share to India	%	1.0	3.6	7.0	7.4	6.7
Export share to Pakistan	%	0.5	0.6	0.7	0.9	0.7
Imports from India	$ mn	568	843	1,439	2,173	2,610
Imports from Pakistan	$ mn	68	65	108	147	178
Import share from India	%	8.2	14.0	18.6	21.9	23.1
Import share from Pakistan	%	1.0	1.1	1.4	1.5	1.6

Source: Central Bank of Sri Lanka, *Annual Report*, various issues.

Notwithstanding the increase in Sri Lanka's total exports to India under the ISFTA, it has also generated some concerns. The increase in exports was, for the most part, driven heavily by a handful of products. The most significant expansion has come in the sector of base metals where predominantly Indian investors established manufacturing bases in Sri Lanka to export copper to make use of the preferential tariff treatment afforded under the ISFTA. Copper and copper articles had jumped from accounting for just 3.5% of Sri Lanka's total exports to India in 2001 to accounting for nearly half of all exports by 2003. The other item of significant export expansion has been vegetable oil, which increased its share of exports to India from 1% in 2002 to 25.6% of total exports by 2005. Again, the main export item of interest is Vanaspati (a hydrogenated vegetable oil) where Indian investors established processing plants in Sri Lanka to make use of the preferential tariff treatment to export to India. Excluding these items, Sri Lanka's total exports to India have increased only from US$55 million in 2000 to US$278 million in 2006. This has raised concerns given that Sri Lanka has no clear comparative advantage in the two products—Vanaspati and copper—that have been driving export expansion. The majority of raw materials and inputs are imported from third countries (some times leading to manufacturers flouting rules of origin requirements as well) with limited domestic value addition or employment creation.

Nonetheless, the knock-on benefits of the ISFTA have been considerable. The most critical factor has been the trade-investment nexus that has been generated as a result. According to Kelegama and Mukherji (2007), Indian manufacturing projects are currently operating in Sri Lanka as a result of investment driven by the bilateral FTA. Indian investors were involved in a total of 18 projects in 1999. By 2006, the number of projects had risen sharply to 83 (Table-4). This translates into an increase in the share of Indian FDI from 1.2% of total FDI in Sri Lanka during 1978–1995 to over 5.6% during 2004–2006. India has in fact emerged as one of the top five foreign investors in Sri Lanka.

The sharpest increase in FDI has been in the services sector. This is despite the fact the ISFTA was confined to trade in goods alone. Nonetheless, the increased Indian FDI into services-related activities in the post-ISFTA era can in part be attributed to an increase in business confidence and contacts generated as a result of the bilateral agreement. Currently more than 70% of total Indian FDI in Sri Lanka is to be found in the services sector—an increase from 13% prior to the implementation of the ISFTA (Table-4).

In contrast to Indian FDI in Sri Lanka, FDI from Pakistan has been very limited and there has not been a significant increase in recent years either. The sectors of interest include garments and printing industries in manufacturing. Since the late 1990s, some investment in the services sector has taken place, but this remains fairly small in value.

Table-4: Number of FDI Projects in Sri Lanka

	India		Pakistan	
	End-1999	**End-2006**	**End-1999**	**End-2006**
Food, beverages, tobacco	2	6		
Textiles and clothing, leather products	2	4	7	5
Wood and wood products	1	3		
Paper and paper products	1	1		
Chemical, petroleum, rubber, and plastic products	4	9	1	3
Nonmetallic mineral products	1	7		
Fabricated metal products, machinery, transport equip.		17		
Manufactured products, n.e.s		6		
Services	7	30		4
Total	18	83	8	12
FDI by value (SLRs million)	916	22,055	303	1,708
O/w services	117	15,675	-	197

Note: SLRs= Sri Lankan rupees.

Source: Board of Investment of Sri Lanka.

Thus, the above discussion suggests that, despite the very similar terms of negotiation in the ISFTA and PSFTA, as well as the depth of liberalization carried out, the PSFTA remains of limited benefit due to low volume of trade complementarities between Pakistan and Sri Lanka. Indeed, this is a reflection of the broader economic relations governing South Asian regional integration that brings into sharp focus the central role of India in any such integration process.

3. Implications of Bilateralism for Regional Integration

The current low levels of intra-regional trade in South Asia and the slow pace of progress under the regional SAFTA process is often taken as an indication that the regional economic integration process in South Asia is likely to stagnate. Growing evidence of South Asian countries' preference for strengthening economic relations with East Asia, for instance, lends some support to such a suggestion. The recent pattern of India's import and export trade suggests that, whilst its trade with South Asia has stagnated at around 3% of its total trade, the country's economic relations with the East

Asian region have been growing quite sharply. India's exports to East Asian economies have expanded rapidly from 15.5% of total exports in 2000 to nearly 25% by 2006 (Table-5).

Indeed, India is not the only South Asian economy that appears to strengthening its trade links with East Asia as opposed to stronger trade flows with the rest of South Asia. Most other South Asian economies too are witnessing a progressive increase in trade with the East Asian region while their share of intra-South Asian trade is stagnating. Pakistan, Bangladesh, and the Maldives have seen their share of trade with East Asian countries improving significantly while their share of trade with SAARC countries has been stagnating or even declining over time. The only exceptions are Nepal and Sri Lanka.

Table-5: Direction of Trade for South Asian Economies: South Asia vs. East Asia

(% of total trade)	2000	2001	2002	2003	2004	2005	2006
India							
SAARC	2.4	3.3	2.9	3.4	2.9	2.7	2.8
ASEAN+3	15.5	21.7	18.1	20.0	19.8	20.2	24.9
Pakistan							
SAARC	2.7	2.9	2.2	2.6	3.3	3.5	3.8
ASEAN+3	18.7	18.3	19.1	19.4	18.9	19.9	26.7
Bangladesh							
SAARC	8.7	10.6	10.4	11.6	10.5	11.5	11.0
ASEAN+3	25.4	25.9	27.4	26.2	23.0	24.6	30.3
Nepal							
SAARC	37.7	44.3	48.0	52.4	57.4	66.3	71.9
ASEAN+3	17.3	21.2	18.7	16.4	16.1	17.2	12.5
Maldives							
SAARC	22.3	23.5	24.3	22.3	19.9	17.3	17.1
ASEAN+3	42.9	40.2	39.9	43.1	42.2	42.1	46.9
Sri Lanka							
SAARC	7.7	8.1	11.0	12.9	15.2	17.4	19.0
ASEAN+3	23.9	22.6	22.2	23.1	21.7	20.7	22.1

Notes: a. ASEAN+3=ASEAN+ China+Japan+South Korea.

Source: IMF, *Direction of Trade Statistics*, Yearbook 2007.

These developments raise important questions regarding the future path of economic integration in South Asia. In particular, India's intentions remain of interest. There is clear evidence to suggest that India is increasingly focusing on bilateral and regional initiatives to strengthen trade and investment linkages with the East Asian region. Such initiatives include a Comprehensive Economic Cooperation Agreement (CECA) signed with Singapore in 2005 and similar ongoing negotiations with ASEAN, South Korea, Thailand, the People's Republic of China, Malaysia, Indonesia, and Japan, testify to the importance attached to its 'Look East' policy.[4] These initiatives are also not confined merely to trade in goods, but go beyond goods to include investment and trade in services.

As a result, India's own economic interests in South Asia are quite minimal and even these have become less so in recent years. Yet, they are integral to any economic integration process in South Asia, India being the dominant trading partner for all South Asian economies. Over 90% of regional trade for countries such as Nepal, Sri Lanka, and Bangladesh are confined to a bilateral relationship with India. Even Pakistan finds nearly two thirds of its total trade with South Asian economies to be related to its bilateral trade with India. In effect, economic integration in South Asia can be argued to consist, in principle, of bilateral links to India, bypassing any notable degree of trade with third countries in the SAARC grouping.

Thus, the notion of creating a free trade area within the South Asian region, in practice, involves market access between India and each of the other South Asian economies. A key question that emerges is whether India—as the larger and more powerful economy—has in fact provided that market access. The evidence to date suggests that it has indeed been doing so through a mix of bilateral and regional initiatives. South Asian economies such as Bhutan, Nepal, and Sri Lanka who have opted for bilateral agreements with India have benefited considerably more than when negotiating with India under regional initiatives. Under the respective agreements, both Bhutan and Nepal have virtual zero duty market access to India without any need to reciprocate in kind. The ISFTA too was negotiated on the basis of 'less than full reciprocity' where Sri Lanka was given significant concessions on the grounds of asymmetries in the two economies. Indeed, the differences in the level of engagement are clear from a cursory look at the applicability of sensitive lists at the time of implementation of the two agreements. For example, only 13% of Sri Lanka's exports to India were subject to the Indian sensitive list under the bilateral FTA when implemented in 2000, while nearly 42% of Sri Lanka's exports to India were found to be excluded under the

[4] See Department of Commerce, India, www.commerce.nic.in.

Indian sensitive list under SAFTA when implemented in 2006 (Weerakoon and Thennakoon 2008).

The evidence overall suggests that India in more recent years has been accommodative of demands for market access by the smaller South Asian economies. In terms of its commitments under the SAFTA treaty, a cursory examination appears to suggest that Nepal, Sri Lanka, and Bhutan face undue market access restrictions to India (Table-6).

Table-6: Bilateral/Regional Trade Initiatives Involving India and Other SAARC Partners

Country	Bilateral Initiatives	Other	Value of Imports Subject to India's SAFTA NL (%)	Value of Indian Imports Subject to SAFTA NL (%)
Afghanistan	PTA (2003)		na	na
Bangladesh	Trade Agreement (2006)	APTA, BIMSTEC	11.2	66.0
Bhutan	FTA (1995)	BIMSTEC	36.8	na
Maldives	Trade Agreement (1991)		3.6	65.2
Nepal	FTA (1991)	BIMSTEC	46.2	64.2
Pakistan			16.4	14.5
Sri Lanka	FTA (1998)	APTA, BIMSTEC	41.5	53.5

Notes: NL= negative list; PTA=preferential trade agreement.

Source: Value of imports subject to NL is calculated using WITS data.

However, it must be borne in mind that all three countries have virtual zero duty access to India under bilateral arrangements. In fact, nearly 97% of Sri Lanka's exports to India currently receive zero duty treatment under the bilateral FTA.

The potential for India to play a catalytic role in generating trade integration in the region is present. As is clearly evident from Table-5, the two countries that have seen their share of trade with South Asia increase while their trade with East Asia has either declined or stagnated are Nepal and Sri Lanka. In the case of Sri Lanka, for instance, its trade share with SAARC increased from 7.7% in 2000 to 19% by 2006, the increase coming almost entirely as a result of higher trade flows with India. Interestingly, Sri Lanka and Nepal are the two countries in South Asia that have the most comprehensive bilateral free trade access to India and it is no coincidence that their increased trade with the SAARC region is reflective of rising bilateral trade with India.

Bangladesh and the Maldives also have been afforded fairly liberal access to India under the SAFTA treaty. For instance, only 11% of Bangladesh's exports are restricted by the Indian sensitive list. In August 2008, India undertook to unilaterally remove a further 264 tariff lines from its SAFTA negative list applicable to less developed countries (LDCs) that is likely to further improve market access for these countries. In addition, there are alternative regional initiatives under negotiation that may also grant further market access to India for certain other participating South Asian partners. These include the proposed transition of the Bangkok Agreement to an FTA under the Asia Pacific Trade Agreement (APTA) and the implementation of an FTA under the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). In addition, Bangladesh is also actively pursuing a bilateral FTA of its own with India. In the case of Pakistan, the Indian SAFTA negative list has offered fairly liberal terms, restricting only 14.5% of Pakistan's exports to India at the time of negotiations.

Thus, market access to India for other South Asian economies is evolving at a fairly rapid pace. The net result of these alternative bilateral and regional agreements in South Asia—with India playing a pivotal role—may eventually become something approximating free trade within the region. However, this will also require that the smaller South Asian economies open up their economies to India to some extent. Bangladesh, Bhutan, and Nepal have continued to restrict over 65% of their imports from India under their respective SAFTA sensitive lists (Table-6). Sri Lanka too has opted to restrict nearly 54% of Indian imports from receiving any preferences under the SAFTA commitments. Bilateral FTAs too have not afforded enhanced market access to India. Both Nepal and Bhutan enjoy nonreciprocal FTAs with India, while Sri Lanka—under the significant asymmetric treatment granted under the ISFTA—also restricts around 50% of Indian imports from receiving any preferences.

Clearly, the granting of preferential market by the smaller South Asian economies to India is more problematic than vice versa. India is a key source of imports for most, accounting for a higher share of total imports of these countries. In essence, it also means that they are more likely to face higher adjustment costs, both in terms of lost revenue and increased competition. By contrast, India's imports from the SAARC region remain negligible, amounting to less than 1% of its total imports. Nonetheless, Sri Lanka's bilateral experience with India does suggest that closer integration with an expanding regional economy can hold significant benefits, particularly in terms of greater trade-related investment flows.

As in the case of India, Pakistan too has been seeking its own trade arrangements with the East Asian region. It has signed FTAs with both China and Malaysia to date. Pakistan's engagement in South Asia, however, remains limited. Indeed, a critical feature of the emerging pattern of integration in South Asia is the absence of Pakistan in the evolving network of overlapping bilateral and regional agreements linking its economy to India. The only trade initiative that does so is SAFTA. But that too has run into controversies over bilateral trade relations governing the two countries. For instance, in the aftermath of the conclusion of SAFTA negotiations, the ratification of SAFTA issued by Pakistan has a rider that Indian imports into Pakistan would continue to be as per the Positive List of 1,075 importable items from India.[5] This decision has been contested by India while Pakistan has maintained that India needs to address issues of nontariff barriers (NTBs) before further liberalization can be envisaged. As long as such bilateral tensions dog the regional liberalization arrangements, SAFTA will continue to lag behind other arrangements granting preferential market access.

As far as India is concerned, it appears to have increasingly opted to offer asymmetric market access to the other South Asian economies while it pursues its trade interests in the wider Asian region. Thus, while regional trade integration in South Asia is occurring—within the scope of SAFTA and alternative bilateral and regional agreements that have offered significant market access to India—Pakistan looks increasingly to be on the periphery of such developments. Such an integration process will only be partial as a result, bypassing many of the political and economic objectives that were intended to be achieved through the SAARC process.

[5] While Pakistan appears to have offered favorable treatment to India under SAFTA, limiting only around 16.5% of Indian imports, this figure has to be viewed in the context of the existing trade restrictions between the two countries.

4. Conclusion

The South Asian regional trade integration process to date has generated only limited enthusiasm. It suffers from significant shortcomings, primarily on account of a very cautious approach adopted to achieve the ultimate objective of 'free trade' within the region. There has also been a fragmentation of the integration process, with some of the SAARC partners opting for a speedier and more liberal bilateral process. Sri Lanka has been at the forefront of engaging in bilateral FTAs with both India and Pakistan. While the FTA with India has come to be viewed as a fairly successful experience, the bilateral FTA with Pakistan has not generated similar results. Historically, bilateral trade flows as well as investment flows between the two countries has been marginal. By contrast, India was an emerging source of imports to Sri Lanka and has had a much longer history of FDI activity in the country.

The latter has been quite important. There have been limitations to Sri Lanka's export expansion to India, driven largely by a handful of commodities. However, the trade-FDI nexus that has evolved and the general improvement in business confidence in the post-ISFTA era can be attributed in large part to the sharp increase in overall Indian FDI inflows to Sri Lanka.

Thus, the preconditions governing trade among South Asian economies is an important determinant of the usefulness of such FTAs. Despite the fact that the PSFTA is as liberal in scope and depth as the ISFTA, there has been little dynamism either in trade or FDI flows in the post-implementation phase. This is a larger reflection of the economic relations governing South Asian economies. For most SAARC countries, India remains the key trade and economic partner. In reality, any notion of South Asian regional integration is preconditioned on bilateral market access to the Indian economy. In the case of Sri Lanka, for instance, the slow pace of progress to generate such market access through the regional SAARC-related initiatives encouraged it to take the bilateral path. Nepal and Bhutan had already done so while the other two LDCs—Bangladesh and the Maldives—gain enhanced access through special concessions offered by India under the SAFTA agreement. Thus, India, for all intents and purposes, has provided market access through a combination of bilateral and regional initiatives, with more such overlapping agreements in the pipeline that hold the potential to further that market access for select South Asian countries.

While India's more accommodative stance vis-à-vis the granting of market access to South Asian neighbors can be read as a signal of its willingness to carry along the region as it attempts to further its links with East Asia, there are divergences of strategic interests among SAARC countries. In the evolving scheme of trade initiatives in South Asia, Pakistan remains on the margins. The SAFTA initiative is the only agreement to link the economies of India and Pakistan, but that is likely to have limitations as well, so long as trade liberalization is constrained by bilateral issues. Thus, while the integration process that is currently evolving might reasonably approximate to 'free trade' in South Asia at some point, the marginal engagement of Pakistan will compromise the many economic and political objectives that were intended to be achieved by SAARC as a forum for an inclusive regional integration process.

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