

New Life within SAARC

Edited by
Nishchal N. Pandey
Dev Raj Dahal

edition : First Edition Nov. 2005

printed copies : 1000 Copies

Copyright : Institute of Foreign Affairs

published by : IFA/FES- Nepal

printed by : **Paru Offset Press**
Dillibazar, Kathmandu, Ph: 4430799

designed by : **MotionGraphics**
Putalisadak, Kathmandu, ph: 4230147

ISBN : **99946-57-87-9**

Political Economy of Monetary Cooperation in SAARC

Rahul Tripathi

Introduction

As the South Asian Association for Regional Cooperation (SAARC) enters the third decade of its existence, it needs a critical appraisal at two levels. First, in its ability to forge a 'regional' identity in South Asia, where the member countries could be seen as endorsing the idea of regionalism alongside their respective national orientations. Second, the regional idea being able to manifest itself in certain key areas where stakes as well as benefits are mutual for all the member countries. In other words, SAARC needs a reassessment of its form as well as content if at all a 'new life' is to be injected in it.

Unfortunately for the grouping, the performance at both the levels has been a lot less than what the strong votaries of the idea of the regional grouping would have desired twenty years ago. Rapidly changing global political and economic scenario, the peculiar pace of the operational mechanism of regional association and frequent differences among member nations have together imparted a unique image to the grouping. Unlike many other such initiatives across the world, SAARC appears to have got affected more by regional developments rather than having shaped them. One convenient reason behind this can be attributed to the fact that while SAARC was indeed seen as a regional economic grouping, it always had to depend on the political impulses for any major breakthrough. Regionalism therefore remained a political project in South Asia and not an economic one.

A stocktaking of the association therefore reflects both the highs and the lows that have come to be associated with the growth of the grouping in the last twenty years. SAARC has definitely articulated a vision of regional solidarity, allowed political leadership to meet collectively over periodic (though irregular) intervals and brought regional integration at the core of

deliberations within a short span of time. At the same time, it has appeared a house divided because of differences between its key constituents, remained by and large a forum for governmental or bureaucratic interaction and fell drastically short in matching the promise with the practice of regionalism when it has come to some of the key economic concerns. Often, the bilateral policy has been seen as coming in the way of the regional consensus that could have strengthened SAARC (Mohsin, 2005,p.36.)

Seeking A Renewed Mandate

Keeping in mind the past experiences at regional consensus building within SAARC, it has become imperative that the grouping must redefine its role and objectives if it is to remain a viable vehicle for collective well being. One way of accomplishing this would be to identify a set of sub-goals, which would be seen as consistent with the long-term vision that the grouping sets for itself, rather than a long check-list that is traditionally associated with SAARC meets. It will not be the first time such an agenda setting would be envisaged within the regional framework. The Colombo Summit (1991) and the Male Summit (1997) took some conscious decisions that would enable identification of certain core areas of economic cooperation. While the former set the tone for a more intensive discussion on key concerns such as poverty alleviation and trade liberalization, the latter appointed a Group of Eminent Persons (GEP) to review and outline a future vision for SAARC, realizing that the past practices hadn't helped. While the substance of what was envisaged in both the cases was somehow followed up, but the spirit was somewhere lost in the intractable motions which the SAARC process went through subsequently.

Trade liberalization within SAARC became an endless exercise with the adoption of a preferential approach to tariff negotiations initially. With the growing unease with the slow pace of negotiations and their minimal impact on trade expansion after several rounds, it was finally decided to achieve a South Asian Free Trade Area with the adoption of a framework agreement at the Islamabad Summit in 2004, almost six years after the GEP had recommended the same (SAARC, 1999,p.53). The most far-reaching recommendation of the GEP, namely the creation of an Economic Union within SAARC by 2020 is yet to be taken up formally within the SAARC deliberations. The Report lays down the steps which would be necessary to attain the Economic Union and very rightly put the onus on the governments, academic community and civil society to initiate research and discussion at national and regional level on different aspects of the proposal (SAARC, 1999,p.57)

Towards Monetary Cooperation

The proposed South Asian Economic Union is seen as a logical culmination of the South Asian Free Trade Area and a South Asian Customs Union, which are envisaged over a specific timeframe. One of the critical components of an Economic Union is harmonization of monetary and fiscal policy among member countries which leads to greater policy coordination in exchange rates, interest rates and inflation (Sobhan, 2005,p.12). Such macro-economic policy coordination, if practiced perfectly prepares appropriate ground for the eventual monetary union, which would include a common currency within the region. Available literature shows however that opinion is divided on whether South Asia does provide the appropriate environment for a full-fledged monetary union.

The issues at stake are both theoretical as well as practical. For a region to be suitable for experimenting with common currency and therefore a common monetary policy it should satisfy the (Optimum Currency Area) OCA criteria which presupposes free mobility of labor and inflexibility of wages in the region. Some empirical studies conducted on SAARC as an OCA have shown negative results which suggest that it should not pursue monetary integration immediately as that might lead to a crisis of adjustment and increase in economic costs (Maskay, 2002,p.217). It has been suggested that a slow but sure path as pursued in Europe should be followed with the initial focus being on meeting the convergence criteria on broad macro-economic indicators. Other studies, which are less empirical and more policy prescriptive refer to the desirability of monetary cooperation in successive stages that could lead to an eventual monetary union which may not entail individual countries surrendering their monetary sovereignty. Such studies talk of greater political cooperation and confidence building among member nations in order to move towards monetary cooperation (Saxena and Baig, 2004,p.23). There has also been a logical extension of the idea at the broader Asian level particularly in meeting the challenges similar to the Asian financial crisis of late 1990s. This includes creation of a parallel currency, which could be used by all Asian countries, which may retain their individual currencies, yet link it to the former. Under this dispensation, individual currencies could vary in relation to parallel currency within a broad band depending on the circumstances prevailing (Agarwala, 2002,p.25)

South Asia: The Road Ahead

The principal question therefore is how should South Asia place itself in the midst of these theoretical and practical formulations relating to monetary

Political Economy of Monetary Cooperation in SAARC

cooperation. Given the fundamental reality that any regional cooperation initiative has to pass the political test before it fulfills the economic logic in South Asia, the realm of monetary cooperation has to be no different. A critical concern therefore would be how the broad contours of monetary cooperation are to be outlined in a manner that they satisfy the binding constraints that exist.

First and the foremost a clear distinction has to be made between monetary cooperation and monetary integration. The former may be seen as a precursor to the latter where substantial monetary policy autonomy may be retained. There should be cooperation, harmonization and integration of monetary policy, spaced out sequentially, to achieve slow but steady gains in the larger direction.

Second, monetary cooperation should not be seen in isolation with the other regional cooperation initiatives but rather in tandem with each other. For example, monetary and financial cooperation should supplement others in the arena of industrial, investment and trade cooperation. At present there appears to be a greater focus on trade liberalization alone-ignoring the basic wisdom that trade expansion in the regional context can occur only when there is an enabling environment provided by a conducive investment climate and a supportive monetary and financial package. The efforts in all the three areas have to be simultaneous and not sequential as it appears at present.

Third, in any scheme of regional financial coordination, existing institutional arrangements should be consolidated and modified rather than new ones being identified.

A case in the point is the Asian Clearing Union (ACU), the only clearing facility of its kind in Asia which has been providing clearing arrangement for multilateral payments settlement and also a temporary credit facility for member nations for almost three decades. The Union was created in 1975 under the auspices of United Nation's Economic and Social Commission for Asia and Pacific as a mechanism to make use of local currencies in settlement of regional transactions, thereby economizing on the use of foreign exchange. Even as drastic changes were made in the operational mechanism with the onset of liberalization of exchange rates among the member countries, ACU has continued to function without there being a default in members' payment obligations. As the Union covers almost all the SAARC countries except one, a strong case has been made to integrate the efforts of

the two groupings. (Tripathi, 2000,p. 194)

Besides there is a need for a greater mandate to SAARCFINANCE which is an organization of Governors of Central Banks and Secretaries of SAARC's member countries. If given a political mandate, the forum could do more than just discussing and sharing monetary and exchange rate developments in the region and come out with some action plan with regard to achieving greater harmonization of policy and creating reserve facilities that meet the short term requirements of member nations. It has been noted that the existing facility in form of South Asian Development Fund (SADF) has been languishing in the absence of adequate resources and leadership (Dubey, 2005,p.29)

It is therefore, the basic contention of this paper that if at all SAARC has to give a greater meaning to regional integration efforts, there have to be movements on parallel fronts gradually but systematically. While the relative merits or demerits of an eventual monetary union may still be debated, it should not preclude whatever small gains that have already been made in the area of monetary cooperation within or outside the framework of SAARC. The real challenge would be in how these initiatives are made part of or made to supplement the larger goal of regional integration. It seems that there has been significant if not sufficient economic thought given to the desirability and feasibility of greater monetary interaction within SAARC, the need is to give it the political backing at the highest levels.

Conclusion

SAARC is premised on the belief that member nations shall work collectively on the issues of mutual interest; Such mutuality is an outcome of shared beliefs and objectives that bind them together. To make it more meaningful, SAARC will have to outline a very specific agenda that builds up on the success achieved so far rather than derive from the very broad though significant vision statements it is normally associated with. As stated earlier, there is a need for a change in both the form and the substance of the 'regional idea' that has gradually taken shape within South Asia. Though twenty years in the life of a regional grouping is too short to judge its successes and failures, yet it is the right time to decide on the future direction. The challenge of transition from a youthful stage to a mature, responsible middle age may be exciting as well as difficult as one faces the hard truths of life. SAARC would be no exception to this rule.

References

- Agarwala, Ramgopal .2002. 'Towards an Asian Economic Community: Monetary and financial Cooperation' RIS Discussion Paper, RIS-DP No.33/2002
- Dubey , Muchkund. 2005 'The Twelfth SAARC Summit: Deeper Integration in South Asia', South Asian Survey, Vol.12, No1
- Maskay, Nephil Matangi. 2001. 'South Asian Monetary Integration in Light of the Optimum Currency Area Criterion of Pattern of Shocks', South Asia Economic Journal, Vol.2, No.2
- Mohsin, Mohammad .2005 . 'The Twelfth SAARC Summit: Quest for Durable South Asian Cooperation' South Asian Survey, Vol.12, No1
- Saxena, Sweta Chaman and Mirza Allim Baig .2004 'Monetary Cooperation in South Asia', RIS Discussion Paper, RIS-DP No.71/2004
- Sobhan, Rehman .2005 'The Twelfth SAARC Summit: Charting the Road-Map for South Asian Cooperation', South Asian Survey, Vol.12, No1
- South Asian Association for Regional Cooperation 1999, ' SAARC Vision Beyond the year 2000. Report of The SAARC Group of Eminent Persons Established by the Ninth SAARC Summit', Shipra Publications: New Delhi
- Tripathi, Rahul .2000, Monetary and Payments Cooperation in South Asia: A Case Study of the Asian Clearing Union. Unpublished Ph.d Thesis, School of International Studies, Jawaharlal Nehru University, New Delhi