Political Stability and Regional Economic Cooperation: The Case of Selected South Asian Economies

Shujaat Farooq and Muhammad Javid

Pakistan Institute of Development Economics (PIDE)
Islamabad, Pakistan

Introduction

- Political stability is one of the key element to promote regional economic cooperation.

- East Asian economies have prospered through an outward-oriented strategy.

- The challenges of regional cooperation and integration among South Asian countries are still ahead.

- Present study aims to analyze:

  - To access the level of regional cooperation among South Asian countries;
  - To Investigate the role of domestic political stability in promotion of regional trade in South Asia

International Trade of South Asian SAARC Countries

Countries	GNI per capita (US$)	Exports (Billion US$)	Imports (Billion US$)	Trade (% of GDP)	Share in World Export	Share in World Import	Adult Literacy Rate
Afghanistan	680	0.5	8.8	68.3	0.0	0.05	31
Bangladesh	1080	29.1	36.3	55.9	0.15	0.19	58
Bhutan	2390	0.5	1.1	96.4	0.0	0.01	57
India	1610	314.0	466.0	54.2	1.7	2.47	73
Maldives	7290	0.3	1.7	223.6	0.0	0.01	97
Nepal	730	0.9	6.6	45.7	0.0	0.03	58
Pakistan	1410	25.2	44.7	33.8	0.13	0.16	58
Sri Lanka	3400	10.0	18.0	57.9	0.05	0.10	95

SAARC Intra-regional Overall Trade
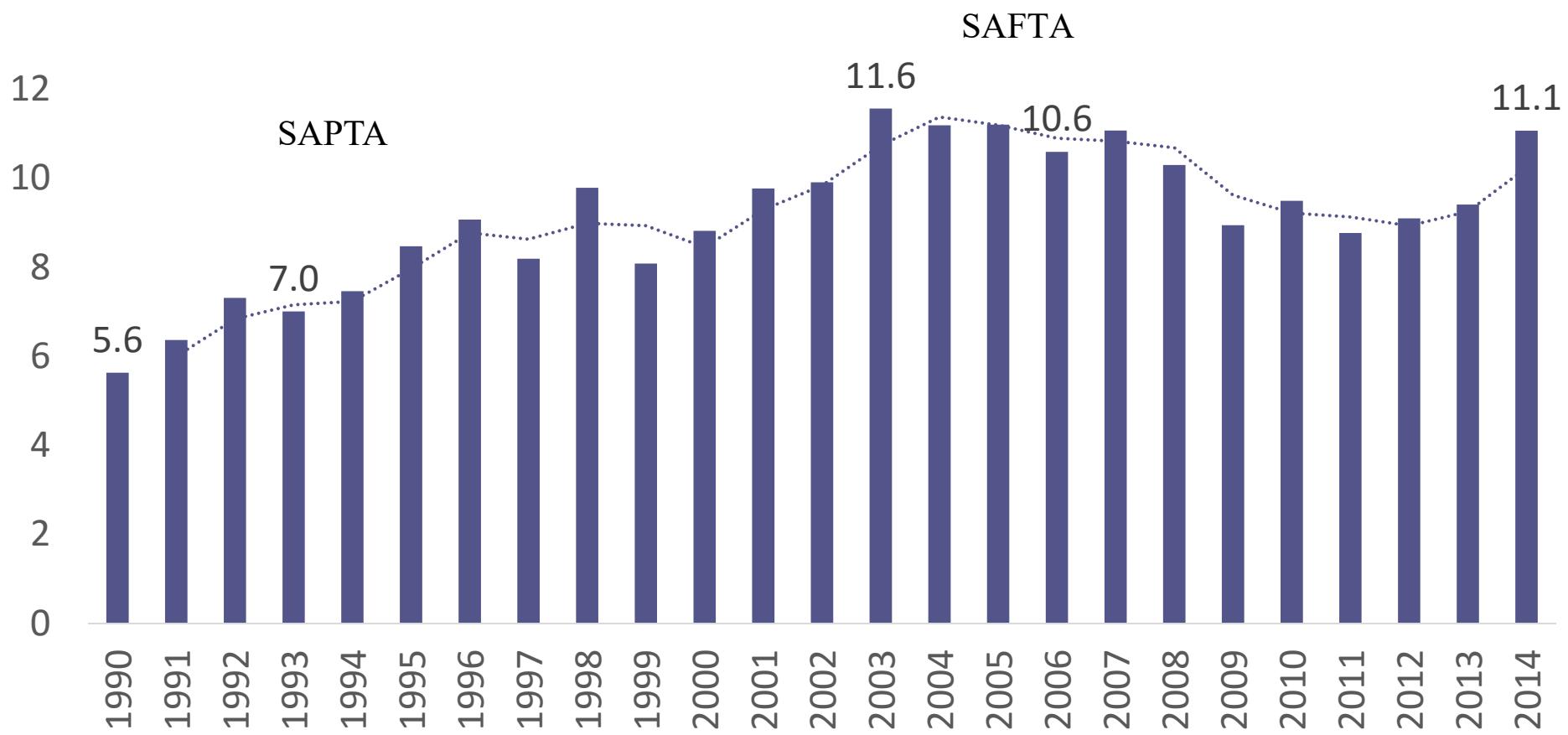
Intra and Inter-Regional Trade of Selected SAARC Countries
(Average of 2010-14 years)

Countries	Exports Shares (%)			Import Shares (%)		
	SAARC	European Union	Advanced Economies	SAARC	European Union	Advanced Economies
Afghanistan	59.1	11.3	18.6	31.2	12.2	31.8
Bangladesh	2.5	46.2	71.4	15.7	6.2	28.8
India	5.2	17.2	44.6	0.6	11.3	35.8
Maldives	14.8	43.1	59.2	13.7	10	39.4
Nepal	62.7	62.7	12.6	55.7	2.4	8.9
Pakistan	4.7	12.6	21.8	4.9	11	25.9
Sri Lanka	7	30.2	61.3	23	9.9	38.5

Intra-regional Export Shares of SAARC Countries (in %)

	1990	1995	2000	2005	2010	2011	2012	2013	2014
Afghanistan	14.2	13.1	42.4	43.2	54.2	58.5	62.6	59.4	60.4
Bangladesh	3.7	2.7	1.7	2.2	2.6	2.8	2.8	2.2	1.8
India	3.1	5.1	4.3	5.4	5.0	4.5	5.0	5.2	6.4
Maldives	14	22.6	18.3	17.4	30.8	18.4	10.7	7.1	6.9
Nepal	7.7	9.2	42.9	67.3	65.8	62.6	63.5	59.4	62.2
Pakistan	4.0	3.6	4.6	11.2	12.5	12.4	12.9	12.4	12.7
Sri Lanka	3.8	2.7	3.5	10.3	6.5	6.1	7.5	7.0	7.9
South Asia	3.4	4.5	4.6	6.6	5.8	5.2	5.7	5.8	6.8

Intra-regional imports Shares of SAARC Countries (in %)

|	1990	1995	2000	2005	2010	2011	2012	2013	2014
Afghanistan	14.5	10.2	27.3	43.3	26.7	24.9	34.2	33.6	36.4
Bangladesh	7.1	17.7	11.8	15.3	15.7	15.6	15.5	15.6	15.8
India	0.5	0.6	0.9	0.94	0.6	0.5	0.5	0.5	0.6
Maldives	12.2	13.2	23.0	17.4	13.5	13.2	13.8	13.0	15.0
Nepal	13.4	17.2	37.4	59.7	57.5	58.2	52.7	52.8	57.3
Pakistan	1.7	1.6	2.7	3.0	6.3	4.2	4.3	5.1	4.6
Sri Lanka	7.0	12.2	10.6	22.4	22.4	23.3	24.7	19.8	24.7
South Asia	2.2	3.9	4.3	4.6	3.7	3.6	3.4	3.6	4.3

Tariff Rates in SAARC countries, 2014
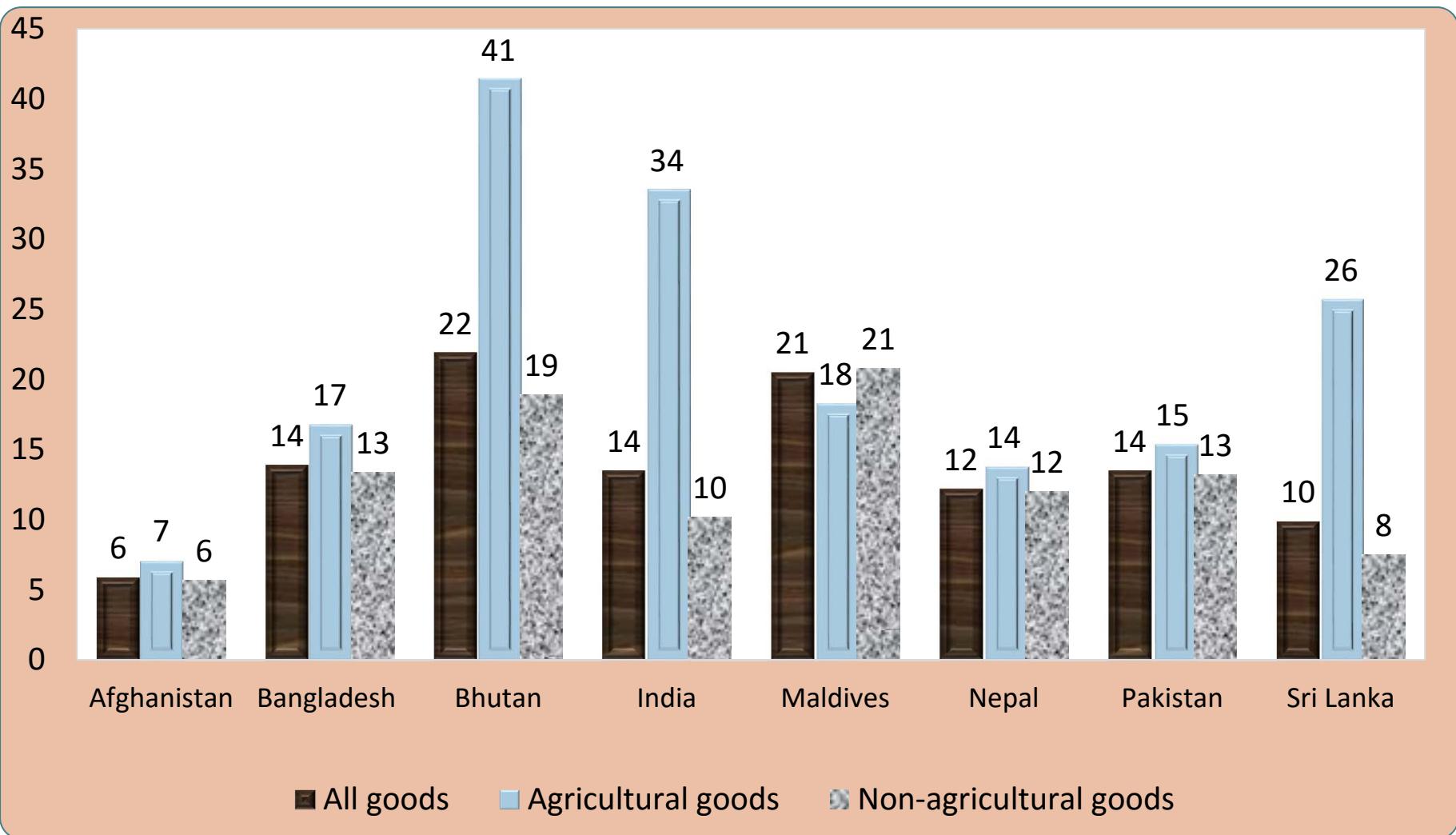
Challenges to Regional Cooperation

- Slow industrialization process and identical comparative advantages
- Trade is concentrated to traditional markets
- Persistent protectionism, long-running conflicts among the larger countries, and transportation constraints
- Lower share in world income and trade

Political Stability Index in Selected SAARC Countries
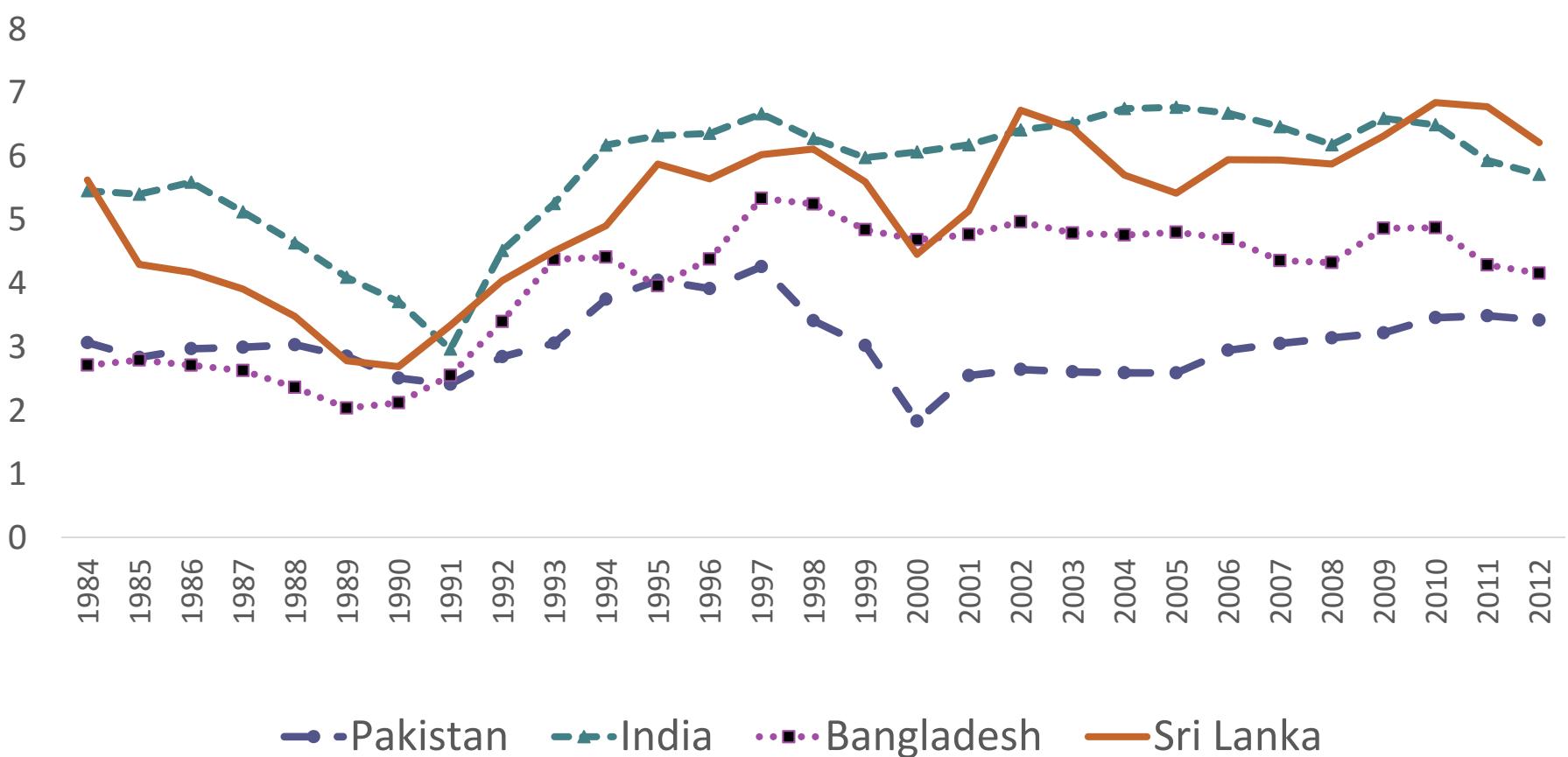
Methodological Framework

- Data is taken from 1984-2012 period
- Gravity model is used

$$X_{ij} = K \frac{GDP_i^{\gamma_1} GDP_j^{\gamma_2}}{D_{ij}^{\gamma_3}}$$

$$\ln(X_{ijt}) = \gamma_{ij} + \gamma_1 \ln(GDP_{it}) + \gamma_2 \ln(GDP_{jt}) + \gamma_3(P_{it}) + \gamma_4 \ln(P_{jt}) + \gamma_5 \ln(D_{ij}) + \gamma_6 Ln(RER_{ijt}) + \gamma_7 Ln(PS_{it}) + \varepsilon_{ijt} \quad (2)$$

Estimates of Gravity Model for Bangladesh

Independent Variables	Fixed Effect Method				Pooled Estimates
	Model 1	Model 2	Model 3	Model 4	Model 5
Exporter income	1.40**	1.86 *	1.23**	1.58**	1.34*
Importer Income	2.83*	4.07*	2.89*	4.19*	0.56***
Exporter Population	-1.33**	-1.3***	-2.68*	-3.0**	-0.81**
Importer Population	2.04*	3.0*	2.1*	3.1*	0.87*
Distance	-	-	-	-	-1.10*
Real Exchange rate	-	1.80*	-	2.11*	1.18**
Political Stability Index	-	-	0.25***	0.25**	0.57*
Country Dummy					
India	43.2*	39.9*	62.9*	63.6*	-
Nepal	45.9*	43.4*	65.7*	67.1*	-
Pakistan	44.6*	40.5*	64.2*	64.1*	-
Sri Lanka	42.6*	37.9*	62.2*	61.3**	-
Constant	-	-	-	-	40.18***
Adjusted R-square	0.75	0.75	0.74	0.75	0.62

Estimates of Gravity Model for India

Independent Variables	Fixed Effect Method				Pooled Estimates
	Model 1	Model 2	Model 3	Model 4	Model 5
Exporter income	0.44*	0.96*	0.46*	0.97*	1.1*
Importer Income	0.68*	0.48*	0.69*	0.44**	0.86
Exporter Population	2.27**	2.34**	2.01***	2.36**	7.31*
Importer Population	1.72*	2.0*	1.72*	2.02*	1.33*
Distance	-	-	-	-	-1.77*
Real Exchange rate	-	1.48*	-	1.50*	0.35*
Political Stability Index	-	-	0.19**	0.13**	0.18**
Country Dummy					
Bangladesh	-87.3*	-90.3*	-83.0*	-91.0*	-
Maldives	-77.5*	-83.9*	-73.0*	-84.6*	-
Nepal	-83.9*	-87.3*	-79.6*	-87.9*	-
Pakistan	-89.3*	-91.4*	-75.1*	-92.1*	-
Sri Lanka	-83.6*	-85.6*	-79.3*	-86.3*	-
Constant	-	-	-	-	-177.3*
Adjusted R-square	0.958	0.97	0.96	0.97	0.93

Estimates of Gravity Model for Pakistan

Independent Variables	Fixed Effect Method				Pooled Estimates
	Model 1	Model 2	Model 3	Model 4	Model 5
Exporter income	0.57**	0.62**	0.56*	0.56**	0.84**
Importer Income	0.36***	0.45**	0.35***	0.37***	1.17*
Exporter Population	-1.68**	-1.8**	-0.63*	-2.66***	-1.73**
Importer Population	1.4*	0.98*	1.40*	0.95*	0.22*
Distance	-	-	-	-	-3.62*
Real Exchange rate	-	0.36**	-	0.68*	0.21**
Political Stability Index	-	-	0.24**	0.43***	0.21***
Country Dummy					
Bangladesh	-17.7**	-39.1*	-18.10*	-43.9*	-
India	-21.9*	-47.7*	-22.3**	-47.1*	-
Maldives	-11.9***	-19.5**	-12.4**	-39.9*	-
Nepal	-19.0**	-36.5*	-19.5**	-46.4*	-
Sri Lanka	-15.0***	-32.3*	-15.5***	-42.7*	-
Constant	-	-		-	-53.4*
Adjusted R-square	0.95	0.95	0.95	0.94	0.92

Estimates of Gravity Model for Sri Lanka

Independent Variables	Fixed Effect Method				Pooled Estimates
	Model 1	Model 2	Model 3	Model 4	Model 5
Exporter income	0.66**	0.82**	0.70**	0.94***	2.84*
Importer Income	1.64*	1.80*	1.67*	1.49*	3.76*
Exporter Population	15.12*	14.16*	14.80*	20.8*	1.94**
Importer Population	7.70*	7.3*	7.76*	16.17*	2.72*
Distance	-	-	-	-	-5.15
Real Exchange rate	-	0.41	-	0.75*	0.34*
Political Stability Index	-	-	0.15*	0.18**	0.35*
Country Dummy					
Bangladesh	-117.7*	-108.5**	-111.6*	-56.7*	-
India	-104.1*	-96.1**	-97.4*	-25.17*	-
Maldives	-157.6*	-144.8*	-151.3*	-149.8***	-
Nepal	-131.3*	-121.3*	-124.7*	-85.5*	-
Pakistan	-116.8*	-107.9**	-110.2*	-55.19*	-
Constant	-	-	-		-76.50**
Adjusted R-square	0.84	0.83	0.83	0.87	0.76

Conclusion and Policy Implication

- Tariff rates are still high in South Asian region
- Political stability can raise the potential exports in the region
- Deeper integration is required among SAARC countries
- Political will and stability is highly important to fill trade and trust deficit.