

## **Prospects of Economic Integration among the ECO Countries**

PERVEZ TAHIR

### **INTRODUCTION**

The idea that the collective regional economic prospects of the countries of a region exceed the sum of their individual prospects has attracted the attention of politicians and economists since the World War II. Its best known example has been the Treaty of Rome in the Euro-Mediterranean region, which has nearly half of the regional trade agreements in operation. GATT rules allowed the regional trade agreements so long as they promoted freer intraregional trade without raising trade barriers for the third countries. These agreements have indeed been seen as complementary to the multilateral free trade initiatives. With the advent of the WTO and the onset of globalisation, the countries categorised as fast integrators are considered to have better prospects than those categorised as slow integrators.

Regional cooperation among developing countries has increasingly been advocated as a strategic tool for economic development. Generally, the rationale for regional cooperation is not merely economic; it is also political and socio-cultural. The economic case is based on small size of domestic markets, economies of scale in production, specialisation, and utilisation of the underutilised potential in terms of human, technological and natural resources. Through regional cooperation, developing countries are enabled not only to expand existing industries but also to establish new ones based on dynamic comparative advantage which helps them to diversify their industrial base.

The message was not lost out on less developed countries, experiencing rising expectations of their people and nurturing desires of catching up with the developed countries. In this region, Pakistan, Iran and Turkey entered into a grouping called Regional Cooperation for Development (RCD) in 1964. In its fifteen years (1964-79)

Pervez Tahir is Chief Economist of the Planning Commission, Government of Pakistan, Islamabad.

*Author's Note:* The author has written this article in his personal, not official, capacity. He acknowledges useful assistance provided by Mr Rab Nawaz Abbasi, Assistant Chief, International Trade and Finance Section of the Planning Commission. The author has written this article in his personal, not official, capacity.

of existence, the intraregional trade never exceeded the pre-RCD level of less than 2 percent of their aggregate GDPs. Economic Cooperation Organisation, the ECO, is successor to the RCD and, unfortunately, inherits all its problems.

### THEORY AND RULES

The orthodox theory of economic integration [Viner (1950); Meade (1955); Lipsey (1957)] determines its gains by judging the relative strengths of trade creation and trade diversion effects arising from economic integration.

Trade creation refers to a shift from high-cost domestic products to the low-cost products of the member countries in an economic union or regional bloc. This shift involves a production effect and a consumption effect. The former saves the real cost of domestic production owing to reduction in the production of and increase in the import of those goods which a member country can produce at a lower cost, while the latter enhances consumer satisfaction because of increased consumption of those goods which are now imported at lower price and were produced domestically at higher costs.

Trade diversion entails a shift in the source of imports from lower-cost external sources to higher-cost member-country sources as a result of economic integration or cooperation. The result is an increase in the cost of imports due to the shift from foreign to member-country sources and a loss of consumers' surplus resulting from the substitution of higher-cost goods for lower-cost goods.

Grubel-Lloyd (1975) show that differential technology and human capital cause intra-industry trade even if factor input requirements are identical. In the case of industries subject to increasing returns, countries can specialise in varieties so as to enter into intra-industry trade [Krugman (1981)].

In general, regional cooperation in developing countries leads to dynamic impacts embodied in technical change and economic restructuring pushed by comparative advantage. They can join hands to see globalisation as an opportunity rather than a threat. In the WTO era, facing up to new forms of protectionism such as anti-dumping duties, environmental quality and social standards, presents a challenge which is better managed by a regional bloc rather than by divisive individualism.

Economic integration is generally achieved through an evolutionary process of regional cooperation. The most outstanding example is the European Union (EU), which after achieving near-complete economic union, is seriously debating political union. In the Americas, the most important regional grouping is the North America Free Trade Area (NAFTA). The Association of South East Asian Nations (ASEAN) is the most successful economic grouping in Asia. These groupings are better positioned than individual countries to exploit opportunities offered by the rapid globalisation of the world economy. Under the WTO arrangements, these Regional Trading Arrangements (RTAs) are viewed as complements to multilateral free trade. Under the Article XXIV of GATT regional economic integration agreements are

permissible provided that the resulting liberalisation of trade among the countries in the group takes place without raising the pre-existing tariffs against third countries.

### THE ECO REGION

The Economic Cooperation Organisation (ECO) is an inter-governmental regional organisation, founded in 1985 by Iran, Pakistan and Turkey to promote economic, technical and cultural cooperation among the member states. ECO is the successor organisation to Regional Cooperation for Development (RCD), which was functional from 1964 to 1979, and its basic charter is enshrined in the Treaty of Izmir, originally signed in 1977. In 1992 it was expanded to include seven new members—Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. The origins of ECO have some similarity to those of ASEAN, as both regional bodies were the result of geo-strategic considerations to which an economic dimension was added. The RCD/ECO had little economic impact before its 1992 expansion and even thereafter. The Treaty of Izmir, which is the basic charter of ECO, lays down the following objectives of the ECO.

- Promotion of sustainable economic development of member states and raising the standard of living and quality of life of its people;
- Promotion of regional cooperation in economic, social, cultural, technical and scientific fields;
- Progressive removal of trade barriers and expansion of intra-regional trade;
- Development of transport and communication infrastructure in the member states;
- Human resource development;
- Development of the agricultural and industrial potential as well as human and natural resources of the region;
- Economic liberalisation and privatisation; and
- Utilisation of region's natural resources, in particular energy resource.

The people of the region are linked not only by natural geographic proximity but also centuries old historical and cultural bonds. In pre-colonial times, trade flowed freely within the region. There was also free movement of labour. The onset of colonialism disrupted these links, and the Soviet advance isolated them completely. As these states have regained sovereignty, there is no reason why traditional cultural links should not be reasserted and joint effort are made for prosperity and closer understanding among the people of the region.

With a total population of about 380 million (6.1 percent of the world population), the combined GDP of the ECO countries amounted to US\$ 500 billion in 2003. This constituted only 1.4 percent of the world GDP. The region is spread over an area of about 8 million square kilometre, twice the size of EU. At present the member countries produce about 6.8 percent of world crude oil supply and

absorb about 3.7 percent of world crude oil demand. The region exports more than 45 percent of the oil it produces, up from 40 percent during 1990s. The region is not only rich in natural resources but also in human capital. Despite being better endowed in natural resources, the economies of the region are facing serious problems of external debt, unemployment and poverty. Countries like Turkey, Iran and Kazakhstan with per capita GNI of \$ 2790, \$ 2000 and \$ 1780 respectively are the high-income member countries. Others like Pakistan, Uzbekistan and Kyrgyz Republic with per capita GNI \$ 470, 420, 330 respectively are low income countries. Afghanistan is at a fairly low level of per capita income (US\$ 174). Some countries have a serious poverty situation. As Table 1 indicates, the share of industry is small and in cases where it is high, the bulk of it is accounted for by oil and gas. A more relevant indicator for regional cooperation is the share of manufactures in exports. Here only Pakistan and Turkey figure prominently although they too have a high concentration in textiles and clothing.

Table 1

*ECO: Key Indicators*

|                 | GNI<br>Per Capita<br>(\$)<br>2003 | Share of<br>Industry in<br>GDP (%)<br>2003 | Share of<br>Manufacturing<br>in Exports (%)<br>2003 | External debt<br>Present Value<br>% of GNI<br>2002 | Poverty<br>Below \$ 1<br>a Day %* |
|-----------------|-----------------------------------|--------------------------------------------|-----------------------------------------------------|----------------------------------------------------|-----------------------------------|
| Azerbaijan      | 810                               | 54                                         | 6                                                   | 21                                                 | 3.7                               |
| Iran            | 2000                              | 37                                         | 9                                                   | 7                                                  | <2.0                              |
| Kazakhstan      | 1780                              | 39                                         | 19                                                  | 80                                                 | <2.0                              |
| Kyrgyz Republic | 330                               | 23                                         | 33                                                  | 93                                                 | <2.0                              |
| Pakistan        | 470                               | 23                                         | 85                                                  | 45                                                 | 13.4                              |
| Tajikistan      | 190                               | 20                                         | 13                                                  | 89                                                 | 10.3                              |
| Turkey          | 2790                              | 22                                         | 84                                                  | 77                                                 | <2.0                              |
| Turkmenistan    | 1120                              | 44                                         | 7                                                   | —                                                  | 12.1                              |
| Uzbekistan      | 420                               | 22                                         | —                                                   | 38                                                 | 21.8                              |

Source: *World Development Report 2005*.

\*Nearest available survey year.

### INTRAREGIONAL TRADE

During the five-year period 1998-2002, the total merchandise exports of the ECO member states reached the peak of US\$ 94.6 billion in 2002. The region contributed 1.54 percent and 1.65 percent of the world merchandise exports and imports respectively in 2003. In 2002, the intra-exports in the ECO region accounted for 5.4 percent. The rates of change in merchandise exports of ECO countries dropped sharply in 1998 when most of the members experienced negative rates of

growth in their merchandise exports reflecting the effect of the Asian crisis. However, the following years (except 2001) witnessed a strong recovery in export performance when member countries registered the highest average rates of change in their merchandise exports in 2002. After 1998, export performance of the region deteriorated again and experienced negative rates of growth (1.1 percent) in 2001, affected by the slowdown of world economy and the deterioration in world commodity prices.

Table 2  
*ECO Trade\**

|                                | (Billion US\$) |       |       |       |       |       |
|--------------------------------|----------------|-------|-------|-------|-------|-------|
|                                | 1998           | 1999  | 2000  | 2001  | 2002  | 2003  |
| Exports                        | 59.3           | 68.7  | 83.2  | 82.3  | 94.6  | 115.1 |
| Imports                        | 81.3           | 75.4  | 93.0  | 84.9  | 103.3 | 126.0 |
| Total Trade Volume             | 140.6          | 144.1 | 176.2 | 167.2 | 197.9 | 241.1 |
| Intra-trade Ratio<br>(Percent) | 5.3            | 5.0   | 5.3   | 5.1   | 5.2   | 5.1   |

Source: WTO, *International Trade Statistics 2003*.

\*Afghanistan not included.

The economic recovery achieved by the ECO countries as a group accelerated significantly in 2000 with average real GDP growth recorded at 6.2 percent compared to 0.6 percent contraction in 1999. However, due to the weakened world economic activity in late 2000 and during 2001, combined GDP of the ECO countries' dropped to US\$ 403.6 billion and real output growth declined to 1.1 percent in 2001, affected by negative growth (7.5) in Turkey. Nevertheless, ECO countries recovered significantly and real output growth increased to 7.3 percent in 2002. The ECO countries' average per capita GDP in 2001 and 2002 remained at US\$ 1,111 and US\$ 1,144 respectively owing to high population growth (2.0 percent during 2001-2002) of the region. At the individual country level, Afghanistan (US\$ 174) and Tajikistan (US\$ 189) were the countries with the lowest GDP per capita in 2002, while Turkey was the highest (US\$ 2,608) in the same year.

Efforts have been made by the ECO member states to promote intra-trade. They have taken steps for improvement of regulatory frameworks and removal of tariff and non-tariff barriers in the region. The regional intra-trade situation is, however, far from satisfactory and the prospects do not seem very good unless private initiatives backed by political will of the member states gain momentum. Total intra-regional trade volume of ECO region (excluding Afghanistan data) in 2002 increased to US\$ 10.2 billion from US\$ 8.6 billion in 2001. The intra-trade ratio of the ECO region (excluding Afghanistan data) in 2002 like the previous years could not cross the threshold of 6.0 percent. In fact, despite a high average rate of

growth in merchandise exports (14.9 percent), the region's share in total merchandise exports of the world increased by 0.2 percentage point over the previous year. This means that the ECO countries could not realise the potential of intra-regional trade reflected in its economic complementarities. When compared to other regional blocs like EU (61.7 percent), NAFTA (36.8 percent), ASEAN (23.31 percent), and Mercosur (19 percent), as seen in Table 3, the situation is rather dismal. The International Trade Centre in Geneva in a joint study with ECO Secretariat suggests that intra-regional trade should be far higher than it currently is. Econometric "gravity" models, which show that in the case of countries for which data are available, intra-ECO trade is actually less than what one would predict if factors such as size, distance, relative per capita income etc. are taken into account.

Table 3  
*Share of Intra-trade in RTAs*

| RTAs (No. of Members) | Exports |      |      | Imports |      |      |
|-----------------------|---------|------|------|---------|------|------|
|                       | 1995    | 2000 | 2003 | 1995    | 2000 | 2003 |
| EU(15)                | 64      | 62.4 | 61.9 | 65.2    | 60.3 | 61.7 |
| NAFTA (3)             | 46      | 55.7 | 56.1 | 37.7    | 39.6 | 36.8 |
| ASEAN (10)            | 25.5    | 24   | 23.3 | 18.8    | 23.5 | 23.3 |
| CEFTA(8)              | 16.2    | 13   | 13.6 | 12.3    | 10.2 | 11.3 |
| MERCOSUR (4)          | 20.5    | 21   | 11.9 | 18.1    | 19.8 | 19   |
| ANDEAN (5)            | 12.2    | 8.9  | 9.4  | 12.9    | 13.8 | 14.7 |

As noted above, Regional Trade Agreements have been one of the important tools for regional economic cooperation. The globalisation has, in many instances, been achieved through a process of regional preferential trade agreements and free trade agreements. The European Union (EU), North America Free Trade Area (NAFTA), the Association of South East Asian Nations (ASEAN) are some of the most successful examples. At present some 215 regional trade agreements and bilateral trade agreements are operational. By 2007, some 300 such agreements are expected to be in force. Some 40 percent of global trade is currently conducted within existing RTAs and BTAs (Bilateral Trade Agreements).

The success of intra-regional trade mainly depends on the countries forming an FTA (Free Trade Area) and allow the imports duty-free or at a preferential rate from the member countries. The products that may not enjoy concessions can be specified. However, the list should be small and must not contain the products that are of export interest for the member countries. If the sensitive list is large and

includes most of the items of export interest of the member countries, trade will not flourish. Similarly Rules of Origin should be so formulated that they do not unnecessarily constrain the growth of intra-regional trade. Moreover the anti-dumping and countervailing measures, though necessary for fair trade, should not be used as protective measures.

Attempts to follow the path in the ECO region have not had much success. A Protocol on Preferential Tariffs was signed by the three ECO members (Iran, Pakistan and Turkey) in May 1991. Lists were drawn up and implementation started in May 1993. However, this Protocol could not make any headway as the lists drawn were very limited in nature and the products on which preferential tariff was offered were not traded and a 10 percent margin could not have much impact anyway.

In July 2003, ECO countries also concluded a Trade Agreement known as ECOTA. The Agreement is a major step towards realisation of the objective of removal of trade barriers and establishment of Free Trade Area in ECO region by 2015. It is comprehensive in terms of commodity coverage to be realised over a period of 8 years by 2015 and will reduce the tariff to a maximum of 15 percent on 80 percent of the goods traded. The three founding member states agreed to adopt a fast track approach for early implementation of ECOTA by reducing maximum tariff to 10 percent within 5 years instead of 8 years.

A High Level Experts Group Meeting held in Islamabad in March, 2005 agreed on a protocol on "fast track" and also finalised the other related matters like ECO Rules of Origin and ECO anti-dumping code, Investment Agreement and sensitive lists of products etc. The forthcoming Ministerial meeting of ECO Trade Ministers is likely to sign the Fast Track Agreement. The Agreement when made operational will boost the trade among the member countries. However, there is need to keep the negative list to only a limited number of products and should not include the products of exports interest to member countries. ECOTA will also strengthen the overall process of economic reforms in the region's economies by having a more dynamic impact. It will serve as a counter balance to regionalism outside of ECO, as most of the member states in the region are part of other preferential trading accords. Without ECOTA this in itself would reduce intra-regional economic interaction. The ECOTA could also lead to greater inflows of FDI to the region as the multinationals perceive the region more as an integrated whole rather than just a group of small segmented countries which puts the region at a disadvantage relative to other developing regions pursuing economic integration accords. Besides removal of tariffs, other obstacles will also have to be removed which create inefficiency without any "trade off" effects. These include inefficient and insufficient telecommunication, transportation, banking and insurance system, high and discriminatory transit fees, unreliable and insecure transit routes, time consuming visa procedures for entrepreneurs, lengthy customs practices, quantitative restrictions on imports, licensing for certain imports etc.

## PAKISTAN AND THE ECO

Table 4

### *Pakistan's Trade with ECO Countries*

| (Million US\$) |         |         |         |         |
|----------------|---------|---------|---------|---------|
| Year           | Exports | Imports | Total   | Balance |
| 2000-01        | 290.87  | 455.63  | 746.50  | -164.76 |
| 2001-02        | 317.76  | 222.21  | 539.97  | 95.55   |
| 2002-03        | 546.96  | 465.57  | 1014.53 | 81.39   |
| 2003-04        | 825.96  | 421.59  | 1247.55 | 404.37  |

Source: Federal Bureau of Statistics.

Trade figures for four years show that Pakistan's exports to ECO countries have increased from US\$ 290.87 million in 2000-01 to US\$ 825.96 million in year 2003-04 showing an increase of 184 percent. However, imports decreased from US\$ 455 million to US\$ 421 million during the same period. Exports to Afghanistan increased from US\$ 140.4 million in 2000-01 to US\$ 492.87 million during 2002-04, showing an increase of 250 percent. Pakistan is also considering the import of gas from Turkmenistan and Iran, and power from Turkmenistan. After the completion of Gawadar Port and other missing transport links, transit trade is likely to get a boost.

## REGIONAL CONNECTIVITY

Without an effective modern transportation and communication network, the expansion of trade and economic integration cannot be realised. That is why the Transport and Communication has been identified as an area of cooperation among the member countries. This is particularly important because seven out of ten member states are land-locked i.e. Afghanistan, Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan and Turkmenistan. The location of these countries could be exploited by facilitating transit traffic links. So far the potential of the Central Asian Countries has not been realised primarily due to the significant "economic distance" from the market endured by transporters throughout the region. The economic distance can be significantly reduced not only by improving physical infrastructure but also by simplifying transit and clearance procedures, providing information to stakeholders and eliminating corruption.

The ECO has been instrumental in promoting cooperation in the field of transport and communication in the region. In this regard, five Ministerial meetings on Transport and Communication were held. The main achievements include the conclusion of a Transit Trade Agreement (TTA) and Transit Transport Framework Agreement (TTFA). The TTFA was signed in 1998 on the eve of Fifth ECO Summit and its 8 annexures were adopted in 2000. It is a comprehensive agreement, addressing all major issues and challenges in related



fields including customs, trade facilitation, road, rail and inland water transportation. The Agreement has been signed by 9 states and ratified by 5, while it awaits one more ratification to become operational. There is a need to familiarise Government officials as well as private sector with the requirements and operation of the TTFA and its annexures. The Agreement can emerge as a key driver for an efficient transit system in the region. If implemented in full, the agreement will integrate this economically developing but geographically landlocked region with the global market.

ECO has carried out a number of other projects to improve links. Preparation of Railway and Road Maps, identification of constraints on the custom border crossing points and common tariff policy are some of them. A container train is running fortnightly from Istanbul to Almaty through Iran. An international passenger train was also started from Almaty to Tehran. However regular train service could not operate due to some technical problems and high transit charges/visa fees by some of the member states. The passenger train can link Central Asian railway network to Iran and Turkey and further to Middle East and Europe. ECO is also working on removing physical obstacles in the field of road transport within ECO region and harmonisation of international road transport of goods. Unfortunately in most cases the member states are facing many technical problems at border points. Border custom authorities are not provided with I.T. equipment for smooth custom clearance, immigration authorities are unaware of visa rules and there is non-availability of maps in English or in Russian. In most cases the working hours are such that the drivers and traffic have to wait for several hours for processing their requests for entry. ECO Secretariat is working on a feasibility study for removal of physical and non-physical barriers on border crossing points. In this context, ECO is also working on another project i.e. Multi-modal Transport Project with the financial support of IDB and UNCTAD. There is long way to go to enjoy a modern and efficient transport and communication network.

A databank has been established on manufacture of products for telecommunications and postal technologies available in the region. ECO is actively promoting cooperation in energy, mineral and environment among member states. NESPAK has been selected for a feasibility study on inter-connection and parallel functioning of power systems in the region. Islamic Development Bank will provide financing for this feasibility study. The ECO Secretariat is exploring funds for another feasibility regarding route of oil pipeline.

Regional connectivity will also improve with the establishment of ECO Trade and Development Bank and ECO Re-insurance Company. Iran, Turkey and Pakistan have already signed and ratified agreements to this effect.

### OTHER AREAS OF COOPERATION

The economies of the region have the advantage of economic complementarities besides their cultural, historical, religious and geographical closeness which pave the way for economic cooperation based on comparative advantage benefiting all countries. For example Azerbaijan, Iran, Kazakhstan and Turkmenistan are oil/gas producing and exporting countries while Pakistan and Turkey are oil/gas importing countries. The Central Asian Republics have significant potential for hydroelectric power. Electricity demand in Pakistan is growing rapidly and is bound to strain domestic supply within the next few years. Similarly in Afghanistan, the underdeveloped power sector is a major constraint to economic and social development. The energy infrastructure in Afghanistan is undeveloped; only 6 percent of population has access to electricity and a mere 270 MW of generation is available domestically, which is far less than the demand. Tajikistan and Kyrgyz Republic have large untapped hydropower resources relative to their needs, which could potentially be developed into competitive regional power plants. There is immense potential for cooperation in this field. Similarly, Pakistan and Kazakhstan are exporters of agricultural products like wheat, rice, fruits and vegetables while Iran and Turkey are importers of these agricultural commodities. Pakistan's Textile Sector is in an advanced stage while countries like Turkmenistan, Kyrgyzstan, and Uzbekistan are trying to establish competitive textile industry. They can benefit from Pakistan who in turn can further strengthen its competitiveness in textile industry in collaboration with these countries. Turkey has developed its automobile industry and Pakistan's automobile industry can benefit from their experience. There is a lot of room for intra industry trade among the countries of the region. Pakistan and Kazakhstan can increase their exports of agricultural products like rice, fruits and vegetables etc. to Turkey and Iran.

### CONCLUSION

The acid test of the success of a regional grouping is its impact on Intraregional trade. In this regard, the performance in the post-ECO period is not very different from the pre-ECO situation. In part, the security situation in Afghanistan and the different stages of transition from the centrally planned to the market economy in the Central Asian Republics are responsible for the lack of progress on trade. Other factors include poor infrastructure, weak institutional implementation mechanism in the member countries, inadequate comprehension of regional cooperation among the bureaucracies of the member states and lukewarm political will. Political will has to become stronger and statesmanship will have to be shown to effectively implement the agreements such as TTFA, TTA, ECOTA. If things remain as they are today, the fate of ECO will be no different from the fate of the RCD.

**REFERENCES**

- ECO (2004) *Bulletin*. November.
- ECO (2005) Secretary General's Report to the 15th Meeting of Regional Planning Council.
- Grubel, H., and P. Lloyd (1975) *Intra Industry Trade: The Measurement of International Trade in Differentiated Products*. New York.
- Husain, Javid (2004) Does Pakistan Need the ECO? *Dawn*, July 8.
- Krugmen, P. R. (1981) Intra-Industry Specialisation and the Gains from Trade. *Journal of Political Economy* 89:5.
- Lipsey, Richard (1957) The Theory of Customs Unions: Trade Diversion and Welfare. *Economics* 24:93, 40–46.
- Meade, James E. (1955) *The Theory of Customs Unions*. Amsterdam: North-Holland.
- Pakistan, Government of (Various Issues) *Monthly Bulletin*. Federal Bureau of Statistics.
- Tahir, Pervez (1974) Economic Regionalism in the RCD Countries. Islamabad: Pakistan Institute of Development Economics. (Research Report Series No. 105.)
- Viner, J. (1950) *The Customs Union Issues*. New York: Carnegie Endowment for International Peace.
- World Bank (2004) *Trade and Transport Facilitation in Central Asia: Reducing the Economic Distance to Markets*. Washington, D.C.
- WTO (2003) *World Trade Statistics*. Geneva.