

**GLOBAL' POLITICAL ECONOMY, REGIONALISM,  
AND SOUTH ASIA**

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CERTIFICATE

Certified that the dissertation entitled "Global Political Economy, Regionalism, and South Asia" submitted by Rahul Mukherji in partial fulfilment of six credits out of the total requirements of twenty four credits for the award of the degree of Master of Philosophy of the University, is his original work and for the content and quality of which, he himself is solely responsible. This work may be placed before the examiners for evaluation. This dissertation has not been submitted for the award of any other degree of this University or of any other university.

  
Prof. S.D. Muni  
Chairperson

  
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## CONTENTS

### ACKNOWLEDGEMENT

CHAPTER-I	THE PROBLEM	1-20
CHAPTER-II	THE POLITICAL FRAMEWORK OF THE WORLD ECONOMIC SYSTEM	21-60
CHAPTER-III	REGIONALISM	61-94
CHAPTER-IV	SOUTH ASIAN REGIONALISM AN "INSIDE OUT" VIEW	95-141
CHAPTER-V	CONCLUSION: WORLD ECONOMIC ORDER, REGIONALISM AND SOUTH ASIA	142-157
	BIBLIOGRAPHY	158-164

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(Rahul Mukherji)

## CHAPTER I

### THE PROBLEM

#### I

#### FOCUS

Much scholarly time and effort has been focused on the problems and prospects of South Asian regionalism in terms of its internal contradictions and compulsions. We, on our part, wish to relate South Asian regionalism to the regional imperative of a strategy to cope up with the existing realities of the global political economy.

How was the normative framework of global economic order articulated through various international regimes in the aftermath of the Second World War? U.S. hegemony, in the aftermath of the Second World War, gave the world an economic order based on a trade regime and an international currency, committed to the philosophy of "**embedded liberalism**". This embedded liberalism compromise: "unlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism."<sup>1</sup>

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1. J.G. Ruggie, "International Regimes, Transactions and Change...", in Stephen D. Krasner, ed., International Regimes (Ithaca and London, Cornell University Press, 1983), p.209.

The "embedded liberalism" compromise worked through the international trading and monetary regime, reflecting a certain configuration of power in the world economy. However, the world economy underwent changes in the distribution of economic power. It witnessed the rise of European (spearheaded by Germany) and East Asian economic power (spearheaded by Japan), the contending competitive nature of which has been a source of some concern for U.S. policy makers. As the interests of the dominant actors on the world stage underwent change, the regimes that represented the world after 1945 were put under severe stress.

Two important questions arise. First, how faithfully do regimes reflect the distribution of power throughout the world economy? Second, how do regimes cope up with changes in the distribution of power in the world economy? These questions help us to appreciate how the distribution of power results in a certain type of world order which is perpetuated by a certain kind of international regimes.

The post Second World War economic order is characterized by U.S. hegemony. **Hegemony**, in the international political economy is defined as a situation when one state is powerful enough to maintain the essential rules governing

inter-state conduct and willing to do so<sup>2</sup>. A hegemonic power must have control over raw materials, control over sources of capital, control over markets, and competitive advantages in the production of highly valued goods<sup>3</sup>. It must possess enough military power to protect the international political economy that it dominates from incursions by hostile adversaries<sup>4</sup>. Hegemony, needs a degree of ideological consensus. This would be fully achieved, when the major institutions and forms of organization - economic, social, and political - as well as the key values of the dominant state become models for emulation in the core or most developed states.<sup>5</sup>

A hegemon endowed with a combination of these attributes defines the principles, norms, rules and decision making procedures around which actor expectations converge

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2. R.O. Koehane and J.S. Nye, eds., Power and Interdependence (Boston, Little Brown, 1977).
  3. R.O. Koehane, After Hegemony (Princeton, Princeton University Press, 1984), p.32.
  4. Ibid., p.39.
  5. Gill, Stephen, American Hegemony and the Trilateral Commission (Cambridge, Cambridge University Press, 1990), p.47.



in a given issue area<sup>6</sup>. The resulting regime prescribes legitimate and proscribes illegitimate behaviour.<sup>7</sup>

Hegemonic regimes have to play the role of a **stabilizer**. They need to manage, in some degree, the structure of foreign exchange rates and provide a degree of coordination to domestic monetary policies<sup>8</sup>. The world trading system calls for principles and management. For example, an open trading regime based on the principle of non-discrimination and unconditional reciprocity - is an example of a collective good.

It has been argued that the hegemonic system is ultimately unstable<sup>9</sup>. The cost of maintaining the system rise relative to the national savings and productive investment. The hegemon grows weary of free riders who take advantage of the system without paying their due. More efficient and competitive economies arise that undercut the

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6. Stephen D. Krasner, "Structural Causes and Regime Consequences...", International Organisation, vol.36, No.2, 1982.
  7. R.O. Koehane, "The Demand for International Regimes", International Organisation, vol.36, No.2, 1982.
  8. C.P. Kindleberger, "Dominance and Leadership in the International Political Economy", International Studies Quarterly, vol.25, 1981, p.247.
  9. Ibid., p.251.

hegemon's international position and the economic surplus that had financed the costs of global hegemony.<sup>10</sup>

Although, it can be argued that regimes are more readily maintained than established<sup>11</sup> or that complex interdependences have developed; the problems of pluralist leadership can give rise to conflictual situations. In the context of the hegemonic stability thesis, where do we situate the USA today ? Do problems arising from the lack of a stabilizing influence on the world economy give rise to discord ? These are some of the key questions about economic order that affect international economic relations.

It has been pointed out that debt, monetary and trade matters, as well as changing security concerns are being reflected in the emergence of **trading blocks**. Greater regionalization may also mean that large segments of the human race will undoubtedly be excluded from the world economy. There is a greater danger that a regionalised world economy will be composed of islands of prosperity in a turbulent sea of global poverty and alienated societies.<sup>12</sup>

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10. Robert Gilpin, The Political Economy of International Relations (Princeton, Princeton University Press, 1987), p.78.

11. C.P. Kindleberger, "International Public Goods without International Government", American Economic Review, Vol.76, 1986.

12. Gilpin, n.10, p.400.

The European Economic Community constitutes one focus for the regionalization of the world economy. The region has already achieved a high degree of monetary unity and policy coordination. The United States has begun to draw its northern and southern neighbours into closer interdependence. The third and most amorphous region is that of the Pacific Basin or Asian Pacific. Centred around Japan and the Asian NICs, the region includes ASEAN, Australia, Canada, New Zealand and parts of Latin America. The U.S. has become a major participant in this economically dynamic region. Between 1960 and 1982, the ratio of the Pacific Gross Product to the Atlantic Gross Product increased from about 40 to about 60%.<sup>13</sup>

While the regionalization of the developed areas is taking place, the world is also witnessing trends towards regionalism in less developed and developing areas. What are these trends? Do these trends assume greater importance in the context of the regionalization of the global political economy. Accordingly, the regional trends in South East Asia, Latin America and Africa also assume importance. We will concentrate on how these regionalisms have shaped economic relations within the region, and how they interact with the global economy.

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13. S.B. Linder, An Essay on Trade and Transformation (New York, Wiley, 1961), p.10.

The South Asian Association for Regional Cooperation (SAARC), conceived more than a decade ago, is beset with internal contradictions. On the other hand, obviously, there are imperatives for its persistence. The legacy of colonial rule in South Asia resulted in sharp inequalities and deprivations. Further, in order to manage conflicts arising out of class inequalities, the colonizers devised a strategy of divide and rule. These legacies have created enormous problems for nation-building in South Asia. Plans and programmes of economic development have also suffered on this account, creating conditions inimical to taking collective economic decisions beneficial for the region as a whole.

What are the internal constraints to and compulsions for South Asian regionalism? Do we need to re-evaluate these compulsions and constraints in the light of the increasing regionalization of the world economy? In the final analysis, these are some of the questions we would like to address ourselves to. For this, we need to look at the global framework governing international economic relations, the trends towards the regionalization of the world economy, and in the light of these investigations, the imperatives for regionalism in South Asia.

## II

### SIGNIFICANCE OF POLITICAL ECONOMY

Economic relations are not merely guided by the efficiency and productivity considerations of states in a fully integrated world economy. Security considerations and the logic of power inevitably find their way into the arena of economic relations. Scholarly writings characterized by monocausal arguments fail to the intimate linkages between politics and economics. Although, economic activity may be largely characterized by non political behaviour, but politics is essential for establishing the setting within which the activity takes place and the structure of relations in the overall system.<sup>14</sup>

In some systems, the level of the structure and the level of the process are relatively well insulated from each other. The basic institutions and practices are accepted, and economic activity occurs within the framework of a set of norms, rules and decision-making processes. In such systems, the need for political intervention is minimised. However, at other times, when the framework of international regimes do not reflect the interests of states in relation to the power they wield, the rules of the game

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14. C.F. Bergsten, R.O. Koehane, and J.S. Nye, "International Economics and International Politics...", International Organisation (MIT), vol.29, No.14, 1975, p.4-5.

themselves are increasingly called into question. The system thus becomes highly politicised National decision-makers focus their attention on the system, as nonroutine behaviour dominates routine behaviour. Debates and quarrels about appropriate institutions and practices break the insulation between the structure of the system and its particular processes. International economic issues rise towards the top of national policy agendas and become increasingly politicised in the process.<sup>15</sup>

The "world political economy" has been defined as the reciprocal and dynamic interaction in international relations, of the pursuit of power and the pursuit of wealth.<sup>16</sup> On the one hand, power creates patterns of property rights within which wealth is produced and distributed; on the other hand, in the long run, changes in productive efficiency and access to resources affect relations of power. Wealth and power are related in international relations through the activities of independent actors, the most important of which are the states.<sup>17</sup>

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15. Ibid., p.6

16. Robert Gilpin, U.S. Power and the Multinational Corporation (New York, Basic Books, 1975), p.43.

17. Koehane, n.3, p.18.

### III

#### THE LOGIC OF ANALYSIS

We wish to examine how the state's quest for power in the international society is being reflected by trends towards regionalization and globalization of the world economy. Are these competing trends, or is there a drive towards one at the cost of the other? These world order trends will have to be viewed within a framework in order to relate them to the South Asian reality.

It is difficult to infer the condition of international politics from the internal composition of states, nor can one arrive at a comprehension of international politics just by summing up the foreign policies and external behaviour of states. Though, states are the most important actors in world politics, exclusive attention to the states conduct of foreign policy forces us to a descriptive level from where it becomes very difficult to draw valid generalizations. A new observation leads to the designation of a new unit level variable, and this in turn can lead to an infinite proliferation of variables. It is important therefore to look at the effects of the system on its constituent elements. These effects cannot easily be attributed to the units.<sup>18</sup>

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18. Kenneth Waltz, "Reductionist and Systemic Theories", in R.O. Koehane, ed., Neorealism And Its Critics (New York, Columbia University Press, 1986), p.52.

The imperatives for South Asian regionalism cannot be explained by merely examining the intraregional economic relations. One has also to examine the world order trends that create the environment within which the foreign economic policies of individual states are able to operate. Thus, hegemonic regimes may be vastly different from those that reflect a more multipolar world. The impact of systemic factors on individual states reflected through changes in the formal and informal rules that order the international economic system cannot be accounted for in the unit level analysis.

A systems theory of world politics explains recurrences and repetitions. It does not account for system change. As a result of patterned behaviour, the theory expects outcomes to fall within a certain range. A system is composed of a structure. This system - wide component helps us to view the system as a whole.<sup>19</sup>

The structure of a system has two important characteristics. First, it may be viewed as a "compensating device", that works to produce uniformity of outputs despite the variety of inputs. One's liver, for example, helps to maintain a blood sugar level inspite of the variety of food and drink ingested. Second, a structure designates a set of

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19. Kenneth Waltz, "Political Structures", in R.O. Koehane, ed., Neorealism And Its Critics (New York, Columbia University Press, 1986), p.70.



constraining conditions. In this sense, the structure acts as a **selector** and not as an agent. A certain type of a market is an example of a selector.<sup>20</sup>

In our empirical world, regimes are the "compensating devices" that work to produce a uniformity of outputs despite the variety of inputs. For example, the fixed exchange rate system reflected a certain configuration of economic power and produced a certain kind of monetary order despite the variety of monetary policies pursued by different states. When the distribution of the world's economic power 'changed considerably, a system of floating exchange rates was supposed to perform the same function by adopting a different set of results. The structure in its role as a selector can produce hegemonic, multipolar or bipolar worlds, depending on the concentration of power among the various states.

The structure to make it a useful tool? Meyer Fortes, the anthropologist, has described the meaning of structure:

"When we describe structure, we are in the realm of grammar and syntax, not of the spoken word. We discern structure in the "concrete reality' or social events only by virtue of having first established structure by abstraction from "concrete reality"<sup>21</sup>

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20. Waltz, n.18, p.62-63.

21. Meyer, Fortes, "Time and Social Structure...", in Meyer Fortes, ed., Social Structure: Studies Presented to A.R. Radcliffe Brown (Oxford, Clarendon Press, 1949), p.56

Since the structure is an abstraction, it cannot be defined by enumerating the material characteristics of the system. Structures are defined by the principle of ordering, the differentiation of units, and the distribution of capabilities across units.<sup>22</sup>

The ordering principle, in the absence of a higher government above the states, is anarchy. Since formally, each state is equal to the other, authority quickly reduces to a particular expression of capability.

Adam Smith demonstrated how self interested actors may produce outcomes that permit free competition. All the people in a freely competitive market work harder and price their products lower. Each firms urge to increase profits, in fact, drives the profit rate downward. International political systems are similar to economic markets as they are formed by the coaction of self regarding units. No state intends to participate in the formation of the structure by which it and others will be constrained. International political systems, like economic markets, are individualist in origin, spontaneously generated and unintended.<sup>23</sup>

States are our units of analysis. Though, there are great variations among them, we take note of the "functional

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22. Waltz, n.19, p.81.

23. Waltz, n.19, p.84-85.

similarity" and club them together. The specification of differentiation is not our major concern at the systemic level. States are unitary actors who, at a minimum seek their own preservation and, at a maximum, drive for universal domination.<sup>24</sup>

We believe that the distribution of capabilities largely predicts the various configurations of the international political system. In spite of the "functional similarity", our units are distinguished by the greater or lesser capabilities for performing similar tasks. If a student of national politics makes distinctions between parliamentary and presidential systems; students of international politics make distinctions between international political system according to the number of great powers and the relations that emerge as a result of this.<sup>25</sup> Given the ordering principle of anarchy and the functional similarity of our units (the states), the major variable affecting the nature of the system is changes in the relative capability of states. Thus, systemic factors that impinge on individual units of the system will depend largely on how power is concentrated among states (units) that constitute the international political economy.

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24. Kenneth Waltz, "Anarchic Orders And Balances of Power", in R.O. Koehane, ed., Neorealism And Its Critics (New York, Columbia University Press, 1986) p.117.

25. Waltz, n.19, p.92.

In hierarchic realms (national politics) unlike units interact, in anarchic realms (international politics) like units coact. In a hierarchic realm interdependence is close and the cost of breaking the interdependent relationship is very high. In an anarchic realm of "functionally similar" units differences arise due to the differences in capabilities of the constituent units. Out of these differences, there develops a division of labour and a much looser variety of transnational interdependence.<sup>26</sup> This is because states not only think of mutual gain, but also of how this gain will be divided. Disproportionate gains for one may be used to destroy the other. Moreover, a state also worries that it may become dependent on others through a network of asymmetrical interdependence. Thus, while the domestic imperative is "to specialize", the international imperative is "take care of yourself."<sup>27</sup>

The conceptual difference between an anarchic and hierarchic realm can be fruitfully used to view the process of regionalism. Although, the "take care of yourself" imperative is present among states within a region, there is a possibility, that the intensity of the realist contradiction may be much less in some regions as compared

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26. Waltz, n.24, p.101.

27. Ibid., p.101-103.

to its manifestation when states interact in a globally. The assumption is that such regions would have sorted out the major intraregional contradictions arising from divergences in strategic perceptions, political systems and economic philosophies. Under these circumstances, the "take care of yourself" imperative and the imperative "to specialize" may vie for ascendancy within the region. On the one hand, states within a region, enjoying the benefits of interdependence are likely to move in the direction of forging closer links. However, when this process approaches integration, states will become hesitant to renounce their sovereign powers in favour of a unit above the nation-state. Hence, while intraregional interdependence continues to grow, full integration is never achieved.

Let us hypothetically assume, that regional integration is the logical culmination of the process of forging closer and closer intraregional interdependence. If such a situation does arise, then our framework will characterize this as **system change**. While hegemony, bipolarity, multipolarity, etc., are changes within the system, due to shifts in the distribution of power, full regional integration will give rise to a new kind of segmentation of the international society. The assumption that states are the units of the international society, will no longer be tenable. However, the other two assumptions, viz.: 1) the ordering principle of anarchy and, 2) that differences in

the distribution of capabilities gives rise to loose international interdependence based on a certain division of labour, will still continue to hold.

As hegemonic cooperation in the economic arena is being increasingly challenged due to challenge in the distribution of world power, the unavailability of stabilizing influence on hegemonic regimes is becoming a serious possibility. While the multilateral system created at the Bretton Woods is under severe stress, are the world's major economic powers beginning to replace multilateral cooperation by regional cooperation? Is there a relationship between the growing regionalism in the world's most prosperous region and the decline of U.S. economic hegemony. These are our major systemic queries.

System level theories explain why units behave similarly and, despite their variations produce outcomes that fall within expected ranges. Conversely, **unit level theories** tell us why units similarly placed in a system behave differently. The theory of international politics therefore, tells us what international conditions national policies have to up with. It cannot predict what national policies these will result in.<sup>28</sup> . The problem with our exclusive attention to the systemic level is that structural

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28. Waltz, n.18, pp.60-61.

change itself has no source other than unit level processes.<sup>29</sup>

There are three major approaches to viewing regionalism as a unit level process. Functionalism, emphasizes the need to concentrate on functions or problems. The nature of the function is supposed to dictate the geographical extent and the administrative structures that have to be taken into consideration in order to solve a problem. Thus, form(structures) should follow function (problems). The federalists on the other hand, stress the need for strong central institutions (structures) for promoting regionalism. Between these opposite paradigms lies the compromise of neofunctionalism. Neofunctionalism recognizes that the process of "quiet technical self-determination" based on functions alone is insufficient to propel regionalism. However, neofunctional institutions are designed to produce a "spill over" so that in due course, problems begin to play an autonomous role. In short, the neofunctionalists stress the inseparability of structure and function. These three approaches provide a conceptual background that helps to view the intimate relationship between the role of power and the importance of welfare functions in forging regional cooperation.

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29. J.G. Ruggie, "Continuity and Transformation in the World Polity: Towards a Neorealist Synthesis", in R.O. Koehane, ed., Neorealism And Its Critics (New York, Columbia University Press, 1986) p.131.

At the level of the process, representative regionalism will be examined to find the relationship between the role of political factors and the role of functions in ensuring the success of regional cooperation. If intraregional interdependence is found to be very high, does that lead to the undermining of the nation-state, or, is regional cooperation just one of the tools used by states to promote their national interest? If the level of intraregional interdependence is low, then how do political considerations check the role of functions. These investigative propositions will help us understand the problems and prospects of South Asian regionalism in a comparative perspective.

Changes in the system are caused largely due to changes in the relative capabilities of the major powers. To the extent that these rules impinge on the state, they fashion world order trends. For example, hegemonic cooperation may have encouraged the efflorescence of regionalism in Europe. Though, the system can promote or discourage a certain trend, it cannot totally account for it. For a fuller assessment of the imperatives of the South Asian regionalism, it is necessary but not sufficient to view the regional process in a comparative perspective. This has also to be supplemented with an assessment of the impact of the emerging world political and economic order on the countries of South Asia. The system level findings will be



related to the unit level findings in order to view the South Asian regional imperative in an era of declining U.S. hegemony in international economic relations.

## CHAPTER II

### THE POLITICAL FRAMEWORK OF THE WORLD ECONOMIC SYSTEM

#### I

#### REGIMES AND ORDER

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The structure and organization of world economic order comprises of international economic regimes on the one hand, and the international division of labour on the other. International economic regimes are constructed by states to coordinate their expectations and organize aspects of their behaviour in economic issues areas.<sup>1</sup> We will limit our attention to the issue areas of monetary and trade relations.

The literature on international organization has a fairly clear idea of what regimes in international relations mean: Regimes are sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actor's expectations converge in a given area of

1. J.G. Ruggie, "Political Structure and Change in the International Economic Order," in J.G. Ruggie, ed., Antinomies of Interdependence (New York, Columbia University Press, 1983), p.424.

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international relations. Principles are beliefs of fact, causation and rectitude. Norms are standards of behaviour defined in terms of rights and obligations. Rules are specific prescriptions and proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective-choice<sup>2</sup>. Changes in principles and norms, being changes in the normative structure of regimes, amounts to regime change; changes in rules and procedures, being changes in the instrumentalities of the regime, amounts to a change within regimes<sup>3</sup>. In an anarchic society, where authority quickly reduces to a particular expression of capability, regimes reflect in large measure, the distribution of power across states in the international system. Regimes being areas of conflict and the exercise of power, may in fact institutionalize inequalities.<sup>4</sup>

How are regimes important for viewing the organizational trends of the world economy? Systemic changes in our model are accounted for by changes in the

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2. S.D. Krasner, "Structural Causes and Regime Consequences," in S.D. Krasner, ed., International Regimes (Ithaca, Cornell University Press, 1983), p.1-2.

3. Ruggie, n.1, p.428.

4. S. Haggard and B.A. Simons, "Theories of International Regimes", International Organization (M.I.T.), Vol.41(3).

distribution of capabilities across states. Regimes, being important areas for the exercise of state power produce a certain kind of world order. **A relationship can be established between the changing configuration of world power, the changing interests of the principle states, and changes in the prevailing regimes.**

**Regimes in our conceptual framework are the agents of the system.** Just as the liver seeks to maintain blood sugar levels in spite of the variety of food and drink ingested, the international monetary regime tries to maintain a certain kind of monetary stability, inspite of the multiplicity of domestic policies of various states. A perfectly competitive market selects on the basis of efficiency. The international political system selects its players on the basis of capability.

Last but not the least, our conceptual framework tells us about certain characteristics of the anarchic realm (the international society of states). Since, the "take care of yourself" imperative comes in the way of the imperative "to specialize", interdependence in the anarchic realm is loose compared to "regional integration" at the national level. Second, and a related point worth mentioning is the "tyranny of small decisions" arising out of the structural characteristics of the international society. A solution to

global problems needs policies that can transcend the narrow confines of national interest. Yet, such problems continue to depend on national policies, where the "take care of yourself" imperative is predominant. Such a structural situation may lead to a proliferation of problems that individual states are all basically against. The problems of loose interdependence and the tyranny of small decisions are structural in nature and can be viewed through the operation of the agents (regimes) of the system.

## II

### INTERESTS, REGIMES AND ORDER

The post World War II period in international relations saw a normative restructuring of international economic regimes. The United States of America with its unchallenged economic might, protected by the most powerful defence forces in the world spent considerable resources to fashion a new world order. What was the ideological base of this new order?

Under the classical gold standard, domestic prices and economic activity had been strongly conditioned by the balance of payments. Later on, the inter-war years witnessed the importance of domestic social and economic policy over external financial discipline. By the 1930s this system lay

in ruins. The post Second World War period saw the rise of the "Liberal internationalist orthodoxy" in the United States. At the same time opposition to unimpeded economic liberalism was almost universal outside the United States. A compromise of "embedded liberalism" was worked out somewhere between the liberalism of the classical gold standard and the protectionism of the inter-war years. This compromise attempted to avoid 1) the subordination of domestic economic activities to the stability of the exchange rate. It also attempted to avoid 2) the sacrifice of international stability to the domestic autonomy characteristic of the inter-war period. Thus the "embedded liberalism" compromise:

**"unlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism."<sup>5</sup>**

This compromise reflected the tremendous productive capacity of the United States (therefore the urge to liberalize) on the one hand, and the war ravaged economies (which needed protection) on the other.

### The Monetary Regime

#### a) The Fixed Exchange Rate System

The IMF (International Monetary Fund) provided for free and stable exchanges. Yet, it also provided for a "double

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5. Ruggie, n.1, p.433.

screen" to cushion the domestic economy against the balance of payments constraints. The "double screen" consisted of: 1) short term assistance, made available conditionally by the IMF to finance payments deficits on the current account; and 2) the ability to change exchange rates with the Fund's concurrence.<sup>6</sup> This is a classic example of the "embedded liberalism" compromise. The questions that arise are: How did American economic dominance work through this normative structure of international economic regimes? How has the changing configuration of world power been reflected through changes in the monetary regime?

The place of the U.S. Dollar in the monetary regime reflected the complete dominance of the USA in the world economy that emerged after the Second World War. In a system of fixed exchange rates, the dollar became the principal currency. It was convertible into gold at \$35 to an ounce. The dollar thus became the principal medium of exchange, the unit of account, and the store of value for the world. As long as the United State kept this pledge, and other states had faith in the US economy, this system worked.

The costs of U.S. hegemony, for example, its role as protector of the Western world against the military threat from the East, were financed largely through the

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6. *ibid.*, p.434.

dollar. The result was that the American economy started running into deficits after 1959. For a while this was tolerated because America's huge gold reserves were adequate to cover its balance of payments problems. However, after 1967, things began to change. Robert Triffin had pointed out in 1960, that there existed a fundamental contradiction between the mechanism of liquidity creation and the international confidence in the system. The growth of foreign dollar holdings that were not backed and redeemable by American held gold at \$35 per ounce would eventually destroy the system. Either America's balance of payments deficits had to stop (thereby decreasing the rate of liquidity creation and slowing world economic growth) or a new liquidity creating mechanism had to be found. As the massive escalation of the Vietnam war led to the deterioration of America's balance of payments situation, Triffin's worst fears, so far neglected, were coming true.<sup>7</sup> A series of cooperative measures taken by the leading economic powers were designed to increase confidence in the dollar and to dampen monetary speculation. Second, the IMF created Special Drawing Rights as a reserve asset to complement the dollar as a reserve currency and thereby solve the liquidity problem.<sup>8</sup>

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7. Robert Triffin, Gold and the Dollar Crisis (New Haven, Yale University Press, 1960).

8. John Williamson, The Open Economy and the World Economy (New York, Basic Books, 1983), p.348.



Even as the circumstantial dominance of the American economy was being eaten up by growth in the other industrialized western nations American hegemony continued through a system of fixed exchange rates where Western Europe and Japan agreed to finance it. The US printed money to finance its position. Europe and Japan would loan money to U.S.A. by holding inflated dollars in the form of interest-bearing United States government securities. Each nation (among the powerful actors) benefited from this.

During this period the U.S. exercised an overwhelming influence over the IMF. The selection of the managing director, a U.S. treasury man as the deputy managing director, the staffing of the organization, the system of weighted voting, and the structure of the IMF, all reflected this. The U.S. share in the weighted voting through a system of quotas meant that decisions of importance could be subjected to a U.S. veto. The tradition of arriving at a broad policy consensus can be viewed as a U.S. attempt to hide its preponderant influence. The attachment of conditions to the use of the Fund's resources, the exclusion of the recipients of Marshal Plan aid from IMF drawings, the expulsion of Czechoslovakia in 1954, and Britain's drawing from the Fund in 1956, stand testimony to the pervasive U.S. influence.

b) The Floating Exchanges

The hegemony of the dollar under the fixed exchange

rate was producing its own tensions. America's economic partners started sharing growing concern over inflation, erratic currency speculation, and increasing monetary instability owing to the vast overexpansion of the world's money supply.<sup>9</sup> Paradoxically, while the role of the dollar as a reserve, freed the USA from balance of payments problems, it could not adjust the dollar in order to improve its trade and payments position. On the other hand, Japan and Europe resented America's export of inflation but prized the effects of an overvalued dollar on their own exports.

As the world's economies became more and more competitive, the seeds of conflict were sown in a **N-1 or consistency problem**. In a system of N countries, N-1 countries are free to change their exchange rate but one country cannot change its exchange rate, because its currency is the standard to which all other currencies peg their values. There is a potential for conflict if everyone tries to change their exchange rate in order to gain competitive or other advantages.<sup>10</sup>

The N-1 or consistency problem can be sorted out if one currency value remains fixed relative to all the others. The

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9. Robert Gilpin, The Political Economy of International Relations (Princeton, Princeton University Press, 1987), p.137.

10. Williamson, n.8, p.334-35.

United States played this stabilizing role for a while. By late 1960s and the early 1970s this attitude of the US began to change as a result of its huge trade deficit. Responding to the first American trade deficit since 1893 - rising pressures for protectionism, a massive outflow of gold, accelerating attacks on the dollar, and fears of a financial collapse - Nixon took a series of unilateral actions designed to stem the outflow of gold and reverse America's rapidly declining economic fortunes.<sup>11</sup> More importantly, the growing power of Western Europe and Japan due to their vast dollar holdings meant that if the dollar was to hold its value and if the dollar exchange system were to be preserved, American autonomy would be curbed. An American official put it: "the growing economic and political strength of Europe and Japan made the Bretton Woods System obsolete."<sup>12</sup>

The Bretton Woods system, born in the aftermath of the Second World War had not perceived the N-1 problem arising out of the increased competitiveness of America's economic partners. It had assumed that the United States with 2/3 rds of the world's reserves of gold and the lion's share in the

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11. Joanne Gowa, Closing the Gold Window: Domestic Politics and the End of Bretton Woods (Ithaca, Cornell University Press, 1983).

12. R.O. Koehane, "The Politics of Inflation", in L.N. Lindberg and C.S. Maier, eds., The Politics of Inflation and Economic Stagnation (Washington, The Brookings Institution, 1985), p.97.

world's manufacturing production, would continue to play a stabilizing role for a long time. It had neglected the fact that when war-torn economies begin to grow, the share of the world's product will be more equitably distributed among the major powers. The changing configuration of global economic power lead to changes in the monetary regime. What are these changes? And, what are its long term consequences?

First, President Nixon suspended dollar convertibility into gold. Second, he imposed a surcharge on US imports in order to force the Europeans and the Japanese to revalue their currencies against the dollar. Third, he instituted wage and price controls in order to check inflation. The most significant outcome of all these was a devaluation of the dollar by December, 1971. By unilaterally delinking the dollar from gold, the President had destroyed the Bretton Woods system. At a meeting of the IMF, in Jamaica in 1976, the Bretton Woods system had come to an end. In the new system: 1) the floating exchange rates were legalized, 2) the reserve role of gold was reduced, 3) IMF quotas were increased (specially those of the OPEC countries), 4) funding for the less developed countries was increased, and 5) the determination of the par value component of the currency became the responsibility of the country itself.<sup>13</sup>

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13. Gilpin, n.9, p.141.

Thus the domestic autonomy component of the "embedded liberalism" compromise triumphed as a diffusion of the world's economic power began to occur. This regime change was called a move towards the renationalisation of the world monetary system.<sup>14</sup>

The decision to close the gold window in August 1971, was a temporary break in U.S. support for the IMF. In a changed situation, the U.S. required the backing of the major players on key issues. **The First (1969) and the Second Amendments (1978) in the IMF began to reflect shift from U.S. economic hegemony to a certain balance of power.** Two special majorities - 70 per cent and 85 per cent - were now required to take decisions of a particular significance. After the U.S. voting share through the quota dropped to below 20 per cent, special majorities protected its dominant position against precipitous decline. The U.S. could at least arrest the change that it found distasteful. Special majorities also provided similar powers to the EC (whose combined quota is greater than the U.S.), and enhanced the bargaining position of the developing countries. Notwithstanding all this, the managing directors could no longer be selected over an American veto. The choice of Michael Candessus as managing director was largely

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14. P.B. Kenen, "An Overall View", in F. Basagui, ed., International Monetary Relations After Jamaica (Paris, Atlantic Institute of International Affairs, 1976), p.9.

a European decision acceptable to the U.S.<sup>15</sup> The U.S. had to engage in active logrolling and bargaining to mobilize a majority on issues that concerned it. Although, the U.S. - IMF relations improved subsequently, the relative importance of the Fund in overseeing the exchange rate system was reduced.

**c) Reagan Period**

The return to a fixed exchange rate system based on the dollar could not take place and is unlikely. The US Federal Reserve, by itself, could no longer manage the monetary system. According to one view, a world bank, or a strengthened IMF, or the establishment of a common world currency such as the SDR, is considered to be the second best solution.<sup>16</sup> McKinnon has argued that the U.S., Japan and West Germany account for nearly 2/3 of the world's industrial output. Thus, if these governments coordinated their money supply, the destabilizing fluctuations in the global money supply could be stopped. The actual composition of dollars, marks, and yen would be determined through the combination of a complex econometric formula and a central

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15. Miles Kahler, "The United States and the International Monetary Fund", in M.P. Karns and K.A. Mingst, eds., The U.S. and Multilateral Institutions (London, Unwin Hyman, 1990), p.99.

16. Gilpin, n.9, p.152.

bank's decision.<sup>17</sup> In a self help system, the proposed replacement of the dollar supremacy by the leadership of the three dominant economic powers is not succeeding at the present.

However, the launching of the **European Monetary System** and the creation of the European currency Unit are significant developments. Faced with a weak dollar and the transmission of American inflation, the Continental powers agreed to strengthen the alignment of their currencies and lessen the probability of policy competition. Triffin has pointed out that these developments imply the creation of an increasingly decentralized and regionalised international monetary system:<sup>18</sup>

Reagan began with a **policy of convergence**. The administration continued to endorse market forces as a determinant of exchange rates among the major industrial countries. American absorption of huge amounts of world capital to finance the budget deficit and to compensate the low rate of savings moderated the consequences for capital

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17. R.I. Mc Kinnon, "An International Standard for Monetary Stabilization", Policy Analysis in Economics (Washington, Institute for International Economics, 1984), no.8, p.75.

18. Robert Triffin, "The International Accounts of the US and Their Impact upon the Rest of the World", Quarterly Review, vol.152, 1985, p.22.

formation in the United States. The resulting overvalued dollar, had a devastating impact on American exports and triggered powerful protectionist forces. The strong dollar and the flow of funds into the United States were interpreted as a sign of health for the US economy.

During the second term, this indifference began to change. Between June 1980 and March 1985 the dollar had appreciated approximately 60 per cent. The US trade imbalance was distorting. The alarmed Reagan administration pressured West Germany, Japan and other industrial countries to intervene in monetary markets in order to lower the value of the dollar. In a coordinated intervention, the G-5 caused a 1/3 decline of the dollar against the yen and the mark by March 1986, from its peak value in 1985. This marked a clear **shift from policy convergence to policy coordination.**<sup>19</sup>

In the spring of 1986, the US administration suggested a set of rules and automatic procedures to force other countries into corrective actions to bring down the value of the dollar and eliminate the US deficit. In the Tokyo summit of May 1986, other summit participants agreed to the idea of increased cooperation by strongly opposing the concept of

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19. Gilpin, n.9, p.156.



"automaticity" and the consequent linking of their economies to the US. One European official pointed out:

"We would all be dependent on the US dollar... and the US doesn't take sufficient notice of other nations in international monetary affairs."<sup>20</sup>

The summit agreement for "enhanced surveillance" was the compromise between American desire for inflexible rules and the desire of its partners for discretion.

To start with, President Reagan believed in limiting the role of a public organization like the IMF to the customary role of a short term lender to finance current account deficits. Countries were encouraged to turn to institutions like the World Bank or to private financial markets. Less finance meant sharper adjustment as the U.S. refused to increase the IMF quota in the first year of the Reagan term. The U.S. position on tighter conditionality was endorsed by FRG, UK, Japan and Netherlands.<sup>21</sup> A perceptible change began to occur in the aftermath of the Mexican rescue (1982). The Fund's role was being extended to constructing financing packages for the major debtors. In a change of policy, the US conceded to a quota increase, given the IMF's central role in maintaining confidence in the international

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20. Wall Street Journal, March 14, 1986, p.30.

21. Kahler, n.15, p.5.

financial system. An organization designed for short term

financial system. An organization designed for short term lending was getting involved in long term lending through mechanisms such as the Extended Fund Facility.

**Notwithstanding this important role of the Fund, today there is a striking asymmetry between the Fund's influence over developing countries, and its influence over the developed ones. Volker thus recounted:**

When disagreement arose between the IMF and member countries on the need for policy changes, if the country was small, it fell into line, if it was large, the IMF fell into line; if several large countries were involved, the IMF disappeared.<sup>22</sup>

Cooperation in the monetary field has been forged through unilateral initiatives, bilateral bargaining, or agreements within the G5 or the G7. The role of the IMF has been reduced to a peripheral one. The club of industrialized countries is increasingly taking over the managerial role in international monetary matters.<sup>23</sup> This perhaps results from the greater symmetry of influence the European powers enjoyed vis-a-vis the U.S.A. in these gatherings.

#### **e) Floating Exchanges and Developing Countries**

**The most troublesome feature of the floating exchange rate system is the increased "turbulence" - erratic short term instability - of foreign exchange markets. Between June**

22. Quoted in Robert Solomon, The International Monetary System, 1945-81 (New York, Harper & Row, 1982), p.250.

23. Kahler, n.15,p.112.

1973 and February 1979, the average percentage change in the pound, franc and mark rates vis-a-vis the US dollar exceeded 2 per cent per month. This was more than twice the average rate of monthly change in wholesale and consumer price levels, and more than twice the monthly change in relative price levels.<sup>24</sup> Though, long term adjustments are more gradually achieved and speculative crises are no longer observed, short-term fluctuations - far beyond the requirements of current account adjustments - have reduced the enthusiasm in the new regime. Banks and other private risk-bearers show unwillingness to take over the function of guaranteeing a range for the exchange rate for any length of time.<sup>25</sup>

The problems for developing countries due to the erratic nature of currency fluctuations was summarized by an IMF Annual Report of 1978. For developing countries that peg to a single currency, greater exchange rate variability between the intervention currency and other currencies may result in an increase in variability in both the countries' effective exchange rate and in the local currency price of

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24. J.A. Frenkel and M.L. Mussa, "Efficiency of Foreign Exchange Markets and Measures of Turbulence", American Economic Review, Vol.70(2), May 1980, pp.374-81.

25. S.W. Black, Floating Exchange Rates and National Economic Policy (New Haven, Yale University Press, 1977), p.176.

its imports and exports. As a result, the developing countries exchange rate vis-a-vis its major trading partners is likely to respond to factors more closely associated with the external position of the country issuing its intervention currency than to its own domestic balance of payments needs. Moreover, switching from a unitary peg to a basket of currencies may be inconvenient when there is a single dominant currency in exchange transactions. While fluctuations in exchange rates have led to a diminished store-of-value function of some of the major currencies, variability in import costs have led to the need for a higher and more assured level of reserves. Added to the need for more reserves in one currency, the developing countries may also need to diversify their reserves.<sup>26</sup> Unpredictability in import prices have created problems for planning in the private and public sectors of the economy.<sup>27</sup>

### **The Trade Regime**

#### **a) The General Framework**

At the time of its conception, the GATT was also a part of the "embedded liberalism" compromise. It operated on the basis of three principles: 1) non-discrimination,

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26. Annual Report, Internal Monetary Fund (Washington, D.C., 1978), p.40.

27. Annual Report, International Monetary Fund (Washington D.C., 1979), p.42.

multilateralism, and the application of the Most Favoured Nation (MFN) principles to all signatories, 2) expansion of trade through a reduction of trade barriers, and 3) unconditional reciprocity among all signatories. This liberal content reflected the US competitive edge in international trade. However, domestic autonomy was not totally undermined. A blanket exception for all existing preferential arrangements and quantitative restrictions were deemed suitable measures for safeguarding the balance of payments that result from domestic full employment policies. The substantial reduction of tariffs was called for but not made obligatory. It was coupled with several mechanisms that would make it possible under specified conditions to protect domestic producers or to avoid altogether obligations assumed under the GATT. Multilateral surveillance of most escape mechanisms was also provided for.<sup>28</sup>

The supreme competitive edge of the US economy, the foundation on which GATT's liberal ideas took form have been considerably eroded. As the economic gains get diffused throughout the World Economy's major industrial powers and the Newly Industrializing Countries (NICs) of East Asia, new challenges have emerged. The shift to floating exchange rates, the OPEC crisis, the intensification of Japanese

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28. Ruggie, n.1, p.434.

competition, the entry of highly competitive newly industrializing countries of East Asia, the relative decline of the US economy, the increasing closure of the EEC, the emergence of global stagflation, all contributed in reversing the trend towards liberalization.<sup>29</sup> Thus by the late 1970s, while tariff barriers had come down, non tariff barriers in most countries had risen. Barter or countertrade, specially with respect to less developed countries had grown rapidly. Between 1976 and 1983, it increased from 2 to 3 per cent to 25 to 30 per cent of world trade.<sup>30</sup> The importance of the state increased for the sale and purchase of armaments, aid packages, and international cartels. Between 1974 and 1980, the ratio of managed trade to total trade rose from 40 per cent to 48 per cent.<sup>31</sup>

After the Tokyo Round of Negotiations, many issues remained unattended, many new issues had also arisen. Few sectors enjoy the domestic political influence that agriculture does. The universal tendency is not only to erect barriers but also subsidize exports. Japan has set some of the highest import barriers. Subsidization of

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29. Gilpin, n.9, p.193.

30. David Goldfield, "Countertrade", International perspective, March-April, 1984.

31. The Economist (London), 25 December 1982, p.93.

agricultural exports is most common in the EEC which is backed by the Common Agricultural Policy. The US began extensive export subsidies in the 1980's. Along with certain developing countries, the US is a principal loser from these trends. In September 1986, at Punta Del Este, Uruguay, services were also brought within the purview of the multilateral trade negotiations. With financial and other services accounting for about 70 per cent of the US GNP, the US demanded other states to open their economies to US services.<sup>32</sup> The US, whose competitive edge in the area of high technology continues, wants to protect **intellectual property rights** from piracy. There have also been attempts by the developed countries, specially the United States, to bring **trade related investment measures** under the GATT. The developing countries have resisted this attempt, and maintain that foreign direct investment is beyond the jurisdiction of the GATT.<sup>33</sup> Rather than go into the latest developments in the ongoing trade negotiations, we wish to throw light on the general trends in trade behaviour. This will enable us to observe, how changes in the global distribution of economic power have changed state behaviour within a regime.

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32. Gilpin, n.9, p.200.

33. Sumitra Chishti, Restructuring of International Economic Relations (New Delhi, Concept, 1990), p.117.

The international trading environment is said to be beset with what is known as the "new protectionism".<sup>34</sup> While tariff barriers have come down, non-tariff barriers have been raised. Moreover, governments also attempt to expand exports and support specific industrial sectors through subsidies, credit guarantees, tax incentives, etc. This form of protectionism, has seen the growth of bilateralism, and is marred by the lack of transparency.

The foremost manifestation of new protectionism has been the governmental use of voluntary export restraints, which the French euphemistically call "organized free trade". By one estimate nearly 1/3 of US and some European markets in manufactured goods were covered by non-tariff barriers in the early 1980s.<sup>35</sup> Although, the total percentage of trade covered by voluntary export restraints remained relatively small, they covered critical areas such as textiles, electronics, leather goods, steel and especially automobiles.<sup>36</sup> The new protectionism has also spread to service and high technology industries. Major

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34. Gilpin, n.9, p.204.

35. W.R. Cline, Trade Policy in the 1980s (Washington, Institute for International Economics, 1983), p.16.

36. B.J. Hindley, "Voluntary Export Restraints and the GATT's Main Escape Clause", The World Economy, vol.3, 1980, p.316.



industrial powers have engaged in heated negotiations and unilateral actions to protect or increase their relative market shares in these areas. This trend towards sectoral protection has become a major feature of the evolving trade regime.<sup>37</sup> The phenomenon of new protectionism has caused a significant shift away from GATT article XIX in the direction of bilateralism and discrimination.

In a competitive world, the number of actors is too many and their individual size is too small to determine economic outcomes. In a **strategic environment** of relatively few large actors, powerful actors can influence economic outcomes.<sup>38</sup> Our framework tells us that such a strategic environment prevails in an international political economy where the number of economically dominant states are few. In this kind of a strategic environment, government policies have a significant effect on the working of multinational corporations. New tactics have been developed to accrue advantage to home firms. In this strategic environment, international trade and international production of multinational corporations are closely linked. Intra-firm trade, joint ventures, subcontracting, etc., have become important aspects of the international political economy. By

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37. Charles Lipson, "The Transformation of Trade: The Sources and Effects of Regime Change", International Organization (MIT), vol.36(2), 1982 pp.428-33.

38. Gilpin, n.9.p.215.

one estimate, nearly 50 per cent of American imports in 1977 consisted of intra firm-transfers.<sup>39</sup>

The new strategic environment has rendered old comparative advantage postulates almost obsolete. Cline points out:

"In some manufacturing products, the traditional bases for trade specialization such as differences in relative national availabilities of labour, capital, skilled labour and technological sophistication may no longer dominate (as industrial and some developing countries become similar in these attributes), while other traditional determinants of trade (such as natural resource endowment) may not be germane. In such products the patterns of trade specialization may be arbitrary, and factors such as noncompetitive firm behaviour and government intervention may determine which country prevails."<sup>40</sup>

Second, non discrimination and unconditional MFN status are giving way to bilateralism and **conditional MFN status**. Unconditional MFN obligated a treaty signatory to extend to its co-signatory, any trade concessions granted to third countries now or in the future without reservation. The conditional MFN clause granted the co-signatory, the opportunity to enjoy the same treatment as the third country, provided it offered the same compensation as the other country had given to obtain a favoured treatment.<sup>41</sup>

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39. G.K. Helleiner, Intra-Firm Trade and the Developing Countries (New York, St. Martin's Press, 1981), p.10.

40. W.R. Cline, "Reciprocity: A New Approach to World Trade Policy?", Policy Analysis in International Economics (Washington, Institute for International Economics), no.2, p.90.

41. Chishti, n.33, p.54.

Reciprocity is being replaced by "specific reciprocity."<sup>42</sup>  
From multilateralism the trading world is perhaps moving in  
the direction of "cooperative protectionism".<sup>43</sup>

Hegemonic regimes have to play the role of a stabilizer. Thus, when the US could not play the role of a stabilizer under a system of fixed exchange rates, the world was forced to shift to a system of flexible exchange rates. Similarly, the US is also losing the desire to protect the world of multilateralism and non-discrimination by playing the role of the stabilizer. The US-Canada Free Trade Agreement (1988), is a departure from the US policy of not exploiting GATT's Article XXIV which provides for non-discrimination. Uruguay Round of trade talks is deadlocked due to the US-EC dispute over the issue of agricultural subsidies. The negotiating strength and weaknesses of the world's major economic powers are therefore only partially reflected in the Dunkel Draft Text (DDT) which was offered by the Secretary General of GATT on a "take it or leave it" basis. The DDT's proposal to set up a Multilateral Trade Organization designed to succeed the GATT, indicates that

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42. R.O.Koehane, Institutions and State Power (Boulder, Westview Press, 1989), pp.132-52.

43. R.O. Koehane, "The World Political Economy and the Crisis of Embedded Liberalism", in J.H. Goldthrope, ed., Order and Conflict in Contemporary Capitalism (Oxford, Clarendon Press, 1984).

the existing trade regime needs to be altered in keeping with the changed distribution of the world's economic power. Europe and the US were not able to sort out their dispute over agricultural subsidies at the G-7 summit held in Munich (July 1992). Notwithstanding these differences, the summit's decision to extend the term of Arthur Dunkel as Secretary General of GATT reflects the Western desire to arrive at consensus on the trade regime at an early date.

**b) Developing Countries in the Trade Regime**

It was in the 1950s that GATT began to address itself to the urgent problems of development. Thus, while Article XI had imposed a general prohibition on Quantitative Restrictions, Article XII and XVIII brought them back by laying down the conditions under which they may be justified. Thus, Article XVIII (Section B) allowed the developing countries to use "protective measures" for implementing "programmes and policies of economic development designed to raise the general standard of living of their people". The introduction of the Development Chapter (Chapter IV) in the GATT in 1965 was caused in part due to the UN decision to establish the United Nations Conference on Trade and Development (UNCTAD) in 1962. The UNCTAD was made a permanent organ of the General Assembly directly responsible to the General Assembly rather than the

Economic and Social Council. This also led to the acceptance of the principle of collective bargaining by the Group of 77 which came into existence within the UNCTAD.

The period between 1960 and 1980 has been described as the "golden age" for the developing countries.<sup>44</sup> UNCTAD-I(1964), generated a number of principles that linked international trade to the needs of development. These principles were enunciated at the initiative of the developing countries, while the developed ones either voted against or abstained. After years of negotiation, UNCTAD-II (1968) achieved an agreement on the principle of the Generalized System of Preferences. Under Resolution 21 (11) of UNCTAD (1968), developed countries were to allow the preferential or free entry of manufactures or semi-manufactures of the developing countries. These preferences embodied non-reciprocity and non-discrimination in favour of developing countries. The move towards special and differential treatment continued until about the end of the 1970s. On 28 November 1979, it was decided that notwithstanding the Most Favoured Nation Clause (Article I of the General Agreement), the contracting parties were to be allowed to accord differential and more favourable treatment to developing countries without according such treatment to other contracting parties.

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44. S.J. Patel, "GATT as Instrument of Re-Colonization", Mainstream (New Delhi), vol.XXX(18), February 22, 1992, p.5.

The events beyond 1980s robbed much of the bargaining power of the developing world. Between 1950 and 1988, the share of the developing countries in world exports fell from 39.1 per cent to 20.4 per cent. As non-oil commodity prices fell, the terms of trade of a large number of developing countries deteriorated. UNCTAD has estimated the loss caused by a deterioration in terms of trade between 1981-86 for all developing countries, to be \$93 billion.<sup>45</sup> Between 1982 and 1989, the total external debt of developing countries grew from \$839 billion to \$1290 billion. As the external debt situation worsened, financial flows were also drying up. The disbursements from private creditors declined from \$78.7 billion in 1980 to \$44.4 billion in 1989.<sup>46</sup> In desperate need for foreign loans, over 50 countries had to accept the IMF's and World Bank's structural adjustment programmes.

As the dependence of developing countries increased, the economic management of the developing world was sought to be coordinated by the GATT, the IMF, the World Bank, and the clubs of the rich industrialized countries. The stage had shifted away from the United Nations. Unlike in the UNCTAD, or even in the IMF, there evolved no developing

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45. S. Chishti, "Crisis in International Economic Cooperation and the Economic Development of Third World Countries", International Studies (JNU), vol.26(2), 1989, p.96.

46. Chishti, n.33, p.29.

country group in the GATT to promote its interests in the manner of the G-77 or the G-9. The developing world was vulnerable and divided. Latin American countries were burdened with debt and had undertaken the structural adjustments prescribed by the IMF and World Bank. They went in for a number of bilateral agreements with the U.S. (e.g. the Caribbean initiative, and the proposed Mexico-U.S. Free Trade Agreement). Moreover, Latin American countries which are agricultural exporters view a beneficial trade off resulting from the linking of liberalization in agriculture to other aspects of the Uruguay Round. Africa, being closely tied to the E.C. for assistance (Lome Convention), and burdened with external debt, does not have much of a voice. Given the level of development in some of the African countries, protection of intellectual property, or, liberalization of trade in services, is not likely to cause substantial losses to these countries. The Association of South East Asian nations (ASEAN), known for its pro-West leanings, has embarked on a development programme in close collaboration with the USA, Japan and the EEC. It was believed that India posed a "counter hegemony" in the 1960s and the 1970s. However, India's own economic crisis and consequent dependence on Western sources of capital are likely to transform its position from an active player to a passive spectator in the trade negotiations.

The loss of developing country bargaining power is clearly reflected in the Dunkel Draft Text. Without going into the divergences of opinion about trade in services, trade related intellectual property rights, trade related investment measures, agriculture, the proposal to bring the textiles within the jurisdiction of GATT, etc., we restrict ourselves to an examination of examining the proposal to establish a Multilateral Trade Organization (MTO) designed to succeed the GATT. The Integrated Dispute Settlement System (IDSS) of the MTO permits cross relation. This implies that:

"the complaining party should first seek to suspend concessions or other obligations in the same sector as that in which the Panel or Appellate body has found a violation or other nullification or impairment."

In case sanctions within the same sector are not "practical or effective", then retaliation in other sectors is permitted.<sup>47</sup> The MTO thus seeks to legalize the multilateralised section 301 of the US Trade and Competitiveness Act. Since, the cross-retaliation provision cannot be used effectively by the developing countries owing to the asymmetry in the North-South interdependence<sup>Q</sup>, this provision is designed to discipline the South in accordance with the wishes of the North. Another way of ensuring this,

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47. Muchkund Dubey, "Political Economy of the Uruguay Round of Trade Negotiations-III", Mainstream (New Delhi), vol.XXX (34), June 13, 1992, p.17.



is by forging closer cooperation between the GATT, the IMF and the World Bank. Given, the developing country's dependence on the last two organizations, joint supervision is viewed as a fairly foolproof way of ensuring adherence to developed country prescriptions. The text of the Functioning of the GATT System (FOGS), included in the Draft Final Act states:

The GATT should, therefore, pursue and develop its cooperation with the international organizations responsible for monetary and financial matters while... avoiding the imposition on government of cross-conditionality or additional conditions. In forging such cooperation with the IMF and World Bank, it is not certain that imposition of cross-conditionality would be avoided: Whatever the intention or objective articulated in the text, the very fact that the IMF and the World Bank will be associated with the regular periodic reviews of the trade policies of individual member countries, will keep the prospect of cross-conditionality hanging over the heads of the vulnerable countries, like the Damocle's Sword.<sup>48</sup>

A reduction in the importance of more democratic institutions like the UNCTAD, the UNIDO, the ECOSOC, etc., and the involvement of organizations where the great powers have a monopoly over decision-making, structurally reduces the importance of the developing world in the international economic management of its own affairs.

This situation has resulted from increased economic dependence of developing countries due to poor economic

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48. *ibid*, p.18.

performance, the collapse of the alternate economic system, and internal divisions due to specific developing country interests. It is interesting to note that this structural domination is also ensuring **acquiescence** among the developing countries. One developing country commentator thus remarked:

What developing countries were in practice likely to be seeking were: greater compliance with the existing rules, generally applicable improvements to certain rules, and the eradication of structural imbalances on market access negotiation. In the new areas, it appeared that accommodating the development dimension was also largely a matter of designing appropriate rules and not working out exceptions for developing countries which would almost certainly be time bound.<sup>49</sup>

This spirit of acquiescence has brought to an end all attempts to bring about a revolutionary restructuring of the framework of economic relations between the developed and the developing world.

### III

#### REGIONALIZATION OF THE WORLD ECONOMY

The realists and the neo-Marxists of the "World Systems" school tend to emphasise the importance of hegemony in maintaining and protecting a liberal order. The neo-liberals (like Koehane, Nye, etc.) are of the view that such "complex interdependences" have developed, that the world has a stake in maintaining the existing regimes beyond the period of hegemonic cooperation. Between these two extremes lies the neo-mercantilist position. It argues that

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49. Chishti, n.33, p.73.

the result of hegemonic decline will neither lead to the conflict of the inter-war years, nor will it sustain the order created by the Bretton Woods. The outcome is likely to be a regionalised world-system.<sup>50</sup> This "benign" mercantilist view is differentiated from the "malevolent" view. According to it:

Such (benign) a system potentially avoids many of the organizational problems of trying to run a global or quasi-global liberal economy in the absence of political institutions on a similar scale. The malevolent view sees a rerun of the mercantilist dynamic of the past, in which protectionism is motivated primarily by considerations of state power.<sup>51</sup>

The recent trend toward regionalism is qualitatively different from past efforts and runs the risk of becoming a substitute for, rather than a complement to the multilateralism embodied in the framework of GATT. It is perhaps much more than a coincidence that the renewed interest in regionalism has coincided with the weakening of the multilateral trading system. It took four years from 1982 to 1986, to break the resistance and begin the latest round of multilateral trade negotiations. Progress towards completion of this round of negotiations has been very slow.

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50. Bjorn Hettne, "Global interdependence or Regionalism?: The Emerging Context of Interregional Relations", in Bjorn Hettne and Helge Hveem, eds., Regionalism and Interregional Relations (Goteborg, P.A.D.R.I.G.U. Papers, 1988), pp.79-88.

51. Barry Buzan, "Economic Structure and International Security", International Organization (MIT), vol.38(4), 1984.

It is well known that regional economic integration runs counter to the principle of non-discrimination embodied in Article 1 of the GATT. However, the "embedded liberalism" compromise did allow for this discriminatory practice under certain conditions. The architects of GATT thought that such arrangements may provide a practical route to universal free trade by allowing for a speedier and more intense liberalization where politics is less of a hindrance. Thus, **Article XXIV** of the GATT permits departures from the MFN obligation for preferential trading arrangements provided that : (1) other GATT members are notified of the details; (2) such arrangements do not raise trade barriers on the whole against other contracting parties to the GATT; and (3) such arrangements cover "substantially all trade" between partners, and commit them to reduce barriers to intraregional trade, possibly by means of a schedule and within a "reasonable length of time". For developing countries the conditions were milder.<sup>52</sup> The third commitment, though somewhat paradoxical, was aimed at limiting the number of preferential trading arrangements to those where the intensity of the political commitment was commensurate with the liberalization and structural adjustment efforts required. The "substantially all trade" requirement recognized that full integration of trade among

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52. Augusto de La Torre and R. Kelly, "Regional Trade Arrangements", Occasional Paper 93 (Washington, DC, IMF, March 1992), p.43.

members of a preferential arrangement would create:

"an important element of single-national characteristics among (these members)...the resulting quasi-national status following from such integration in trade (would legitimate) the exceptions to MFN obligation towards other GATT members."<sup>53</sup>

The argument is, that if provinces within a nation-state are allowed the full liberty to integrate in a multilateral system, larger units like international regions too may not pose any danger to this basic principle of the GATT.

Today there is widespread use and abuse of Article XXIV. According to a former Deputy Director General of GATT:

of all the articles, (Article XXIV) is one of the most abused, and those abuses are among the least noted.<sup>54</sup>

Of the 70 regional trading arrangements notified between 1948-90 and examined by the GATT, only 4 were deemed to be compatible with Article XXIV. These were, the South Africa - Rhodesia Customs Union (1948); the Nicaragua - EL Salvador Free Trade Agreement (1951); Nicaragua's participation in the Central American Common Market (1958); and, the Caribbean Common Market (1973). With most GATT members being involved in regional arrangements, there is a trend not to criticise each other. Even the US, previously a

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53. Jagdish Bhagwati, "Departures from Multilateralism: Regionalism and Aggressive Unilateralism", Economic Journal (Cambridge), vol.100, December 1990, p.1308.

54. Torre and Kelly, n.52, p.44.

critic of discriminatory arrangements, has become a user of Article XVIV.<sup>55</sup>

Our account of the evolving trade regime reveals that in an environment of strategic trade policy economic protectionism and alliances among states and corporations are growing rapidly, notwithstanding the process of global economic integration spearheaded by the multinational corporation. In 1980, 5 per cent of U.S. imports were affected by quantitative restrictions (QRS); by 1986, 18 per cent were so affected. Western Europe and Japan continue to be similarly protected. The Economist (London) has observed:

"the world economy shows signs of moving towards a trading system partitioned into three blocks: the Americans, the European community, and the Asia Pacific region centred on Japan."<sup>56</sup>

The term regionalisation of the world economy is a term being applied to three different processes occurring in Western Europe, North America and East Asia. The U.S. wants free agricultural trade, freer trade in the services sector, and the protection of intellectual property rights. The US disappointment with the progress of the Uruguay Round has

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55. *ibid*, pp.43-44.

56. Robert Gilpin, The New World Political And Economic Order (Princeton, Unpublished, 1992), p.5.

led to an important shift in foreign economic policy. The US- Canada Free Trade Agreement is the most important result. A huge North American market with an annual gross product of \$ 6 billion as opposed to the EEC output of \$4.5 billion as has become a significant consideration in U.S. thinking.<sup>57</sup> As competitiveness erodes, Americans are pointing out the costs the nation pays for the unrestricted market access of Japanese goods. Although, there are impediments to regionalism in North America, commentators believe that the abandonment of unquestioned multilateralism and the movement towards a regional trading arrangement signify an important shift in international economic relations.

Although no single consolidated enterprise like the EC has assumed importance in East Asia, a number of initiatives like the Association of the South East Asia Nations (ASEAN), Asia - Pacific Economic Cooperation Conference (APEC), Pacific Basin Economic Council (PBEC), etc., are facilitating intraregional commercial intercourse. Intra-Pacific Basin trade, has grown much more rapidly in recent years than trade with the outside world. The "flying geese pattern" of economic growth is spreading downward from Japan and the NICs to the ASEAN. The most important regionalising force are the Japanese MNCs. Four thousand five hundred

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57. *ibid*, p.7.

Japanese firms employ nearly a million workers. In 1985, Japanese investment was twice the US investment in the region. Between 1982 and 1989, Japanese trade within the region increased from \$61.8 billion to \$126.4 billion. With Japanese foreign aid at \$4.4 billion, Japan has assumed the role of the most important player in the region.<sup>58</sup> A regional block is perhaps an alternative for the Japanese if the global system breaks down.

What **conclusions** can one draw about the future of world order? On the one hand, some people believe that the inexorable logic of economic efficiency and technological development will crush the divisive tendencies in the world economy; while on the other, there are those who believe that the world economy will become more prone to conflict in the era of declining US hegemony. In our view, **two contradictory processes are on**. First, the distribution of capabilities among states in the international economy accounts for a certain degree of interdependence. Some economically important regions like Europe, the Asia-Pacific, and North America are finding it easier to forge interdependence at the intra-regional level, where the imperative "to specialize" has been able to counter some of the individualistic tendencies encouraged by the realist imperative "to take care of yourself." Second, in an

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58. Ibid, p.13.



anarchic realm the "take care of yourself imperative" is also gaining in importance as "new protectionism" rises in an era of declining U.S. hegemony. What we are witnessing perhaps is a dialectical interaction involving these two contradictory yet responsive processes occurring within the world economy.

## CHAPTER III

### REGIONALISM

#### I

#### ANALYTIC FRAMEWORK

We have noted from our "Logic of Analysis," that systems level analysis helps to examine why units behave similarly within a certain range of expectation. However, unit level accounts reveal why units similarly placed in a system, behave differently. While a systems theory of international politics can explain the systemic conditions facing a group of states, it cannot predict what policies these will result in.

**Systemic factors** discussed in the previous chapter, point out to the emergence of multipolarity in economic relations. The decline of U.S. hegemony in the economic field, the growing importance of Japan and Europe as economic players, and the concomitant growth of regionalism in the international political economy are visible trends. Fears that the relationship between EC, Japan and the US may lead to an uneasy concert have been reflected in the changes in U.S. strategy. The overwhelming U.S. commitment to

multilateralism has been replaced by a three track strategy which includes multilateralism, unilateralism and regionalism as three definite responses to the changed scenario.<sup>1</sup> Preoccupation with the Uruguay Round of GATT and attempts to introduce "cross retaliation"; Special 3001; and, the North America Free Trade Agreement; reflect the multiplicity of objectives being pursued by the US policy makers. It is not certain whether the United States has formulated a complete strategy based on the convergence of these three tracks. For the present, regionalism and unilateralism appear to be at loggerheads with multilateralism. The apprehension that regionalism is unlikely to give birth to a situation of free trade among supranational players is being reflected in numerous public pronouncements of the US government. The US Secretary of Commerce, Robert Mosbacher expressed this fear at the time of the failed Uruguay Round ministerial meeting in December 1990:

We could be okay either way (multilateralism or regionalism). The US always could make regional or other agreements. In all truth, we are doing this now.<sup>2</sup>

1. E.H. Preeg, "America and World Trade", Span (New Delhi, USIS), vol.XXXIII(7), July 1992, p.38.
2. ibid.,p.38.

While intraregional interactions have increased in Europe and East Asia, there is a lurking fear that a regionalised world economy may be composed of islands of prosperity in a turbulent sea of global poverty and alienated societies. Apart from other extra-regional factors, the current strategic importance of regionalism is also being felt in the developing world.

Since systemic conditions cannot predict what national policies these conditions will result in, we shall closely follow the "inside out" or the unit level approach in discussing various regionalisms in this chapter. The European Economic community (EEC) and the Association of South East Asian Nations (ASEAN), deserve our special attention. They are among the most developed regional organizations - one in the developed world, and the other in the developing world. Attention will also be paid to the progress of regionalism in Latin America and Africa.

Before we begin to assess various regionalisms, it is important to point out its conceptual basis. The literature has revolved mainly around functionalism, neo-functionalism and federalism. Since, most of the conceptualization has the post Second World War European history in mind, it suffers from an ethnocentric bias. Yet, various shades of the

argument are important , as they continue to be the most serious attempt at conceptualizing about regionalism.

Europe, between the end of the Second World War and 1950, saw the rise of two views about the organization of the continent. The British and the Scandinavians tended to present "functionalist" views, while continental Europeans tended to be "federalists."<sup>3</sup> There seemed to be a consensus about moving away from the Europe of absolute Sovereignty and internecine conflicts.

For the federalists: the worst way to cross a chasm is by taking small steps. The stronger the initial institutions, the stronger would be the integration process. The centralized federal framework with centralized information agencies, check against divisive forces, etc., was expected to play a leading role in minimizing conflicts.<sup>4</sup>

The functionalists reasoned that the federalists depended on the existence of a strong political will for the creation of an "all or nothing" situation. The functionalists wanted to attack the ill-effect of sovereignty by a sort of spontaneous cooperation, based on

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3. Uwe Kitzinger, The Politics and Economics of European Integration (New York, Praeger, 1963), pp.4-7.

4. Amitai Etzioni, Political Unification (New York, Holt, Rinehart & Winston, 1964), p.37.

something more solid. Disillusioned with ideology, dogma, philosophical systems, etc., Mitrani pointed out to the need for concentrating on problems or functions.<sup>5</sup> He was convinced that it was possible to discover an irreducible set of relations between things, which was distinguishable from relations suggested by a constitution or a dogma, and which if left to themselves, would suggest the ideal geographical extent in which the problem could be handled, and the most appropriate administrative arrangements. Interrelationships and interdependences were to develop according to the requirements of the function. Form was thus supposed to follow function.

Widening the electorate had served to dilute the scope for popular initiative and control. Stronger representative institutions had therefore to be created in areas which directly touched the life of the people (e.g. health, transport, energy, etc.). The International Labour Organization was one such assembly representing three major interest groups - labour, management and government. The European Coal and Steel Community brought together an advisory, specialist, consultative council of producers and consumers. The Tennessee Valley Authority, Mitrany's favourite functional model, had helped to sort out the problem of sovereignty of various states. Mitrany believed

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5. Paul Taylor and A.J.R. Groom, eds., The Framework of International Cooperation (London, Pinter, 1990), pp.127-36.

that his method could produce a dynamic peace. Functionalists did not expect to abolish governments, though the choice of goals for themselves would increasingly come to be predicated upon the survival of the cooperative framework.

The Schuman Plan of 1950 has been described as the invocation of a new tactic by the federalists. According to Joseph Nye:

"Basically, the neo-functionalists were federalists in functionalists clothing, pursuing federal ends through what appeared to be "functionalist means".<sup>6</sup>

The **neo-functionalist** approach differed from the functionalist one in two important ways. The path of quiet technical self determination was discarded. A politically important sector was chosen, which could be planned by technocrats and yet did not need immediate commitment to federal institutions. Some of the federalist attack on sovereignty was retained, and Schuman called his plan the first step in the direction of the federation of Europe. The second departure of neo-functionalism can be found in the deliberate design of institutions that would lead to further integration through what was called *l' engrange*, or "the **expansive logic of sector integration**". The "spill over"

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6. Joseph Nye, Peace in Parts. (Boston, Little Brown & Co., 1971), p.51.

was not left to technical self-determination from one field to another. The difficulty of balancing integration in one sector would create pressures for integrating further sectors. In short, the neo-functionalists saw the inseparability of power and welfare. Functions motivated by welfare demands alone would be ineffective in forging cooperation unless it does not involve the political game.<sup>7</sup> Mitrany, called the European Community experiment an experiment in "functional federalism".<sup>8</sup>

The neo-functionalists had their setbacks. The idea of a European Defence Community and associated Political Community were rejected by the French Assembly. Defence and foreign policy, being areas closest to the heart of sovereignty could not be brought under the neo-functionalist fold. Moreover, the creation of EEC and EURATOM, it has been argued, represented less of a "spill over" affected by the inherent linkages of tasks undertaken by the ECSC than an example of some lessons learned through ECSC being applied with new political initiatives.<sup>9</sup>

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7. ibid., pp.51-52.

8. R.J. Harrison, "Neo-Functionalism", in Paul Taylor and A.J.R. Groom, eds., The Framework of International Cooperation (London, Printer, 1990), p.144.

9. Nye, n.6, pp.53-54.



Integration based on functions alone may lead to inequalities. In order that inequalities do not come in the way of integration efforts, the gains from integration have to be distributed more evenly. This needs a guided approach to integration such as planning at the regional level, regional banks, etc. Integration, may also have to take account of the conditions of assymetrical dependence among countries. A sort of collective self-reliance against metropolitan countries may also result in regional trends. Aron Segal has spelt out the four conditions necessary for the success of regionalism in LDCs.: 1) There must be agreement about the distribution of economic benefits. 2) They must not threaten existing relationships which are perceived as beneficial. 3) They must not threaten the basis of support of national political elites.<sup>10</sup>

## II

### REPRESENTATIVE REGIONALISMS

#### EEC

Figures in Table-1 testify that the growing unity of Europe has made it an important economic power. This power has lent it bargaining strength vis-a-vis the USA and, especially Japan. All evidence suggests that Western Europe

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10. A.P. Rana, "Integrative Possibilities of Regional Order In The Third World", in Rama Melkote, ed., Regional Organizations (New Delhi, Sterling Publishers, 1990), pp.21-23.

will continue to seek to improve its their negotiating position in the world economy. This will help it achieve greater reciprocity with other economies, and will allow it to use its enhanced economic and political strength for diplomatic purposes.

TABLE 1

	Population (Millions), 1987	GDP(In billion Pounds, 1987	Share of World Trade (%)
EEC	320	255	18
USA	234	370	17
JAPAN	119	135	9

Source: Wistrich, 1989.<sup>11</sup>

In this context, the **Single European Act (SEA)**, 1986, is a major milestone. The SEA links liberalization of the European market with procedural reform. We shall briefly examine the logic of events that have led to this development.

It has been argued that the Single European Act was intended to overcome the Europessimism and Euroscelerosis of the 1970s and the early 1980s. The Albert-Ball Report (1983), showed that in spite of a tariff free Europe, other

11. Ernest Wistrich, After 1992 (New York, Routledge, 1989), p.11.

barriers to trade within Europe were being erected. Between 1960-73, the EC economies had grown at the rate of 4.6 per cent per annum. Between 1973-80, the same figure fell to 2.3 per cent per annum. During this period the share of private and public consumption as a share of G.D.P. (gross domestic product), rose by 6 per cent whereas investment fell by 20 per cent. Between 1973-81, the industrial output of the community rose by 8 per cent, while the same figure was 16 per cent for USA and 26 per cent in Japan.<sup>12</sup>.

The EC economies were trying to find national solutions to their problems. However, with at least 50 per cent of the trade with each other, economies of member countries had become increasingly interdependent. The Albert-Ball Report thus summarized its conclusion:

"Any country wishing to go it alone in pursuit of growth is bound to lose. Any country which, having put its house in order, agrees to go for growth with others and according to the rules reflecting collective interest, is sure to gain by this action."<sup>13</sup>

An authoritative estimate of the "**costs of Non Europe**" was provided by Paolo Cecchini (1988). It calculated the overall costs of the existing barriers to be around ECU 200 billion (Sterling Pound 130 billion), about 5 per cent of

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12. *ibid.*, p.4.

13. *ibid*, pp.4-5.

the Communities' Gross Domestic Product. The administrative costs of customs formalities for private firms were estimated at 2 per cent of the value of the goods traded. The total value of the purchases made by the public sector and its agencies accounted for ECU 500 billion in 1986, which was more than the value of the intra-community trade. The national public purchasing policies discriminated largely in favour of domestic producers. Differing technical regulations, standards, testing, and certification procedures are also barriers to free trade. The cost of these restrictions was estimated to be ECU 3.5 billion for telecom equipment, ECU 2.6 billion for cars, ECU 1.7 billion for building products and between ECU 500 million and one billion for foodstuffs. Different regulations affecting financial services cost the community ECU 22 billion. Though, Europe's total expenditure in the field of research and development in technology was close to that of USA and double of what was spent in Japan, yet in the early 1980s eight out of ten personal computers sold in Europe came from the USA, and nine out of ten video recorders were from Japan. The main reason for this was attributed to the fragmentation of research that often led to duplication and other wasteful expenditures.<sup>14</sup>

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14. *ibid*, pp.5-6.

The SEA (1986) has been hailed as a major achievement in the field of regionalism. It links liberalization of the European market with procedural reform. The free movement of goods, persons, services and capital is ensured. Comprehensive liberalization in trade in services, and the removal of non tariff barriers are also to be carried out. The Act also sought to increase the cohesion of economic and monetary policies of member governments, reduce disparities among regions, reduce the fragmentation of research and development efforts throughout Europe, and pay greater attention to health and environmental issues.<sup>15</sup>

Procedural matters also underwent reform. The adoption of general principles of new policies still required unanimous approval. Measures to implement these policies however, required only a qualified majority vote. The votes are weighted among member states according to their population. France, Germany, Italy, and the U.K. have ten votes each, Spain has eight, Belgium, Greece, the Netherlands and Portugal have five each, Denmark and Ireland three each, and Luxembourg two votes. A qualified majority is represented by a minimum of fifty-four votes out of a total of seventy six. Legislative powers were also increased. Where the Council acts by a qualified majority,

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15. *ibid*, p.8.

the Parliament can reject or amend decisions. Unanimous agreement in the Council is required to overrule these decisions. Applications for membership or association with the community also require parliamentary approval. The SEA also stipulates that member governments should jointly take decisions about foreign policy and achieve closer cooperation in the field of European security. A political secretariat is to assist the ministers of foreign affairs, the European Commission, and keep the Parliament informed.<sup>16</sup>

Moravcsik has used "supra-national institutionalism" and "intergovernmental institutionalism" to assess the developments that lead to the SEA.<sup>17</sup> Supranational factors have been defined as pressure from EC institutions, political entrepreneurship of the Commission and lobbying by transnational business groups. The "intergovernmental institutionalism" approach is more akin to the "modified structuralist view" of Robert Koehane.<sup>18</sup> It stresses the traditional concepts of national interests and power.

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16. *ibid*, pp.8-9.

17. Andrew Moravcsik, "Negotiating the Single European Act", International Organization, vol.45(1), Winter 1991, pp.19-56.

18. R.O. Koehane, After Hegemony (Princeton, Princeton University Press, 1984), pp.61-64.

The European Parliament was divided into two groups. The 'maximalist group' or the 'crocodile group' named after the Strasbourg restaurant where they first met, spearheaded by Altiero Spinelli advocated European Federalism. The second group of the 'minimalists', also called the 'kangaroo group' (due to the marsupials ability to hop over borders), were skeptical of federalism, and concentrated on the liberalization of the internal market. Their efforts were funded by eight sympathetic business interest's. The history of the negotiations points out to the victory of 'minimalists' to the exclusion of the 'maximalist' demands. The Parliament members protested against their exclusion from the 'real participation' and overwhelmingly passed a resolution that the SEA "in no way represents, the real reform of the community that our peoples need. According to Wise Dekker, the Chief Executive Director of Phillips, politicians had played a key role in the European integration of the 1950s, but in the 1980s, a similar stimulus was provided by European business. Viscount Etienne Davignon, the EC's internal market commissioner between 1976-1980, brought together a group of European information technology firms in 1981 to form the Thorn-Davignon Commission. In 1981, Peter Gyllenhammer (Chief Executive Officer, Volvo), and Dekker helped to found the Roundtable of European Industrialists comprising of Europe's largest MNCs. In February, 1984, UNICE, the leading EC

industrial interest group became active in promoting liberalization. Once SEA was adopted, the Roundtable formed a "watchdog" committee to press for implementation. Between autumn of 1984 and early 1985, Dekker's "Europa 1990" plan echoed many suggestions which found a place in the Delor's proposal to the European Parliament a few months later and in the White Paper of June 1985. What needs to be explained is, why did the governments listen to these proposals?

International political leaders, Cockfield and Delors have been congratulated for their political skills that lent a remarkable speed and decisiveness to the entire process. Nevertheless, it has been argued that the broad outlines were proposed, negotiated, and approved, often in advance of the Commission initiatives, by the heads of governments themselves.

**Political statecraft, rather than supranational variables have been regarded as decisive**<sup>19</sup> None of the three supranational variables seems to account for the "timing, content, and process of negotiating the SEA". In this sense, the negotiations for ECSC and SEA both seem to be strikingly similar, viz, commitment to European unity,

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19. Moravcsik, n.17, pp.47-48.



the convergence of national interests, the Pro-European idealism of the heads of government. European integration developed in fits and starts rather than incrementally. EC moved towards intergovernmental decision making rather than towards increasing substantially the authority of the supranational bodies. Even business at the supranational level, was emerging as a powerful lobby with the emergence of interstate consensus for reform. While it is true that like in the times of ECSC, neo-functionalism based on functions and the political will to attend to them is also witnessed in the negotiating history of the SEA; the historical prediction of neo-functionalism, namely, that over time, growth in the autonomy and responsibility of supranational actors and organizations will facilitate further integration, seems to be bereft of historical evidence.

We will now assess the importance of "inter-governmental institutionalism" in the negotiating history of SEA. This is characterised by intergovernmentalism, lowest common denominator bargaining, and the protection of sovereignty.

'Intergovernmental institutionalism', stresses the central importance of power and interests. It can be described by intergovernmentalism, lowest common denominator bargaining, and the protection of sovereignty.

Intergovernmentalism is represented in the EC when the Heads of State backed by a small group of ministers and advisors take major initiatives in the Council of Ministers. EC policies thus becomes a continuation of domestic politics by other means.<sup>20</sup> The absence of a "European hegemon", has given rise to interstate bargains that reflect the relative importance of various states. Small states can be bought off with side payments, but larger ones exercise a de facto veto over fundamental changes in the scope or rules. Bargains thus tend to converge towards the lowest common denominator of large state bargains. The bargains initially comprising of France and Germany are now trilateral agreements that include Britain.<sup>21</sup> The threat of exclusion can be effectively used under these circumstances. Two major states can isolate the third and threaten it with exclusion. If this threat undermines the substantive interests of the excluded state, then this may bring about an agreement at a level of integration above the lowest common denominator. The only major exception to the lowest common denominator bargaining concerned the issue of majority voting on internal market issues. Britain yielded to the Franco-German pressure to convene an intergovernmental conference due to the threat of exclusion. However, Thatcher succeeded in a

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20. Paul Taylor, Limits of European Integration (Beckenham, Croom Helm, 1983).

21. Helen Wallace, "Bilateral, Trilateral and Multilateral Negotiations in the European Community", in Roger Morgan and Caroline Bray, eds., Partners and Rivals in Western Europe : Britain, France and Germany (Aldershot, Gower, 1986), pp.156-74.

fundamental revision in the net obligation to the EC as well as in limiting institutional reform to internal market issues. Agriculture also represented the new balance of power. Intergovernmental institutionalism tends to protect the sovereignty of the constituent governments from getting eroded. The steady narrowing of institutional reform to the 'minimalist position' in which majority voting is restricted to internal market policy, the power of the Parliament is limited, and the future spill over to areas such as monetary policy is blocked, confirms the enduring pre-occupation of all the three major powers with maintaining their sovereignty.

Neofunctionalism remains the major attempt at conceptualising European integration. However the "supranational institutional" variant of neofunctionalism does not stand the scrutiny of historical evidence. The more relevant approach, i.e. the "intergovernmental institutional" approach is more relevant. It affirms that the primary source of integration lies in the interests of states and the relative power that each brings to Brussels.

### South East Asia

The Association of South East Asian Nations (ASEAN) came into being at a meeting of representatives from

Indonesia, Malaysia, Phillipines, Singapore, and Thailand in Bangkok in 1967. The main purpose of the new organization as laid down in the Bangkok declaration were: a) "to accelerate economic growth, social progress, and cultural development in the region", b) "to promote active collaboration and mutual assistance...in the economic, social, cultural, scientific, and administrative fields", and c) "to promote regional peace and stability."<sup>22</sup> Though regional peace and stability was on the agenda, ASEAN would not directly deal with security issues, and would steer clear or avoid controversial political issues.

In 1976, the Heads of Government met for the first time in Bali. Three major documents, reflecting the future course of action were signed here. Of these documents, the **Treaty of Amity and Cooperation** was the most significant. It emphasized the right to self determination and the obligation of non-interference, the settlement of disputes by peaceful means, and the renunciation of the threat of use of force. The institutional mechanism set up by the treaty was a major step in the peaceful settlement of disputes.<sup>23</sup>

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22. Michael Haas, ed., Basic Documents of Asian Regional Organizations (N.Y., Oceana Publications, 1974), pp.1269-71.

23. Yoga Jyotsna, "ASEAN - A Perspective", in Rama Melkote, ed., n.10, p.184.

Nearly a decade elapsed between the second summit in Kuala Lumpur and the third Summit in Manila (1986). In spite of this, the ongoing work of the Secretariat and various other committees under the supervision of the foreign ministers of ASEAN countries have led to laudatory appreciations of their work. We will concentrate briefly on three aspects of ASEAN: a) the importance of security considerations; b) the role of ASEAN as a regional player; and, c) progress in the field of economic cooperation.

Although ASEAN has not developed into a military alliance, **security** concerns formed an important part of the considerations to establish and perpetuate the ASEAN. This preoccupation with security concerns was reflected in the Kuala Lumpur declaration of ASEAN foreign ministers (1971), in the proposal of South East Asia as a zone of Peace, Freedom and Neutrality (ZOPFAN). The treaty of Amity and Cooperation also reaffirms the ZOPFAN proposal. The ZOPFAN proposal notwithstanding, ASEAN countries depended mainly on measures outside the ASEAN to promote regional and national security.

With the American withdrawal from Vietnam (1975) the ASEAN countries were faced with new security threats. The threats seemed to be even greater after the Vietnamese invasion of Cambodia and the fall of Pol Pot's Khmer Rouge (1978). ASEAN however, has not turned into a security

organization. Military topics are kept off the formal agenda of ASEAN Ministerial meetings. However, top officials have made use of these meetings to exchange views outside the formal discussions. ASEAN has openly backed an opposition coalition, and has recognized that coalition as the legitimate government of Cambodia. It has played a major role in negotiations with all four Cambodian parties. If tensions between ASEAN and the Communist States of Indochina come down, the prospects of peace, stability, security and development in South-East Asia may be enhanced.<sup>24</sup>

ASEAN has provided a channel for communication with the states with which it has the most extensive economic, and to a limited extent, security relationships. At the Second Summit in Kuala Lumpur (1977), the Prime Ministers of Japan, Australia and New Zealand had informal meetings with the Heads of State. This practice soon became a regular feature, though it has not been elaborately institutionalized. The foreign ministers of ASEAN's main "dialogue partners" - the US, Canada, Japan, Australis and New Zealand and an EC representative hold informal meeting after the ASEAN ministerial meetings. While economic issues tend to predominate, these meetings have also been used to fruitfully discuss developments in Vietnam and Cambodia.

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24. Norman D. Palmer, "The New Regionalism in Asia and the Pacific" (Massachusetts, Lexington Books, 1991), pp. 70-71.

ASEAN's dialogue partners are establishing joint business councils with the ASEAN. For example, in 1979, a Korea - ASEAN business clubs association was established. With the help of its "dialogue partners", ASEAN has established a relationship with the three continents. In the Asia - Pacific region it is developing its relations with other states such as South Korea and Papua New Guinea.

ASEAN has also associated itself with major international organizations. thus, ESCAP, ADB, GATT, UNCTAD and several other agencies of the UN system have begun to have links with ASEAN. After considerable hesitation and prolonged negotiations the ASEAN countries agreed to send representatives to the Conference on Asia - Pacific Economic cooperation, held in Canberra in early November 1989. This conference was convened to consider the proposal of a comprehensive official All Asia-Pacific economic cooperation.

Notwithstanding the proliferation of interregional contacts, cooperation among ASEAN states has been limited. These states are inclined to work through the ASEAN only to a limited degree. The principles agreed upon at Bali are worth noting:

" The right of every state to lead its national existence; free from external interference, subversion of coercion; noninterference in the

internal affairs of one another; settlement of differences or disputes by peaceful means; and the renunciation of threat or use of force."<sup>25</sup>

Although, peace within the region is stressed, nowhere is there an indication of an urge to transcend the state. The primacy of the state is stressed to the detriment of regional cooperation.

The success of ASEAN, stems not from intra-regional economic cooperation, but mainly from it having become an effective interlocutor for cooperation in economic matters and foreign affairs. ASEAN's intra-regional trade (18.6 per cent in 1990), is relatively high in comparison with other developing country regions. However, this is largely attributed to transshipment trade rather than the existing preferential arrangements<sup>26</sup> In 1987, out of a total of 12,783 items offered in the Preferential Trade Arrangement (PTA), only 337 were granted tariff preferences. Outward orientation varies from Singapore on the one hand, to Indonesia on the other. The share of Indonesia's exports to ASEAN under PTA rose from 1.4 per cent (\$25 million), to 3.5 per cent (\$84 million). The same figure for imports

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25. Alison Broinowski, ed., Understanding ASEAN (Hongkong, Macmillan, 1982), p.274.

26. Augusto de la Torre and M.R. Kelly, "Regional Trade Arrangements", Occasional Paper 93 (Washington D.C., IMF, March 1992), p.81.



ranged from 1.2 per cent (\$15 million) in 1986, to 1.6 per cent (\$28 million) in 1989.<sup>27</sup>

The ASEAN Industrial Joint Ventures (AIJV) introduced in 1983, and the ASEAN Industrial Complementation (AIC), established in 1981, were aimed at resource pooling and market sharing. At the Manila summit, the minimum ASEAN equity requirement for AIJV was reduced from 50 to 40 per cent for all applications received before December 1990. Eighteen products have so far received AIJV accreditation, and most of the AIJVs have a majority foreign equity participation. Lack of progress has resulted from inadequate promotion, bureaucratic delays and interstate differences about market sharing among ASEAN countries. In order to avoid the problems of market sharing inherent in the PTA and the AIJV, the AIC was set up with the aim of dividing different production stages of vertically integrated industries among different ASEAN countries. It is concerned almost exclusively with the automotive industry. Problems associated with this arrangement arose largely due to the preference of all member countries for locating the manufacture of parts with a higher value added

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27. M. Pangestu, H. Soesastro and M. Ahmad, "A New Look at Intra-ASEAN Economic Co-operation", ASEAN Economic Bulletin (Singapore, ASEAN Economic Research Unit, Institute of South East Asian Studies), vol.8(3), March 1992, p.336.

component within their own territories. Singapore, and Brunei did not join the scheme because they did not have an automotive industry, while Indonesia stayed out because it wanted to protect its automotive industry. Although Indonesia's non-participation has resulted in a smaller ASEAN market, there is a possibility that Indonesia may participate in 1992. Toyota's recent entry to the car makers' group of Volvo, Benz, Nissan and the DAF, is said to be associated with Indonesia's change of mood. The ASEAN economic ministers' meeting in October 1991 took the decision to include non-automotive parts in the Brand to Brand Complementation programme of the AIC.<sup>28</sup>

In the case of ASEAN, differences in economic philosophies and strategies of development constitute a major stumbling block to intra-regional trade liberalization. Too many exclusions to the PTA have reaffirmed the recurring perception about the ineffectiveness of ASEAN economic cooperation programmes. Addressing the Nineteenth Annual Meeting of Foreign Ministers of ASEAN countries in 1986, Mrs Aquino remarked:

After nineteen years of existence, ASEAN should already be evaluating the impact of regional economic cooperation; instead, it is endlessly discussing how to get off the ground...ASEAN has problems which...threatening to render meaningless our continual association.<sup>29</sup>

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28. *ibid*, pp.337-38.

29. Palmer, n.24, p.69.

## Other Developing Regions

Developing countries have typically viewed regionalism to be a means of promoting economic development and political stability in the region. It is also thought to enhance their bargaining power in multilateral fora. Views about the role of regional integration in various developing regions have been affected by historical circumstances, as well as, by different strategies for national development.

Movements towards regionalism in Latin America began in the 1950s. This led to the establishment of the Latin American Free Trade Agreement (LAFTA) and the Central American Common Market (CACM). Influenced by the Economic Commission for Latin America (ECLA), intraregional trade liberalization was regarded as a means to overcome the limits imposed by the small domestic market on the development strategy of import substitution. This philosophy was also reflected in the establishment of other regional arrangements like the Andean Pact and the Caribbean Community (CARICOM). Interest in regionalism declined in the mid 1970s owing to disappointing results and the debt crisis in the major Latin American group (LAFTA). The current upsurge of regionalism is characterized by more upward oriented strategies.

CACMs intraregional trade rose from 7.0 per cent of its total trade in 1960 to 25.7 in 1970, and then declined

appreciably to 10.2 per cent in 1986. It has stabilized to around 14 to 15 per cent between 1989 and 1990. In the Andean Pact, where oil exports influenced aggregate trade statistics, non oil intraregional trade more than trippled during the 1970s, with most of the increase accounted for by manufactured exports. Despite its weak implementation, LAFTA provided for a larger market for the expansion of manufactured exports within the region, and contributed to the diversification of exports. This was particularly true for Argentina, Brazil, and Mexico.<sup>30</sup>

Despite its problems, the CACM gave evidence of relatively better implementation of the regional strategy. The success has been attributed to the initially weak position of import competing sectors within the member countries. Intraregional trade was affected during the 1980s due to unsupportive national policies. Debt crisis and external imbalances lead to restrictions even on intraregional trade. The official exchange rates remained pegged closely to the US dollar. While the dollar appreciated with respect to these currencies, each CACM country simultaneously faced an overvalued regional currency. The depreciation of the currencies with respect to the dollar, and their appreciation with respect to each other reduced the competitiveness of the CACM exports. Intra-regional

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30. Torre and Kelly, n.28, pp.30-32.

trade among countries of the LAFTA was adversely affected by vested business interests. This was perhaps the main reason behind the slow product by product negotiation strategy. The Andean Pact proposed to set up mechanism for allocating new industries on a non-market basis. Conflicts of interests arose due to the unavailability of criteria acceptable to all, as well as , the problems of bureaucratization.<sup>31</sup>

Sub-Saharan Africa has the largest number of regional groupings in the world. Many of these are either dormant or dead, and have considerable overlapping of membership. They emphasized the need for collective economic self-reliance and security, with intra regional trade as a key mechanism to promote this. The Lagos Plan of Action (LPA) was launched by the Organization of African Unity (OAU) in 1980 with a view to providing a uniform framework. The Economic Community of West African States (ECOWAS), established in 1975, encompasses and broadens the memberships of the Economic Community of West Africa (CEAO) and the Manu River Union (MRU). Eastern and Southern Africa have had Preferential Trade Area(PTA) since 1984. In Central Africa, the Economic Community of Central African States(CEEAC) which is under negotiation plans to encompass and broaden the membership of the Customs and Economic Union of Central Africa(UDEAC) and the Economic Community of Great Lakes Countries (CEPGL).

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31. *ibid*, pp.32-35.

The South African Development Coordination Conference (SADCC), established in 1980, aims at reducing the economic dependence of the member country, particularly on South Africa. It emphasizes cooperation among members through specific projects rather than multi country agreements for promoting trade among members. The SADCC seeks to expand trade among members along the narrow lines of production covered by the SADCC-sponsored industrial programmes. With a GDP of \$25 billion, the regional grouping caters to 79 million people with an average per capita income of \$315.<sup>32</sup>

Rich in mineral resources such as copper, cobalt, chrome, diamond, silver and uranium, nearly all the member countries are heavily dependent on South Africa. Zimbabwe, the most industrialized country accounts for 80 per cent of the intraconference trade, deriving about 30 percent of the GDP from manufacturing. Six of the ten member states are landlocked, and transport and rail links to Mozambique ports have been severely affected by guerilla attacks, causing landlocked countries to depend on South African ports.

Regional groupings in Africa are typically characterized by low levels of intraregional trade (less than 5 per cent). This conceals the fact that such trade is important for some individual members. The failure of ECOWAS to promote intracommunity trade partly reflects the

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32. *ibid*, p.29.

economic diversity of its members. Its members ranged from Cote d' Ivoire (per capita income = \$790 in 1989) to Burkina Faso (per capita income = \$320 in 1989). Less developed members feared that they would not be adequately compensated by the Communities compensation fund. The SADCC has been fairly successful in achieving some of its objectives, though its dependence on South Africa has not been appreciably reduced. Projects with positive externalities for the region, such as transport and communication have been on the top of the list of priorities. Despite military activity around transport corridors, in 1990, 60 per cent of the trade of landlocked states moved through SADCC ports. The comparable figure in 1980 was only 20 per cent. Air links improved through greater cooperation among national carriers, the intraconference share in the total international telecommunication traffic rose to 15 per cent, and new crop strains from the SADCC research centre are now being widely used. Bulk of the SADCC sponsored projects are in the area of transport and tele communication (75 per cent), followed by food and agriculture (12 per cent), energy (8 per cent), and, mining in trade and industry.<sup>33</sup>

### III

#### LESSONS

The EEC, is an archetype of a well developed regionalism among industrial countries. The ASEAN

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33. *ibid*, p.29.

is among the success stories of regionalism in the developing world. Although, it is not as well developed as the EC, it is perhaps the most advanced regional formation in Asia. We have also taken a peep into Latin America and Africa. What do these unit level accounts reveal?

The inadequacy of supranational institutions to account for the negotiating history of the SEA, and the better explanatory power of the "intergovernmental institutionalism" variant of the neo-functional paradigm indicate that interests of states and the power that each brings to Brussels is at the root of regional integration. While it is true that neo-functionalism based on power and welfare helps us to understand the negotiating history of the SEA, the neo-functional prediction, that over time, the growth in the autonomy and responsibility of supranational actors and organizations will facilitate further integration, seems to be bereft of historical evidence. European integration thus developed in fits and starts rather than incrementally. Negotiations leading to the ECSC and the SEA therefore appear to be strikingly similar. Both were characterised by a commitment to European unity, convergence of national interest and the pro-European idealism of the heads of state.

Though Europe has witnessed growing economic interdependence through intraregional cooperation, ASEAN



does not give evidence of much progress in this direction. In the latter, the preponderance of sovereignty has come in the way of the development of intrerdependences as predicted by neo-functionalists. European Statism can be explained to some extent by relating power and welfare through the neo-functionalist argument, however, the ASEAN seems to be too preoccupied with Statism to allow functions to play their legitimate role and regional cooperation.

The threat perception of the ASEAN countries from Communist Indo-China has been a binding force through the decades. However, this did not turn the organization into a military one. This non-military solidarity of the non-Communist powers, in the absence of a hostile west endured and developed through the years. ASEAN's strength lies in the comprehensive institutional framework that has evolved over the decades. Its success stems mainly from it having become an active interlocutor for cooperation in economic matters and foreign affairs.

In Latin America, the findings of ECLA stimulated the growth of intraregional intercourse. CACM and the Andean Pact both registered appreciable rise in intraregional trade in the first decade of regionalism. Even LAFTA provided a large market for the manufactured goods of Brazil, Argentina and Mexico. The strategy of regionalism as means of introducing economies of scale for import substituting strategies seemed to be succeeding. However, advent of the

debt crisis and contradictory economic strategies, brought an end to this phase. In the current phase regionalism in Latin America is characterised by more outward oriented strategies. Though, numerous regional organizations have proliferated in Africa, these groupings have typically registered very little intraregional trade (less than 5 per cent). Problems of redistributing benefits among the developed and the less developed members of an organization have surfaced very often. The SADCC appears to be a novel experiment in developing country regionalism. By emphasizing on cooperation through projects that have positive externalities for the region, the SADCC has been able to circumvent many of the contradictions inherent in intraregional trade among developing countries. The main objective of minimizing contradictions and enhancing regional welfare have thus been well served.

In summary, developing country regionalism has suffered from the worsening of the external economic environment, powerful insular vested interests, and the problem of attending to the need for regional redistribution of resources among the more developed and less developed countries of a region. Even if we exclude the rich oil exporting countries of the Middle-East and the Newly Industrializing Countries of Asia, the share of intra regional trade in developing country regional groupings is in most cases less than the share of South-South trade in

the total trade of the South<sup>34</sup>. Though developing countries have woken up to the realization that regions are going to play an important role in the world political and economic order, there has so far been no substantial response to this change. In developing country regional organizations, form invariably tends to follow function.

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34. *ibid*, pp.31-32.

## CHAPTER IV

### SOUTH ASIAN REGIONALISM AN "INSIDE OUT" VIEW

#### I

#### EVOLUTION

We propose to view South Asian regionalism from the unit level, taking South Asian states as our units of analysis. This section is concerned with South Asian regionalism as it has evolved after the proposal made by the late President Zia-ur-Rahman (Bangladesh) in May 1980. This proposal was made after consultations between President Zia (of Bangladesh) and other South Asian leaders over a period of two to three years. While the proposal was promptly endorsed by Nepal, Sri Lanka, Maldives and Bhutan, both India and Pakistan had some reservations.

Mrs Indira Gandhi's government which had just come to power in India was sceptical about a proposal that had been worked out in consultation with the Janata Party - a rival political party now in opposition. There were fears in New Delhi that the neighbours would collectively try to isolate India on global issues and check her influence in dealing with bilateral and regional issues. The Bangladesh proposal's comparison between the proposed regional forum

and the ASEAN, was a source of concern due to the ASEAN's pro-West leaning. The Western support and approval behind the move, and the offer of financial support for regional cooperation to harness river water resources (1978), was also viewed with a certain degree of scepticism.<sup>1</sup>

Pakistan, on the other hand, had an erroneous perception that the move was prompted by India in an attempt to capture the regional market. There was hesitation about joining any kind of regional cooperation without resolving its most pressing bilateral problems with India. There was also an apprehension that a deeper involvement in South Asia could come in the way of developing a useful relationship with the South-West Asian region.<sup>2</sup>

Neither Pakistan nor India could outright reject the proposal. They sought instead to modify it in order to accommodate their respective apprehensions. The South Asian foreign ministers discussed the matter at the U.N. headquarters between August-September 1980. There emerged a consensus among the foreign ministers to have a meeting at the level of foreign secretaries which would prepare the

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1. S.D. Muni and Anuradha Muni, Regional Cooperation in South Asia (New Delhi, National Publishing House, 1984), p.31-32.

2. Ibid, p.33.

ground for a ministerial meeting and subsequently lead to a summit. Bilateral and politically controversial issues were to be excluded from the agenda of this meeting.<sup>3</sup>

Bangladesh circulated a draft paper in November 1980.<sup>4</sup> It made suggestions about the institutional and organizational aspects of cooperation. This draft paper became the basis for discussions at the first meeting of foreign secretaries held in Colombo between 21-23 April 1981. Three other such meetings were held in Kathmandu (November 1981), Islamabad (August 1982), and Dhaka (March 1983), before the first ministerial meeting could be held in August 1983 (New Delhi). The meetings of the foreign secretaries of South Asian countries did considerable groundwork in formulating the structure of the organization and identifying the areas of cooperation. This was reflected in the Delhi Declaration adopted at the meeting of the South Asian foreign ministers (1983). It restated the famous Five Principles of Peaceful Coexistence. These were "sovereign equality", "territorial integrity", "political independence", "non interference in the internal affairs of other states", and "mutual benefit". Two other functional principles were adopted. Decisions would be made on the

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3. Ibid, p.33.

4. The Tribune (Colombo), 2May 1981, p.2.

basis of unanimity, and, bilateral and contentious issues would be kept outside the purview of the newly announced organization - South Asian Regional Cooperation (SARC).<sup>5</sup> the Declaration on South Asian Regional Cooperation marked the end of the preparatory phase.

The SARC now needed the public endorsement of the Heads of State of the seven member countries. This historic event took place in Dhaka in December 1985. The South Asian Regional Cooperation (SARC) was renamed as the South Asian Association for Regional Cooperation (SAARC). The Dhaka summit accepted and approved the need for the establishment of a permanent secretariat and charged the foreign ministers to propose its location and organizational structure. In addition to the areas of cooperation already agreed upon (Agriculture, Rural Development, Meteorology and Health, and Population) the summit decided to attack the menace of terrorism and drug trafficking.<sup>6</sup>

After Dhaka, there have been summit meetings in Bangalore (1986), Kathmandu (1987), Islamabad (1988), Male (1990), and Colombo (1991). The fifth summit was to be held

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5. S.D. Muni and Anuradha Muni, n.1, p.194-198. The Delhi reproduced in these pages resembles the Charter of the South Asian Association for Regional Cooperation launched after the meeting of the Heads of State in Dhaka on 8th December, 1985.

6. R.P. Anand, South Asia in Search of Regional Identity (New Delhi, Banyan Publications, 1991), p.60.

in Colombo in 1989. However, owing to the tension between India and Sri Lanka over, the withdrawal of the Indian Peace Keeping Force, Sri Lanka refused to attend the meeting of the foreign ministers at Islamabad which was to act as a preparatory meeting before the Colombo summit. The cycle of holding an annual summit meeting of the heads of state as enshrined in the Charter was broken in 1989 (Article III, paragraph 1). The Sixth summit at Colombo had to be postponed after the King of Bhutan expressed his inability to attend the meeting as a result of domestic unrest. India asserted that under the principle of unanimity, there was no option but to cancel the show. Although, it was alleged that there was an Indian hand behind this disruption, Sri Lanka's own policies and its indifferent attitude towards the SAARC after the initial euphoria, contributed to the fiasco. Sri Lanka's publicly stated intention to join the ASEAN only to be rebuffed by Singapore; its refusal to attend the meeting of the SAARC Council of Foreign Ministers in Islamabad and the inability of Sri Lanka to hold the 1989 summit; and President Premadasa's disapproval of the 1990 summit held at Male; and, the expulsion of the All India Radio correspondent A. Karuppaswamy, are all likely to have contributed to the summit fiasco. Under these circumstances, an informal meeting of South Asian leaders was held in Colombo (November 1991). It proposed an amendment of the Charter provision that all leaders of South Asian countries must be present for the summit to materialize. Prime



Minister Nawaz Sharif also took this opportunity to raise the Kashmir issue.

A business-like one day summit was finally held in Colombo on 21 December 1991, six weeks after the November meeting of the SAARC Heads of State could not be legitimized as a SAARC summit owing to the non-availability of some leaders. Prime Minister Nawaz Sharif of Pakistan called it a "disruptive postponement."<sup>7</sup> The summit drew attention to the negative consequences of the emergence of the world's most developed economic regions as trading blocs. An inter-governmental group was asked to study the Sri Lankan proposal for the establishment of a SAARC Preferential Trade Agreement (SAPTA) by 1997. The Colombo Declaration also covered various issues such as terrorism, drug trafficking, environment, security of small states, establishment of a regional development fund, poverty alleviation and the welfare of women and children. Tourism<sup>8</sup> was added as the

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7. Gursharan Singh Dhanjal, "SAARC: On the Move?", Mainstream (New Delhi), Volume XXX(12), January 11, 1992, p.12.

8. The other twelve areas of the Integrated Programme of Action include agriculture; rural development; telecommunication; meteorology; health and population activities; transport; postal services; scientific and technological cooperation; sports, arts, and culture; women in development; prevention of drug trafficking and drug abuse; and education. The five additional ideas (adopted at the Bangalore summit, 1986) include, SAARC audio-visual exchange (SAVE), organized tourism with limited currency convertibility, SAARC documentation Centre, SAARC chairs, fellowships and scholarships, and the SAARC youth volunteer programme.

thirteenth area of the Integrated Programme of Action (IPA).

Although noble pledges and declarations have characterized the SAARC meetings, there is very little evidence of a regional approach to the task of promoting "the welfare of the peoples of SOUTH ASIA and to improve their quality of life"<sup>9</sup> (Article I of the SAARC Charter). With over a decade having elapsed since the late President Zia-ur-Rahman mooted the idea of SAARC, it will be useful to assess the characteristic features of SAARC. The political contradictions highlighted by the Indo-centric nature of South Asia, the systemic divergences of the political systems of South Asian states, and the external environment effecting the South Asian states will be brought up for discussion under the rubric of political factors. Both functionalism and neo-functionalism stress the need for forging cooperation in the core areas of regional cooperation such as trade, industry, monetary policy, etc. It has been argued, that such cooperation in an area lesser political salience helps to develop interdependences which have a "spill over" into areas of greater political salience. We wish to assess the level of cooperation in

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9. R.P. Anand, n.6, p.91.

trade, joint ventures, monetary policy, environment and natural resources. Last but not the least, South Asian leaders have noted at Colombo (1991) that the emergence of trading blocs may have a deleterious effect on South Asia. While the ASEAN and the EEC have been able to evolve some kind of a regional approach to dealing with the other regions, South Asia has not progressed very far in this endeavour. The nature of economic interaction between South Asia and the EEC, and, South Asia and the ASEAN, will help us to assess the need for an inter-regional strategy.

## II

### CHARACTERISTIC FEATURES OF SAARC

The South Asian Association for Regional Cooperation is still in the confidence building stage as "bilateral" and "contentious issues" are sought to be kept out of the SAARC agenda. India has been responsible for this provision. According to Prof. Muni:

"India has been particularly keen on this provision since the composition of the South Asian region is such that any bilateral issues (bilateral issues) would most likely involve India as one of the parties. As for contentious issues, debate on these in the SAARC forum can only vitiate the regional atmosphere without resolving the given controversies. Here again, most of the regional contentious issues are bilateral in nature."<sup>10</sup>

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10. S.D. Muni, "SAARC as an Approach to Mutual Confidence Building", SAARC Perspective (Kathmandu, SAARC Secretariat, 1988), vol. 2(4), p.20.

SAARC has adopted a cautious **step by step approach** as a way of building confidence among states in the region. The "minimum common denominator bargaining" is reflected in the **unanimity principle**. Any state, however big or small, can squash a move of the organization if it does not find it to be in its own interest. This cautious approach is also reflected in the excessive dependence of the SAARC's organizational structure on political leaders and bureaucrats.

Unlike many other regional formations, India has insisted that SAARC should not be one more **sponsored regionalism**. The exclusion "of external security sponsorship is almost a precondition for the viability and vitality of the SAARC".<sup>11</sup> While India wants to limit the involvement of extraregional powers, other countries have different perceptions. There is a tendency of the smaller South Asian countries to look for extraregional sources for balancing India within the region. Sri Lanka is a leading example of this trend. Apart from the nominal aid received from the EEC and the decision to establish contact and information with the ASEAN, there has been no interregional move of any consequence. While SAARC may be fairly immune from external

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11. S.D. Muni, "Geo-strategic Implications of SARC", in Sridhar Khatri, ed., Regional Security in South Asia (Kathmandu, Centre for Nepal and Asian Studies, Tribhuvan University, 1986), p.246.

dependence, the sections on trade cooperation and inter-regional cooperation will highlight the increasing dependence of individual South Asian countries (even India) on external sources of capital. This somewhat paradoxical situation may be corrected if South Asian countries decide to gainfully apply inter-regional strategies to negotiate with the rest of the world. However, regional solidarity and an overcautious approach being contradictory trends, the future does not augur well for regional solidarity.

Notwithstanding all its problems, SAARC has provided a regular forum for dialogue among political leaders. Moreover, informal talks have been useful supplements to formal meetings. They have helped to avoid misunderstandings arising from routine communication gaps. Thus, for example, President Zia visited India on 17 December 1985 after attending the First SAARC summit at Dhaka. The two leaders Zia-ul-Haq and Rajiv Gandhi resolved that neither country would attack the others nuclear installations. Similarly, the Bangalore summit provided the opportunity for Indian and Pakistani leaders to exchange notes on operation "Brass Tacks", a military exercise being carried out by India along the Indo-Pakistan border. The Bangalore summit also provided the occasion for the Indo-Sri Lanka talks on the devolution of power to the proposed Tamil areas in Sri Lanka. SAARC has thus provided opportunities to discuss

"bilateral and contentious issues" at an informal level.<sup>12</sup>  
It has exercised a benign influence on bilateral problems.

### III

#### POLITICAL FACTORS

It is very difficult to appreciate the dynamics behind the evolution of SAARC and its resulting characteristics without first trying to understand the intraregional and extraregional strategic considerations that impinge on the region. India's centrality and the legacies of partition play a major role in the formation of strategic perceptions in South Asia. To add to this, the political systems of various South Asian nations have developed in various ways. Pressure groups and lobbies articulate themselves through these diverse political systems. Last but not the least, regionalisms all over the world have been influenced by the external environment. South Asia is no exception. It will be useful to find out how a changed world order is likely to affect regionalism in South Asia.

#### Strategic Factors

India alone is larger than all other South Asian countries put together. It accounts for 76 per cent of the

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12. S.D. Muni, "India and the SAARC", The Journal (Kathmandu, Nepal Council of World Affairs), Souvenir Issue, December 1987, p.26-27.

population, 76 per cent of the GDP, 79 per cent of the value added in manufactures, 80 per cent of the total exports, and 60 per cent of the total imports.<sup>13</sup> It shares boundaries with virtually all the South Asian states. Being a relatively large country with the capacity to wield power, India has believed in relative autonomy for the region. On the other hand, other South Asian states whose bilateral problems such as the settlement of boundary disputes, the sharing of river waters, ethnic unrest, trade and transit, refugees, etc., are mostly with India, have spared no pains to reduce their vulnerability vis-a-vis India by bringing in "outside has preferred to keep South Asia away from the influence of extra regional factors. Itequalisers."

Ever since independence, **Pakistan** has opposed an Indian inspired regional security framework by enlisting the support of the United States since the heydays of the Cold War. India, on the other hand, strengthened its relations with the Soviet Union after negotiating a "Treaty of Friendship and Cooperation" (1971). While the USA was attempting to check the growth of communism, USSR was happy to find a reliable friend. It allowed India to play a

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13. Rehman Sobhan, "The Economic Background", in Bimal Prasad, ed., Regional Cooperation in South Asia: Problem and Prospects (New Delhi, Vikas, 1989), p.89.

fairly autonomous role in the region.<sup>14</sup> After Bangladesh's war of liberation and India's implosion of a "peaceful nuclear device", Pakistan noted India's growing influence with a degree of concern. The Indira doctrine (1983), was taken to be a formal statement of India's quest to bring all its neighbours within its security parameter.<sup>15</sup> The problem in Kashmir, the memories of Pakistan's partition, and the abetting of terrorists (despite SAARC proclamations to check the menace) have added up to a fairly strained bilateral relationship between India and Pakistan. The Cold War being over, the Indo-Pakistan rivalry continues.

India's humiliating experience with China (1962) had brought in the China factor as a major consideration in India's strategic planning. Indo-China relations seem to be improving in the post Cold War scenario. The upturn began after Rajiv Gandhi's China visit (1988). The recent visits

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14. Mohammed Ayoob, "India as a regional hegemon: external opportunities and internal constraints", International Journal (Canadian Institute of International Affairs), vol.XLVI(3), Summer 1991, p.429.
  15. Pervaiz Iqbal Cheema, "Security in South Asia: An approach", South Asia Journal (New Delhi, Indian Council of South Asian Cooperation), vol.4(3), January-March 1991, p. 286-287. the India doctrine has been quoted as: "India will neither intervene in the domestic affairs of any states in the region, unless requested to do so, nor tolerate such intervention by an outside power, if external assistance is needed to meet an internal crisis, states should first look within the region for help."



of Premier Li Peng and President Venkataraman seem to indicate that the worst period is over. India, however, cannot help worrying about the China-Pakistan nuclear collaboration, as well as reports about China's supply of M-11 missiles to Pakistan (capable of carrying nuclear and chemical weapons).<sup>16</sup>

The end of the Cold War has changed the nature of superpower involvement in South Asia. Between the option of an independent Nehruvian course and joining the Pax-Americana, India seems to have opted for the latter due to the changed Soviet perceptions about strategic cooperation with India.<sup>17</sup> As a result, Indo-U.S. ties have been warming since the 1980s. In 1984, the United States observed that despite India's unwillingness to condemn the Soviet invasion of Afghanistan, India remained a barrier to the spread of communism. On 11 October 1984, in a secret directive, President Reagan instructed all government agencies "to seek improved relations with India and accommodate Indian requests for dual use technology".<sup>18</sup> The 1986 decision to allow India to buy the General Electric F-404 jet engines for its Light-Combat Aircraft (LCA); the 1987 decision to sell India a Cray XMP-14 supercomputer for meteorological forecasting; the 1988 decision to supply

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16. S.D. Muni, "India And The Post-Cold War World", Asian Survey(University of California), vol.XXXI(9), September 1991, p.870.

17. Ibid.,p.865.

18. Aziz Hanifa, "Still friends, US assures India", India Abroad, 1 March 1991, p.7.

India with advanced ring laser gyroscopes for use in the LCA; and the 1990 Presidential approval for the sale of a second Cray supercomputer to the Indian Institute of Science (Bangalore); all point towards the change of mood. Similarly, the benign U.S.' reaction to the role played by India in crushing the coup in Maldives (1988); the deployment of the Indian Peace Keeping Force following the Indo-Sri Lanka Accord of 1987; the strong U.S. support for the \$1.8 billion IMF credit cleared in record time (19 January 1991); the joint Indo-U.S. naval exercise (May 1992) notwithstanding the Indo-U.S. differences over the sale of Russian cryogenic engines to India; and attempts to thrash out Indo-U.S. differences over the question of nuclear proliferation in South Asia, also point in the same direction.

These accommodative gestures have inevitably increased U.S. leverage over India. The refuelling of U.S. military transport aircraft between 9 January 1991 and 20 February 1991 enroute to the Gulf War is a case in point. India's heavy dependence on credit from financial institutions where the U.S. still wields the maximum clout is likely to increase this leverage. This may have a negative effect on India's traditional image of a champion of the South against the injustices perpetrated by the developed North.

The Pakistani refusal to accept India's security framework was successful largely due to U.S. support. The degree to which Pakistan could succeed depended on the nature of Soviet-American relations, and the U.S. perception about Pakistan's ability to counter local threats. The end of the Cold War and the Russian withdrawal from Afghanistan has resulted in a reduction in Pakistan strategic importance to the U.S. In 1990, President Bush refused to certify that Pakistan was using its nuclear facilities for peaceful ends alone. Early in 1991, the administration decided to slash the notional aid to Pakistan. Pakistan's reduced leverage at the end of the Cold War almost coincided with the upturn in Indo-American relations. While Pakistan has the capacity to insulate itself from an India dominated region fairly successfully, its capacity to act as an alternative pole encouraging other small states to defy India's wishes may be drastically reduced if the U.S. strategic interest in Pakistan gets weakened.<sup>19</sup>

The Sri Lankan scholar Shelton Kodikara has made an assessment of the Indo-Pakistan power struggle at the end of the Cold War. According to him:

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19. Mohammed Ayub, n.19, p.434-35

As regards the rest of South Asia, apart from India and Pakistan, what the current changes imply is that they will be in a position of greater dependence on the regional Big Power, India, than they were in the past, and that the diminution of Super Power rivalries on the subcontinent as well as the Indian Ocean area will leave India to pursue its own hegemonic goals in the region.<sup>20</sup>

Whether or not the end of the Cold War will lead to a greater autonomy for India, only time can tell. What is clear, however, is that the end of the cold war, eventhough it has not had any noticeable effect on bilateral problems between India and Pakistan, may be said to have changed the nature of superpower involvement in South Asia.

The future of regional cooperation depends on a certain level of mutual understanding among participating sovereign nations. When apprehensions about each others intentions abound in a hostile regional atmosphere, regional cooperation cannot take off in any substantial way. Regional cooperation through the SAARC is inhibited by the contradictions inherent in the Indo-Pakistan relationship. Unless these contradictions are amicably resolved, the "take care of yourself" imperative of international politics will impede the regional imperative "to specialize" in a mutually

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20. Shelton U. Kodikara, "The International Environment and the Indo-Pakistan Power Struggle in 1990s: A View from Sri Lanka", South Asia Journal (New Delhi, Indian Council of South Asian Cooperation), vol.4(2), October-December 1990.

beneficial way by allowing for the growth of interdependences. In South Asia, the former takes precedence over the latter.

### Divergence of Political Systems

South Asia has witnessed the growth of a variety of political systems. India, Sri Lanka and Maldives have practised various shades of democracy. Pakistan and Bangladesh have alternated between democratic rule and praetorian rule. Nepal has alternated between monarchy and democracy. Bhutan continues to be ruled by a monarch from Thimpu. The nature and stability of political systems in South Asia have the potential to impede the growth of intraregional cooperation.

India, Sri Lanka and Maldives are South Asian countries where democracy has endured. The Congress Party had a virtual monopoly over state power in India until 1977. However, emergency provisions clamped in August 1975, severely curbed the rights of the Indian citizen. The post emergency election in 1977 saw the first peaceful transfer of power to a non-Congress government in India. Ever since, the alternation of Congress and non-Congress governments has become a regular feature. Sri Lanka shifted from a parliamentary system with a collectively responsible

TABLE 1. EVOLUTION OF POLITICAL SYSTEMS IN SOUTH ASIAN COUNTRIES (1947-92)<sup>21</sup>

Country	1947-55	1956-65	1961-65	1966-70	1971-75	1976-80	1981-85	1986-92
India	Constitution and parli- democracy.	Democracy	Democracy	Democracy	Emergency proclaimed.	Emergency withdrawn (1977). First transition to non Congress government.	Democracy	Democracy
Pakistan	Unstable civilian government.	Military rule (1958)	Basic democracy (1962) and elections (1965).	First popular election 1970.	Democracy (P.P.P. government).	Military rule re- established (1977).	National referendum to legiti- mise military rule.	Civilian rule with strong military say (1986).
Bangladesh	-	-	-	-	Democracy & Awami League Govt. (1972-75).	Military rule.	Referendum to legiti- mise military rule.	Military rule replaced by B.N.P. govt.
Nepal	Rana rule overthrown. Democracy initiated by the King.	Parliamen- tary govt. established under the (1959) and dismissed (1960).	Panchayat system Kings tutelage (1962).	Panchayat	Panchayat	National referendum to legiti- mise the Panchayat.	Panchayat	Panchayat collapsed (Feb.-April 1990) Multi- party democracy revived.
Sri Lanka	Constitution and parli- mentary democracy.	Democracy	Democracy	Democracy	Elected govt. extended upto 1972.	Democracy	Presiden- tial system 1982. Erosion of democratic institutions.	Presidential system.
Bhutan	Monarchy	Monarchy Democratic govt. suppressed, parties outlawed.	Monarchy	Monarchy	Monarchy	Monarchy	Monarchy	Monarchy. Political unrest.

21. Adapted from S.D. Muni, "Patterns of Democracy in South Asia", *International Social Science Journal*, vol.128, May 1991, p.370.

executive to an all powerful executive Presidency in 1982. This seems to have enhanced the scope of authoritarian elements.<sup>22</sup> Maldives is governed by an all powerful executive President elected directly by the people for a period of five years.

Pakistan, Nepal and Bangladesh have alternated between civilian rule and authoritarianism. After an unstable run of civilian rule between 1947-1958, Pakistan came under military rule. The "Basic Democracies" movement towards guided political participation (1962), was an attempt to legitimize the military. However, Bhutto's democratic government (1972-77), the imposition of "Martial Law" under General Zia, and the present government of Nawaz Sharif have lent a degree of uncertainty to democratic practice in At all times, the military wants to reign supreme, and any attempt to clip its wings results in a change of government. The elements of praetorianism pervade through the facade of civilian rule. The Nepalese polity has alternated between monarchy and democracy. The Panchayat system was an attempt to legitimize the monarchy. Democracy in Nepal has been restored after April 1990. The centrist

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22. *ibid*, p.364.

government of the Nepali Congress faced a keen electoral contest from the left parties. Having inherited the pre-partition legacies, Bangladesh's polity has also alternated between civilian and praetorian rule. The military continues to be a potent force in this country. Bhutan, has so far not been affected by the democratic functioning of her South Asian neighbours. Despite the suppression of popular pressures for democracy in the early 1950s, the Buddhist Kingdom of Bhutan has been quiet and peaceful. Recently, however, there seems to have emerged a contradiction between the preservation of a national identity (Bhutanese/Drukpa) and the urge of the Nepali population to assert itself as a result of its being a very large minority community. The King of Bhutan could not visit Colombo for the SAARC summit in November 1991. Domestic unrest, was cited as the reason for his inability to attend this important meeting.

The power of the military in Pakistan has contributed to the tension between India and Pakistan. The death of Mujib and the rise in the importance of the military in Bangladesh has also had a negative impact on Indo-Bangla relations since the mid 1970s. Another feature, the growth of Islamic fundamentalism in Pakistan and Bangladesh is also likely to sharpen the contradiction between Islamic



fundamentalism on the one hand, and the practice of secularism on the other. Yet, democracy alone is not sufficient to ensure political stability against regional, linguistic, ethnic, and other sectional divides which get exacerbated by political competition among different elite groups in a democracy. It is essential, therefore, to stimulate the elements of stability and responsiveness in the political systems of South Asian countries.

#### IV

#### REGIONAL COOPERATION

South Asia covers 3.5 per cent of the earth's landmass and feeds 20 per cent of the world's population. It contributes only 2 per cent to the world's total gross national product (GNP).<sup>23</sup> With a per capita income less than U.S. \$450, all the SAARC countries belong to the 41 low income countries of the world. The skewed pattern of income distribution results in a high incidence of absolute poverty and deprivation. While the average life expectancy at birth has crossed the 75 years mark in western countries, the same

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23. "SAARC Regional Study on Trade, Manufactures and Services," in the Report of the Second Meeting of Coordinators for Finalizing the Regional Study on Trade, Manufactures and Services (New Delhi, June 1991), p.12.

figure for South Asia is 56 years.<sup>24</sup> The share of agriculture in the gross domestic product (GDP) has gone down in all South Asian countries, yet South Asian economies continue to depend heavily on this sector.

South Asia presents the picture of a poor Asian region in need of economic development and social welfare. The politico-strategic constraints in South Asia have been an enduring obstacle in the path of regional cooperation. Notwithstanding these politico-strategic constraints, we wish to investigate the level of regional cooperation in South Asia.

### Intraregional Cooperation

#### a) Trade and Balance of Payments

Competitiveness in international trade is inevitably related to the level of economic development of a country. The SAARC countries generate 0.8 per cent of the world's exports and consume 1.3 per cent of the global imports. The smaller South Asian countries are more heavily dependent on international trade. Thus, while the share of trade in GDP for India is 15.6 per cent, the same figure is much higher for the smaller South Asian countries like Maldives (90.16 per cent), Sri Lanka (58 per cent), Bhutan (52.08 per cent),

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24. Figures have been estimated from: World Development Report 1991 (New York, Oxford University Press, 1991), p.204. The life expectancy figure for Maldives was not available.

Pakistan (34.9 per cent), Nepal (28.4 per cent) and Bangladesh (21.8 per cent).<sup>25</sup>

The share of manufactured products in the total exports of South Asian countries is more than two-third for all countries except Sri Lanka. However, the bulk of the manufactured exports is made up of textiles and clothing. India is the only exception whose manufactured exports other than textiles and clothing account for 48 per cent of its total exports. Manufactured imports also account for more than half of the total imports of South Asian countries. The machinery and transport equipment component of manufactured exports comprise of 20 per cent to 30 per cent of the total import bill of South Asian countries.<sup>26</sup>

Table 2 provides us the external dependence scenario of six South Asian countries, namely Bangladesh, Nepal, India, Pakistan, Sri Lanka and Bhutan. Section A demonstrates how the negative current account balance has deteriorated over a period of nearly two decades. Section B gives us an idea of the magnitude of this imbalance in relation to a country's GDP. While the magnitude of the negative current account balance is the highest for India, in terms of a proportion

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25. SAARC Regional Study on Trade, Manufactures and Services, n.29, p.15-16.

26. Ibid, p.17-18.

TABLE 2, BALANCE OF PAYMENTS AND FOREIGN ASSISTANCE.

Country	(A) Current Account Balance Before Official Trans- fers (in millions of US \$)		(B) Current Account Balance as a percent of GDP		(C) Official Deve- lopment Assis- tance (1989)  Net Dis- Per burse- capita ment (\$) (million \$).		(D) Official Develop- ment Assistance as a per cent of GNP. (1989)
	1970	1989	1988	1989			
Bangladesh	(-)234 <sup>a</sup>	(-)1402	(-) 5.7	(-) 6.9	1791	16.2	8.9
Nepal	(-) 25 <sup>a</sup>	(-) 308	(-) 8.8	(-)10.96	488	26.5	16.0
India	(-)590 <sup>a</sup>	(-)8038 <sup>a</sup>	(-) 3.0	(-) 3.41	1874	2.3	0.7
Pakistan	(-)705	(-)1943	(-) 4.9	(-) 5.42	1119	10.2	2.8
Sri Lanka	(-) 71	(-) 546 <sup>a</sup>	(-) 9.5	(-) 8.61	558	33.2	7.9
Bhutan	-	(-) 66 <sup>a</sup>	-	(-)23.5	40	28.5	-

Source: Estimated from World Development Report 1990  
and World Development Report 1991.

a: figures estimated by World Bank

of the GDP, the Indian imbalance seems to be the least. Section B also reveals that with the exception of Sri Lanka, the negative current account balance for all South Asian countries has grown within the one year period between 1988 and 1989. Official Development Assistance (ODA) helps to finance the deficits. While the magnitude of the ODA received by India is the highest, Section C tells us that in per capita terms the Indian figure of \$2.3 is much lower than the other countries. Last but not the least, ODA as a percentage of a nations GNP, can also be taken as a measure of dependence. The Indian figure of 0.7 per cent is clearly much less than all other South Asian countries. Though, the Indian dependence on external finance has grown considerably over the period between 1970 and 1989, the Indian economy still emerges as a relatively less dependent one.

The growing deficit in the current account of South Asian countries is being financed through external assistance. A reduction in the external assistance of a tied nature and an increased financing of imports through export earnings and workers remittances will not only make the South Asian countries less dependent, but may also have the effect of checking the trade diversion away from South Asian countries.

The increasing dependence on external finance and the evolution of SAARC since 1985 has not had any positive

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effect on intraregional trade in South Asia. Between 1985 and 1990 intra-South Asian trade as a percentage of the world trade of South Asian countries has varied between 2.49 per cent and 2.67 per cent. Between 1980 and 1990, the share of intraregional exports as a percentage of the total exports of South Asian countries came down from 4.49 per cent to 3.24 per cent. Intra-regional imports constituted about 2 per cent of the global imports of South Asian countries. No significant trend is noticeable between 1980 and 1990. Apart from Nepal, the intraregional imports and the intraregional exports of no other South Asian country accounted for more than 10 per cent of its global imports and exports respectively.<sup>27</sup> Although, South Asia has not yet witnessed economic integration, intra-trade of most regional groupings among the countries of the South declined during the period of debt crisis.

The major trade inhibiting factor is the trade restricting policies of South Asian countries. Intra-SAARC trade is characterized by high nominal tariffs and a variety of non-tariff barriers such as quantitative restrictions, fiscal charges, and discriminatory practices. An Asian Development Bank study based on UNCTAD source reveals that

27. I.N. Mukherji, Regional Trade, Investment and Economic Cooperation among South Asian countries (New Delhi, Centre for South, Central, Southeast Asian and Southwest Pacific Studies, JNU, January 1992), pp.4-6.



the average ad valorem tariff rate was 80.6 per cent in Pakistan, 74.7 per cent in Bangladesh, 71.5 per cent in India and 41.2 per cent in Sri Lanka during the period 1980-84.<sup>28</sup> In addition to the customs duty, imports were subjected to various kinds of defence surcharges, import license fee, business turnover tax, auxiliary and additional (countervailing) duty, sales tax, etc., in Bangladesh, India, Pakistan and Sri Lanka.<sup>29</sup>

In addition to tariff barriers, non tariff barriers abound in South Asia. Bangladesh has banned the entry of 172 products, some of whom are of export interest to South Asian countries. Bangladesh, India and Sri Lanka have also imposed for an import quota for many such products. Pakistan has banned entry of some products, applied quantitative restrictions on some, while others are canalized through the Trading Corporation of Pakistan. Until July 1982, private traders in Pakistan were not allowed to trade with their Indian counterparts. Thereafter, Pakistani traders could trade in 42 specified items through the Trading Corporation of Pakistan. It was only after 1986

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28. De Rosa Dean A., "Trade and Protection in the Asian Developing Region", Asian Development Review, vol.4(1), 1986, p.27-62.
29. I.N. Mukherji, "Regional Synthesis", in V. Kanesalingam and A.R. Kemal, eds., Trade Expansion in South Asia (Delhi, Macmillan, 1990), p.130-171.

(after Pakistan's Minister of Planning and India's Finance Minister exchanged visits to India and Pakistan respectively) that Pakistan's traders were allowed to have direct dealings with their Indian counterparts. Further, in April 1988, the list of items which Pakistan's private sector was allowed to import from India was increased from 42 to 249. In July 1988, Pakistan's import policy was further liberalized with respect to India to include raw materials and intermediate goods. Notwithstanding all these developments, India is still not permitted to supply finished manufactured goods even at competitive prices.<sup>30</sup>

We have already noted the increased dependence of the region on external finance. Between 40 per cent and 75 per cent of South Asian imports were being financed from external sources which are generally tied.<sup>31</sup> Borrowing countries are left with very little choice in importing the commodities from the countries of their choice. The lack of adequate export finance and credit arrangements in comparison to comparable facilities provided by industrial countries further constrains intraregional trade. Poor banking and commercial links further constrain the

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30. I.N. Mukherji, n.27, p.8-9.

31. SAARC Regional Study on Trade, Manufactures and Services, n.23,p.55.



mobilization of whatever resources are available inside the region. In spite of the geographical contiguity, the lack of transport links resulting in fragmented transportation, as well as unfavourable freight rates, only add to the problems. Moreover, the lack of quality control, inadequate after sales service, and the lack of uniform standards are a common feature.

Most South Asian countries being primary producers tend to export similar products. An examination of the top ten principal exports of South Asian countries during 1980-85 reveal the importance of marine products in the exports of Bangladesh, India and Sri Lanka; jute manufacturers for Bangladesh, India and Nepal; leather products for Bangladesh, India, Nepal and Pakistan; and cotton and cotton fabrics for India, Bangladesh, Pakistan and Sri Lanka.<sup>32</sup>

Products like tea and coffee, cotton and textiles, natural rubber, iron and steel, medicines pharmaceuticals and agro chemicals, etc., can be fruitfully traded within the region. Unfortunately however, the cosine measures of trade complementarity are not very favourable for bilateral pairs of most South Asian countries. A situation of partial complementarity however obtains between India-Pakistan and India-Sri Lanka trade. India's exports match fairly well with

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32. I.N. Mukherji, n.27, p.8.

Pakistan's and Sri Lanka's imports though the converse is not true.<sup>33</sup> Thus, while the possibilities of sustained trade expansion are limited due to the poor complimentarities, the partial complementarities that exist could induce unilateral trade flows in favour of India.<sup>34</sup> Hence, India's economic size and diversification are such that most South Asian countries prefer dependence on external sources at a greater cost to the free flow of intraregional trade which may make them dependent on India.

**b) Joint Ventures (JVs)**

Joint ventures may be a good medium of generating planned complimentarities in order to expand and diversify the production base and trade structure of South Asian countries through regional import substitution. Further, JVs with buy back arrangements with the home country can help to correct the perennial bilateral trade imbalances which may emerge due to limited exportable commodities of the host countries.

Studies have revealed that JVs could be introduced in production areas such as fertilizers, milk (and cream preserved), durum wheat unmilled, vegetable oils,

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33. Ibid, p.13.

34. Ibid, p.21-22.

medicaments, cement, machinery, marketing and procurement.<sup>35</sup> These are areas which contribute to the South Asian dependence on external finance. Export similarity of South Asian countries often leads to undercutting of prices and products in export markets. Such competitive situations can be transformed into mutually beneficial joint marketing strategies through JVs in marketing. Similarly, there is also considerable import similarity among South Asian countries. Joint imports through a consortium of State Trading Organizations (STOs) could obtain better terms for South Asian countries.

Despite these well known advantages, intraregional JVs have not prospered in South Asia. In December 1988, there were 152 Indian JVs in operation. Only 24 of these were in South Asian countries (Only 8.5 per cent of total equity was in South Asian countries).<sup>36</sup>

### c) Monetary Cooperation

We have noted that the expansion of intraregional trade is constrained by the lack of credit arrangements. The emergence of the Asian Clearing Union (ACU) in December 1974 at the initiative of the Economic and Social Commission for the Asia and the Pacific (ESCAP) was a significant

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35. Ibid, p.26-30.

36. Ibid, p.23.

development. The Central Banks of India, Bangladesh, Iran, Nepal, Pakistan and Sri Lanka were the original participants. The ACU commenced operations from November 1975, and Burma joined it in 1977. Five of the seven countries of ACU are from South Asia.

The main objectives of ACU are: a) to promote a facility to settle, on a multilateral basis payments for current international transactions among territories of the participants; b) to promote the use of participants currencies in current transactions between their respective territories and thereby effect economies in the use of the participants exchange reserves; and c) to promote monetary cooperation among the participants and closer relations among the banking systems in their territories and thereby contribute to the expansion of trade and economic activity among the countries of the region.<sup>37</sup>

Between 1980 and 1990 the value of transactions channelled through the ACU increased from 140,560 Asian Monetary Units (AMUs) to 1,007,182 AMUs. While in 1980, 50.2 per cent of this volume was settled in foreign exchange, in 1990, this figure came down to 30.6 per cent.<sup>38</sup> Not only did the total value of transaction increase over the decade,

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37. These principles are found in ESCAP, Agreement Establishing Asian Clearing Union, Article II.

38. I.N. Mukherji, n.27, p.32. These figures have been located from Table 8 on the page mentioned above.

the dependence on foreign currency and international funding was also curbed. Moreover, it is possible that the actual volume of transactions is even larger as some of the dealings are settled by authorized dealers. After Iran granted permission to include oil within the facility (1984), there was a substantial increase in the value of transactions credited by its Central Bank (particularly since 1986). This increased the proportion of transactions cleared within the agreement as a whole.

An ACU Swap Arrangement was introduced for September-October 1989 settlement period. Bangladesh availed itself of the swap facility for an amount of AMUs 21.2 million. In 1990, the Bangladesh Bank, the Reserve Bank of India, and the State Bank of Pakistan availed of the swap facility of AMUs 23.1 million, 30 million and 2.1 million respectively. This swap facility was able to provide temporary credit for intraregional trade payments resulting in the increased volume of trade among the member countries.<sup>39</sup>

**d) Natural Resources and Environment**

Water resources represent the rich hydraulic heritage of South Asia. Nepal alone has a hydropower potential of 83,000 megawatts, of which 30, 000 megawatts can be

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39. Ibid, p.35.

generated economically. Only 0.5 per cent of this capacity is exploited. India, Pakistan and Bangladesh exploit approximately 20 per cent, 10 per cent, and 10 per cent respectively, of their potential hydropower.<sup>40</sup> After years of impasse, India and Nepal have agreed to go ahead with the Karnali and Pancheshwar multipurpose projects, the Kosi-Bhimpur barrage, the Baghmata-Kamla scheme, the Subta-Kosi high dam and the Burhi Gandak project, besides other flood warning and protection works.<sup>41</sup> Indo-Nepalese cooperation in the field of hydropower generation is the first step in the direction of a regional approach to managing the natural resources of South Asia.

India has emerged as a major nation in the area of providing data on natural resources from the earth-orbiting satellites. There is a growing interest among South Asian countries in the area of developing an integrated geographic information system (GIS) based on a combination of economic and social data with the information available from satellite imagery. The GIS could be used to assess climatic changes over a particular area. India is making efforts to

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40. W.R.H. Perera, Perspectives for the Development of Himalayan Resources (Colombo, Marga Institute, 1984), p.22-26.

41. Times of India, New Delhi, December 6, 1991.

provide such information to user agencies through the five regional remote sensing service centres throughout the country. The United Nation's Food and Agriculture Organization has already prepared a vegetation map of South Asia and continental South East Asia.

Degradation of the environment is a source of common concern for all South Asian countries. South Asia inherited not only underdeveloped economies but also the legacy of a high rate of natural resource exploitation from the colonial rulers. The computerized GIS based on remote sensing data is being used to prepare the Mountain Environment and Natural Resource Information System established by the International Centre for Integrated Mountain Development at Kathmandu in Nepal. Bangladesh, China, Indonesia, Pakistan, Malaysia and India are using GIS technology for assessing the state of the environmental problems in the respective countries.<sup>42</sup>

The wanton exploitation of natural resources and the degradation of the South Asian environment may have a high degree of correlation if South Asian countries continue their fragmented approach motivated only by their immediate developmental problems. The earths environment has no political borders. Deforestation in Nepal can cause flash floods in the Gangetic basin. Untreated municipal and

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42. Times of India, New Delhi, December 28, 1991.

industrial wastes of the Ganges can intensify water pollution in the lower region of Bangladesh. Multipurpose development of Himalayan water resource is possible only by countries sharing common Himalayan watersheds. A regional approach to the environment policy is therefore necessary to check the large scale degradation of the South Asian environment.

In July 1988, a group of experts exchanged views on country-wise concerns and discussed in depth the objectives, the terms of reference, methodology, funding, and the time frame of a study on environmental problems in South Asia. At the SAARC Summit in Kathmandu (November 1987), the Heads of State expressed their deep concern at the fast and continuing degradation of the environment, including the extensive destruction of forests in the region. However, the problematic of the South Asian environmental protection has so far only, attracted the attention of scholars, bureaucrats and politicians at the level of seminars, discussions and pledges. There is little evidence to show that any bold steps have been taken for forging regional cooperation in this area.

### Interegional Cooperation

#### a) SAARC-EEC Cooperation

We have noted the growing importance of the EEC as an economic power. EC exports to the developing countries



account for one-third of the EC's global exports which in value terms is higher than EC's exports to the USA or to Japan.<sup>43</sup> Moreover, the EC has preferential agreements with 68 Lome convention countries and has signed commercial and cooperation agreements and special sectoral trade agreements (e.g. textiles) with several other countries including some SAARC countries. The EC-12 is the largest donor of Official Development Assistance (ODA) in the world. Out of every \$100 in aid to developing countries, \$36 are from the EC-12. In 1988, India was the largest recipient of net ODA (\$674 million) among South Asian countries, followed by Bangladesh (\$316 million), Pakistan (\$227 million), and Nepal (\$150 million).<sup>44</sup>

The EC is a significant trading partner of the SAARC countries. In 1989, the EC absorbed 22 per cent of South Asia's (excluding Bhutan) exports in value terms.<sup>45</sup> Moreover, of all the imports entering the SAARC countries (excluding Bhutan), the EC's share was 21.5 per cent.<sup>46</sup> While the EC is a major trading partner of the SAARC

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43. Charan D. Wadhwa, "SAARC Countries and the European Community ...", South Asia Journal (New Delhi, Indian Council for South Asian Cooperation), vol.5(1), July-September 1991, p.20.

44. Ibid, p.41.

45. Ibid, p.21. See Table 1.

46. Ibid, p.23.

countries, the converse is not true. EC's exports to the SAARC constituted merely 0.9 per cent of the EC's global exports. Of this share, 75 per cent came to India. While EC exports to developing countries accounted for 15.5 per cent of its global exports in 1989, the South Asian countries' share was only 5.8 per cent. A similar situation prevails when we look at EC imports, EC imports from the SAARC countries was merely 3.7 per cent of its imports from all developing countries.<sup>47</sup>

The most important factor blocking the further increase of SAARC exports to EC markets is a result of the loss of market share to the Asian Newly Industrializing Countries (NICs) such as South Korea, Taiwan, Hong Kong, Singapore, and countries like China. India, being a fairly industrialized exporting country with 80 per cent manufactured goods in its export basket has registered significantly lower growth rates in the EC markets for exportable products.<sup>48</sup>

The results of a study bring out this point very clearly.<sup>49</sup> A group of 10 important and relatively homogeneous export products of India were labelled as C-10 products. These included gems and jewellery; apparel; hides

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47. Ibid, p.23.

48. Ibid, p.34.

49. Ibid, pp.34-37.

and skins; spices; leather products; footwear; crocheted and knitted goods; and marine products. Of these 10 products, 7 products are also the major exports of other SAARC countries like Bangladesh, Pakistan, Nepal and Sri Lanka. For a comparative positioning of India in the C-10 products nine other countries competing with India were identified. The S-10 countries other than India were, Brazil, China, Hong Kong, Malaysia, Pakistan, Singapore, South Korea, Taiwan and Thailand. Between the period 1981-88, India experienced a lower growth rate in the export of C-10 products to the EC than the group of "all developing countries", as well as, the S-10 group of countries. India's market share in the EC is declining vis-a-vis its competitors in apparel, in hides and skins, and in carpets. In the other seven commodities C-10 India's market share has increased only marginally. As seven out of the C-10 products were also of interest to the other major South Asian countries, the story is likely to be the same even for them.

**b) SAARC-ASEAN Cooperation**

The SAARC and ASEAN cover two developing regions of the world. The ASEAN countries having registered high growth rates in the 1980s inspite of a noticeable decline in the prices of their dominant primary product exports. They are coming close to attaining the NIC status and are already being dubbed as the near-NICs. Notable among the ASEAN

countries, Malaysia registered a growth of exports to the tune of 9.4 per cent, while the same figure for Thailand was 11.3 per cent during the 1980s.<sup>50</sup>

TABLE 3. TRADE BETWEEN SAARC AND ASEAN.

Year	SAARC Exports to ASEAN (million US \$) (A)	SAARC Imports from ASEAN (million US \$) (B)	Balance of Trade: (A-B)= (C)
1980	458.8	1501.6	-1042.8
1985	552.7	2110.2	-1557.5
1988	950.8	2941.1	-1990.3

Source: Calculated from C.D. Wadhwa, 1991.<sup>51</sup>

Table 3 describes South Asia's trade with the ASEAN region. While the total imports of SAARC countries from the ASEAN countries grew by 95.9 per cent between 1980-88, the same figure for exports was 107.2 per cent. In spite of the higher growth rate of South Asian exports, the negative balance of trade has only increased for the SAARC countries.

50 Charan D. Wadhwa, Regional Economic Cooperation Between SAARC and ASEAN and Selected other Countries of the Asia Pacific Region (New Delhi, Centre for Policy Research, 1991), p.11. This paper was presented at the Second Workshop on "South Asia as a Dynamic Partner: Prospects for the Future" held at Honolulu, Hawaii (U.S.A.) during August 21-24, 1991.

51. Ibid, p.67-69. Figures have been estimated from Table 4, Table 5 and Table 6.

It is often believed that trade between the countries of the SAARC and ASEAN region has not grown as much as the trade between the SAARC countries and the developed world due to lack of complementarities. While this may have been true for the period when the SAARC and ASEAN countries concentrated on import substitution, from the mid 1980s, this situation seems to be changing. As the major SAARC and ASEAN countries embark on an outward oriented strategy, there is evidence to show the emergence of growing complementarities.<sup>52</sup>

If the SAARC and the ASEAN is considered as one region, then the intraregional trade in 1985 was 17.4 per cent of the global trade of this region. Intra-regional exports accounted for 18.7 per cent of the global exports, and intraregional imports accounted for 16.2 per cent of the global imports. However, there is a basic assymetry in the degree of openness and the orientation of trade between the economies of the SAARC and ASEAN countries at the present. The ASEAN countries collectively and individually are more open than the SAARC countries. While trade between countries of the two groupings have grown since the 1980s,

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52. Charan D. Wadhwa, "Economic Cooperation among the Countries of ASEAN and SAARC", in Prem Vishishtha, ed., Commonalities, Complementarities and Cooperation (New Delhi, Association of Development Research and Training Institutes of Asia and the Pacific, 1989), Chapter 4.

the "import dependence" of the SAARC countries on the countries of the ASEAN has grown to a much larger extent than the other way round. South Asian nations either individually or collectively are not seen as significant trading partners of the ASEAN countries in their global setting.<sup>53</sup>

SAARC has not been able to evolve a workable approach to relate to other regional organizations. Very limited progress was made at the Male Summit (1990). A step was taken which permits the exchange of information, publications, etc., with the two regional organisations namely the ASEAN and the EEC. There is no regular and serious dialogue between SAARC and the other two regional organisations.<sup>54</sup>

## V

### SUMMING UP

The first two sections sum up the history and the characteristic features of SAARC. The fourth, gives an idea about the level at which the regional intercourse is taking place at the intraregional level as well as the nature of interregional interactions between South Asia and the EEC; and, South Asia and the ASEAN. Section III on Political Factors provides the missing link between Sections I and

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53. Charan D. Wadhwa, n.32, p.28-29.

54. K.K. Bhargava, n.14, p.266.

II, and Section IV. Notwithstanding the success of the Bangladesh initiative, it explains how the political contradictions impede the development of regional cooperation in South Asia.

A formal organization with a charter and a secretariat, SAARC has made little headway in forging an interdependent relationship among South Asian states. At the confidence building stage, bilateral and contentious issues are kept out of SAARC deliberations. The cautious approach is also reflected in the unanimity principle. In Europe, the threat of exclusion is a binding force. In South Asia, states do not have a very big stake in their regional organization. Hence, these provisions keep the regional organization both alive and ineffective.

SAARC has played a beneficial role by providing a regular forum for dialogue. Informal discussions outside the SAARC meetings have helped to foster better understanding among the states. Yet, political factors point out the glaring contradictions that thwart the evolution of a cooperative relationship. First, India's position of centrality in South Asia's power structure is vigorously opposed by Pakistan. Pakistan's propensity to be the alternative pole has led to an armed conflict between India and Pakistan on four occasions. Second, while India has had uninterrupted civilian rule, the influence of the

military in Pakistan and Bangladesh stretch beyond their customary role in varying degrees. The position of the military in Pakistan draws sustenance from as well as reinforces the first contradiction. Finally, India's secular society is based on a consensus that allows for the co-existence of all religious faiths. Pakistan, on the other hand, is a state exclusively meant for Muslim people. These basic contradictions persistently create problems for the smooth conduct of Indo-Pakistan relations.

The withdrawal of the Soviet Union as a major player in South Asia has changed the nature of superpower involvement in the region. By increasing its leverage over India, the U.S. has the best opportunity in decades to carve out a security order by exploiting its position of preeminence. Whether this will lead to a greater role for India as a regional manager due to a reduction in Pakistan's strategic importance to the U.S., or, to a policy of parallelism devised to exploit the basic contradictions, is yet to be seen.

The fourth section, "Regional Cooperation", gives an idea of the "dynamic density" of transactions taking place both within the region and among regions. The quantity and diversity of this economic intercourse provides revealing insights. First, all South Asian countries are now dependent



on international sources of finance in a very big way. Second, intra-South Asian economic intercourse is very limited. Third, South Asia's economic interaction with two major regional groupings show how South Asian trade relations are characterized by the singular lack of competitiveness. Where competitiveness did exist, markets are being captured by the newly industrializing and other developing countries. Moreover, there is no perceptible shift towards the growth of exports in manufactures which have a high value added component. At a time when South Asia's dependence of foreign borrowed capital is very high, the ever increasing deficits in the current account of the balance of trade transactions is a cause for concern. If the period of recession continues and barriers are erected in strategic areas, South Asia's trade imbalance may "Latin Americanize" the region. External dependence too, apart from the political factors, may have the effect of diverting South Asia's economic intercourse away from the region.

Monetary cooperation can have a positive effect on the growth of intraregional trade. For this, the states will first have to take the decision to qualitatively improve trade in areas where it reduces expensive external dependence. The management of South Asia's natural resources and the preservation of environment are related areas. Even here, the level of cooperation is largely

restricted to the generation and dissemination of information.

Economic factors are playing an increasingly important role in international relations. The collapse of the Soviet Union, moves towards the integration of Europe, and the compartmentalization of the world economy into regions are indicative of this trend. South Asian countries are conspicuous by their neglect of economic considerations in formulating their policies with respect to their neighbours. The political imperative to "take care of yourself," obstructs the imperative "to specialize" as intraregional interdependence cannot flourish in the absence of a firm political will.

## CONCLUSION: WORLD ECONOMIC ORDER, REGIONALISM AND SOUTH ASIA

Our objective is to view South Asian regionalism by analyzing the problem at two levels. First, the South Asian regional imperative will be situated in a systemic context. More specifically, this would mean examining how the emerging world political and economic order impinges on South Asia. Second, we wish to view the regional process in South Asia in the context of regional processes occurring in other parts of the globe. Do regionalisms elsewhere offer lessons for South Asian regionalism?

### I

#### EMERGING WORLD ECONOMIC ORDER AND SOUTH ASIA

We have viewed changes in the world economic system largely in terms of changes in the relative distribution of the capabilities of the major states. These changes within the system are reflected through changes in the functioning of our systemic agents - the monetary and trade regimes - created to order the international economic relations among states.

The post Second World War international monetary and trade regimes born at the Bretton Woods Conference, reflected U.S. hegemony in international economic relations

in the aftermath of the Second World War. The U.S. dollar became the principle medium of exchange, the unit of account, and the store of value for the world through a system of fixed exchange rates. The supreme competitive edge of the U.S. economy was also asserted through a trade regime whose liberal ideology was reflected in the principles of multilateralism, non-discrimination and unconditional reciprocity. Not only was the United States capable and willing to play the role of a hegemonic stabilizer, special exceptions to the liberal principles were also accommodated within the framework of these international regimes in order to accommodate the concerns of the war ravaged economies.

#### The Monetary Order and South Asia

With the rapid development of the war torn economies, the U.S. competitive edge began to erode. Faced with an N-1 or consistency problem, the U.S. unlike the rest of the world, could not vary its exchange rate, because it was the standard to which all other currencies had pegged their values. In the face of a U.S. trade deficit, President Nixon's administration decided that it could no longer play the role of hegemonic stabilizer through a system of fixed exchange rates. A change from the regime of fixed exchange rates to a system of flexible exchange rate, dubbed as the "renationalization of the world economy", reflected a diffusion of economic power. Automatic international coordination of monetary affairs was dropped in favour of a

system that afforded greater domestic autonomy. Subsequent developments have further reduced the role of the U.S. as the single factor in the management of international monetary affairs. The IMF's role as a coordinator of monetary policy is being increasingly taken up by the exclusive meetings of the G-7. Though, the IMF's coordinating role has come down, its new role as a long term lender to developing countries facing an awkward trade imbalance, has increased its power vis-a-vis the developing world.

Developing countries of South Asia are affected by the erratic short term instability of foreign exchange market in a system of floating exchange rates. Though, long-term adjustments are achieved more gradually, short-term fluctuations far beyond the requirements of current account adjustment have reduced enthusiasm in the regime. For countries that peg their currencies to a single currency, greater exchange rate variability between the intervention currency and the other major currencies may increase the variability of the country's currency as well as the price of its imports and exports. A higher and more assured level of foreign exchange reserves is thus required by these poor countries to carry out their international trade.

Problems arising out of exchange rate variability were reduced in Europe through the functioning of the European Monetary System. Since, intra-European trade is a large

proportion of the international trade of the EC, it has benefited immensely from the creation of the European Currency Unit. In South Asia, neither the SAARC nor extra-regional dependence have stimulated intra-regional trade. Intra-trade being less than 5 per cent of the total trade of South Asia, South Asian countries continue to depend on foreign exchange reserves in an environment of erratic short-term fluctuations. The Asian Clearing Union, established under the Economic and Social Commission of the Asia and the Pacific, includes five of the seven South Asian countries. Although, the ACU has promoted trade among the seven-member countries by reducing the needs for foreign exchange reserves, this has not substantially altered the South Asian countries' dependence on foreign exchange reserves.

While the role of the IMF as the world's coordinating authority, in monetary affairs has been reduced owing to changes in the monetary regime, the IMF has become involved with financing packages for the major debtors. Not only is the IMF playing the role of a long term lender, it is also in a position to set conditionalities and influence the economic policies of developing countries. The deterioration in the balance of trade of South Asian countries has necessitated their dependence on IMF funds. Long-term IMF lending with conditionalities imposed on to developing countries in general, and South Asian countries (India,

Bangladesh, Sri Lanka, Nepal and Pakistan) in particular has increased the Fund's control over these countries. This increase is reflected in the enhanced influence the rich countries exercise by virtue of their share in the weighted voting and staffing inside the Fund. While this may have some beneficial side-effects, the IMF prescriptions are not necessarily always consistent with the national interests of the borrowers as they perceive it themselves.

### Trade Order and South Asia

The U.S. commitment to a liberal trade regime is on the wane. While tariff barriers have come down, non-tariff barriers have gone up. A liberal trading environment protected by the U.S., is being replaced by a strategic one comprising of the U.S., the E.C. and Japan. This has put the Bretton Woods system under severe stress.

In a strategic trade environment, the traditional bases of trade specialization--such as **differences** in the national availabilities of labour, capital, skilled labour, and technological sophistication, etc., among nations may no longer dominate, since the other traditional determinants of trade specialization (like natural resources) may no longer be germane. Non-competitive firm behaviour, government intervention, and a trade regime reflecting the bargaining positions of the major trading states are likely to become increasingly important factors in determining the competitive edge of nations.

Erosion of the principle of non-discrimination (Article I of GATT) is finding expression through growing regionalization of the world economy. What was allowed in the Bretton Woods system in exceptional cases, is now being universally practised by flouting all or most of the conditions under which this was allowed. The United States, at one time the hegemon propounding the non-discrimination norm, has itself taken steps to forge greater regional interdependences in North America. The recent trend towards regionalism is qualitatively different from its earlier manifestations and runs the risk of becoming a substitute for, rather than complement the multilateralism embodied in the framework of GATT.

The regionalization of the world economy's major trading regions (Europe, East Asia, and now, North America), is not merely a culmination of the regional process at the unit level. This has also to be viewed as one of the options presented by the strategic trade environment in an era of "new protectionism". Regional interdependence is easier to forge if the realist contradictions emanating from the "take care of yourself" imperative are more effectively reduced at the intra-regional level. Once this is realized, states can sort out the problems of market size and economies of scale within the region. For economically developed regions, the consolidation of the large internal



market coupled with the competitive edge of the states in various spheres of production, will enable them to influence the trade regime more effectively.

The economic performance of developing countries (with some exceptions like the NIC's ) during the 1980s have led to their increased dependence on external sources of finance. The conditionalities attached to these lendings have not only provided the major powers with some leverage over the domestic policies of these countries, it has also been very effective in ensuring developing country adherence to norms agreed upon by the concert of economic powers. As a result, the importance of UNCTAD, UNIDO and ECOSOC have been undermined, as GATT has occupied the centre stage. While the GATT has provided a more convenient arena for thrashing out the interests of the world's major economic powers, the proposal to replace the GATT by a Multilateral Trade Organization that will work in close coordination with the World Bank and the IMF, as well as permit "cross-retaliation" both within and across sectors, indicate the structural impotence of the South in the evolving trade regime. The developing world's right to special and differential treatment within the trade regime is being attenuated.

The South Asian developing countries are structurally insignificant in the world economic system. Along with most of the developing world, these countries have also become

dependent on external finance due to poor economic performance, and the incapacity to finance imports through export earnings. India, Bangladesh, Sri Lanka, Pakistan and Nepal, are carrying out structural adjustment under the Fund's supervision. Not only do these countries have to reduce their fiscal deficit, they have also to increase their competitiveness in international trade.

The regionalization of the world economy is likely to make matters worse for South Asian countries. Intra-trade in the EC and ASEAN is being facilitated by discriminating between intra-regional and extra-regional trade. In relation to the NICs and Brazil, India's relative share in the EC market for traditional export items is declining. The pattern for other South Asian countries is likely to be the same. Trade between countries of the SAARC and ASEAN has grown in the 1980s. Even here, not only has the South Asian import dependence increased, these countries are also not viewed as significant partners of the ASEAN in their global setting. Most South Asian countries being primary producers tend to export similar products. As a consequence, negotiating in the world market as individual states in competition with each other, they are likely to lose much bargaining power.

South Asian countries are facing illiberal times. The internal problems facing the world's major economies will

discourage them from providing market access where they need it the most. Further, the decline in the bargaining power of the developing world is making them more vulnerable to great power control. These countries are constrained to reconcile with these structural conditions.

Thus, on the one hand, South Asia's trade imbalances need to be restored by helping these states become more competitive, while on the other, the evolving trade regime expects these backward post colonial states to protect intellectual property rights (as defined by the trade regime), to free their services sectors from protection, to reduce the level of protection they provide to agriculture, and to extend national treatment to TNCs. For all this and more, textile, a major export item of some SAARC countries, would be brought under the purview of GATT. Even here, substantially improved market access can be expected only after 2000 A.D. With the Fund-Bank-GATT trinity reviewing the trade policies, and the prospect of "cross-conditionality" hanging "like the Damocle's sword", there remains very little space for manoeuvrability by the developing states to pursue their national interests unhindered.

South Asian countries confronted with regionalising and protectionist challenges, and an almost complete structural domination by a disaffectionate regime, have not taken to regional cooperation in a substantial way. The intra trade as a proportion of the total trade has not even reached the

low five per cent mark. In the post-hegemonic era, the powerful concert of the U.S., the E.C., and Japan, have assumed leadership of the world economic system and is defining and dictating its structural characteristics. While it is difficult to conceive of the efflorescence of developing country regionalism in opposition to this centralizing tendency, regional cooperation can help the developing countries of South Asia to promote development and welfare by reducing excessive extra regional dependence.

## II

### THE REGIONAL PROCESS AND SOUTH ASIA

International political systems can tell us what conditions national policies have to cope up with. However, they cannot predict what policies these systemic conditions will result in. The problem with our exclusive attention to the systemic level is that even structural change has no source other than unit level processes. For example, the regionalization of the world economy spearheaded by the fear of a highly competitive single European economic space, has its origins in unit level or state to state interaction which began in the aftermath of the Second World War.

#### Power and Function

Regional cooperation being an interstate intercourse, national interest embodied in the "take care of yourself" imperative invariably creeps in. It has been pointed out that cooperation among states can be forged by attending to functions motivated by welfare considerations that do not infringe the sovereign character of states. The role of functions and the role of power are both necessary ingredients of the regional process.

In Europe, supranational factors such as pressure from E.C. institutions, political entrepreneurship of the Commission, and lobbying by transnational groups, have played a significant role in the negotiating history of the Single European Act (SEA). However, these three variables do not account for the timing, content and process of negotiating the SEA. The state interests reflected in the EC Council of Ministers played the key role. In the absence of a European hegemon, interstate bargains reflecting the lowest common denominator bargaining approach account for the major part of the SEA. Small states were bought off with side payments, while the large ones (U.K., France and Germany) exercised a veto over the major decisions. The threat of exclusion of one state in a situation where the other two major states had common interests resulted in bargains above the minimum common denominator level. The historical prediction of neofunctionalism, that over time, supranational actors and organizations will facilitate further integration is not confirmed in the case of the SEA.

The "intergovernmental institutionalism" variant of neofunctionalism stressing the importance of national interest and power provides a better explanation. This is reflected in the narrowing down of institutional reform to the "minimalist" position.

The threat from Indo-China and the Western support for the organization have been helpful in binding the ASEAN. However, while European regionalism has a functional content, ASEAN is faced with political impediments to functional cooperation. As a result, regional cooperation through the Preferential Trade Arrangement (PTA), the ASEAN Industrial Joint Ventures, the ASEAN Industrial Complementation, etc., have not made much progress. While power and function enjoy an intimate relationship in the case of the EC, it was state's interest that bound the ASEAN irrespective of the considerations of welfare. Now that the organization has been sustained over two decades, the member states are beginning to appreciate the functional role of regionalism.

SAARC is in the third stage. In this case, functions have been totally ignored in a region which lacks a firm basis for solidarity. A regional organization at this stage can be viewed more in terms of structures and processes rather than in terms of its effectiveness as an instrument of state power.

The E.C. and the ASEAN, point out to the importance of political factors in the success of a regional organization. The assumption is that the intensity of the realist contradiction (take care of yourself) is much less at the regional level as compared to its manifestation when states interact in a global setting. The South Asian experience questions the general validity of this assumption. The fear of a regional hegemon (India) overwhelming its small neighbours has led to the assertion of the realist contradiction at the cost of the promotion of urgent welfare functions that can be addressed through regional cooperation. E.C. has benefited from the democratic institutions governing its constituent national political units. In South Asia, divergences from democracy to authoritarianism, and from secularism to religious fundamentalism, have added to intra-regional contradictions.

#### Lessons from the Regional Process

South Asia is characterized by the singular lack of regional cooperation. There is neither preferential trade nor joint ventures. Despite the size and diversity of India's economy, and the problem of contradictory national interests, South Asia can learn from some experiments in regional cooperation.

Most South Asian states are apprehensive about becoming dependent on India through preferential trade.

Notwithstanding partial trade complementarities between India and Pakistan, and India and Sri Lanka (India's export match well with the imports of the other two countries ), and the generally poor intra-trade complementarities , the current negotiations on preferential trade in South Asia are a movement in the direction of regional cooperation. However, one cannot be certain about the level of commitment that the South Asian states bring to these negotiations.

The ASEAN Industrial Joint Ventures (AIJV), suffered problems when the question of market sharing arose. However, the Brand to Brand Complementation (BBC) Scheme of the ASEAN Industrial Complementation (AIC) programme has some innovations that seek to reduce the problems inherent in the PTA and the AIJV. The AIC was set up with the aim of dividing different production stages of vertically integrated industries among different ASEAN countries. In South Asia where problems of equity are likely to surface , such schemes may help to forge cooperation by assuring the members about the distribution of the benefits of the cooperation. Once, the fruits of cooperation are reaped at this level, one can move ahead on the basis of the momentum already gained from the cooperative endeavour.

Pursuing a similar idea, the South African Development Cooperation Conference (SADCC), aimed at reducing the



dependence of the member countries on South Africa through specific regional projects. The expansion of trade among members occurs through the narrow lines of production covered by the SADCC - sponsored industrial programmes. Uncontroversial projects with positive regional externalities such as transport and communication have been on the top of the list of priorities. Like the BBC programme, this experiment too has an element of sharing in the nature of the tasks it has undertaken. Apart from the Indo-Napalese cooperation in the joint exploitation of the hydro-potential of the two countries, there is little evidence of bilateral or multilateral cooperation in areas where there are definite positive externalities. South Asian regional cooperation can be developed in a step by step manner by taking a cue from these experiences.

At the confidence building stage, the role of SAARC is limited largely to providing a forum for dialogue. Regional cooperation demands going beyond this stage. The existence of a political will to attend to welfare functions is almost a pre-requisite for cooperative endeavours. While the "intergovernmental institutionalism" variant of the neo-functional paradigm provides a good explanation for the logic behind the SEA, it also explains the extremely low level of regional cooperation in South Asia. The interests of state being the prime force behind the regional process, South Asian regional cooperation is significantly affected by intra-regional political contradictions. On the other

hand, however, the systemic imperatives are only too obvious. Whether or not the South Asian leaders are able to mobilize political support in favour of regional cooperation remains a moot question.

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1920