

PROSPECTS AND POSSIBILITIES OF INTRODUCING A COMMON CURRENCY IN SAARC COUNTRIES

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ABSTRACT

The growth of regional economic cooperation arrangement is one of the major developments in the post World War II period. The formation of regional integration has been greatly successful in bringing historically hostile countries together. The classic example is the state in the European Union and the South East Asia where economic dimensions have brought long time foes in the same dais. The basic premise on which SAARC was founded was that by activating cooperative cultural identities and economic interests, political conflicts and tensions in South Asia could be moderated, if not completely eliminated. It looks advantageous if SAARC countries could adopt a single currency-substantially enhancing their bargaining power together in the world market. In this paper drive has been made to analyze the possibilities and benefits of a single currency in SAARC countries. A common currency's attraction is that it doesn't represent the currency of any single country. It's advantageous to deal with a lesser number of currencies since each time one converts a currency there is a huge loss. The common currency regime, when achieved, can present substantial benefits to the region. With uncertainty about exchange rates removed, and transaction costs reduce trade and investment in the region can get a big boost. Also with money creation under regional guidelines, there would be better prospects of synchronization of inflation, interest rate and GDP growth, all of which can contribute to accelerated growth and poverty reduction.

Keywords: exchange rate, gross domestic products, transaction cost, economic integration.

INTRODUCTION

After the Second World War, the world experienced a major change in terms of economic cooperation. The growth of regional economic cooperation arrangement is one of the major developments in the post war period. The formation of regional integration has been greatly successful in brining historically hostile countries together. Both economic and political factors are responsible for the formation of regional agreements, but economic factor is the prevailing factor in pushing a country towards regional integration. The classic example is the states in the European Union and the Southeast Asia where economic dimensions have brought long time foes in the same dais.

The basic premise on which SAARC was founded was that by activating cooperative cultural identities and economic interests, political conflicts and tensions in South Asia could be moderated, if

not completely eliminated. SAARC now stands at a critical stage of are evolution where, given the right push, it can overcome past constraints and barriers to emerge as a dynamic factor in the peace and prosperity of more than a billion South Asians. The recent SAARC head of states conference in Dhaka showed a hint of improved cooperation among the member countries. The activation of SAFTA is a step towards more integrated economic cooperation.

A common currency's attraction is that it doesn't represent the currency of any single country. From an economist's point of view, it's advantageous to deal with a lesser number of currencies since each time one converts a currency there is a huge loss. From the perspective of comparative advantage enjoyed by some of the South Asian countries in export of certain items like tea in the case of India and Sri Lanka, jute in the ca e of Bangladesh and India, basmati rice and cotton in the case of India and Pakistan, it looks advantageous if SAARC

countries could adopt a single currency-substantially enhancing their bargaining power together in the world market.

This report evaluates the opportunity of introducing a common currency for the SAARC and also examines the feasibility of that common currency while taking overall current situation under consideration.

Literature Review

Very few researches have been conducted on the implementation and benefits of common currency in south Asian countries.

Sexana (2004) tried to identify whether the South Asian countries satisfy the criteria to form a monetary union and to enjoy the benefits of single currency. This study discovered that not only the economic criteria but also the geo-political factors are the important determinants in the decision to move to a single currency. It argued that the benefit of monetary union and common currency would help to develop the economic integration in the form of higher formal trade, peace, and stability within the South Asian countries. The literature emphasized trade as the main channel through which benefits from a common currency would be enjoyed, because they are likely to benefit from low transaction costs and elimination of exchange rate risks. This study also mentioned that labor mobility had been emphasized in the optimum currency area literature as it helps the members of a monetary union to adjust to asymmetric shocks by allowing labor to move from high unemployment areas to low unemployment areas. Rajesh (2002) mentioned that with the implementation of common currency in the European Union, created the opportunity of the era of boundless prosperity. He also stated that South Asia could be benefited by implementing the common currency. If common currency is implemented by South Asian countries the transaction costs of one currency to another can be eliminated, which will reduce the costs of production and distribution. He also mentioned that if conversion costs can eliminate and South Asian countries permits free trade, the informal trade could be translated to formal trade, in turn government would be able to earn valuable revenue. In this study he found some impediment towards a common currency. He mentioned that considerations of sovereignty had traditionally weighted heavily on South Asian countries, this is

why the collective decision making in SAARC network is very slow. The major drawback in the implementation of common currency is the economic condition of the countries. South Asian countries are plagued with weak economic fundamentals as well as different level of economic development. To overcome these situations he suggested establishing South Asian Central Bank which will formulate an appropriate common monetary policy.

Common Currency:

Common currency means that individual countries do not have their own currency, and whole task of currency creation and monetary policy is agreed at a regional level with agreements on national component of currency and money creation. Interest rate and exchange rate policies are also centralized. That system requires surrender of monetary sovereignty associated with currency creation and monetary expansion.

In the context of European integration movement, the first stage was introduction of European Currency Unit (ECU), a composite monetary unit consisting of a basket of European Community currencies and the process of consolidation under European Monetary Union (EMU) before gradual evolution to the single currency, Euro.

Benefits of a Common Currency

The common currency regime, when achieved, can present substantial benefits to the region. With uncertainty about exchange rates removed, and transaction costs reduced trade and investment in the region can get a big boost. Also with money creation under regional guidelines, there would be better prospects of synchronization of inflation, interest rates and GDP growth, all of which can contribute to accelerated growth and poverty reduction. In fact, a common currency regime can eventually play an important role in convergence towards a target of 7-8 per cent per annual GDP growth for all countries of the region, which is essential. South Asia could benefit most if a common currency is instituted for the whole region. The benefits could be:

** Reduction in transaction costs across the frontiers. In fact, conversion of one currency to another involves costs that increase the production and distribution costs.

** Facilitating the movement of scientific and technical manpower among member nations, as conversion losses will be neutralized.

** As the conversion costs are eliminated, a common currency could play a major role in reducing informal trade. If free trade is permitted in the region, much of this informal trade could be translated into formal trade that, in turn, could earn valuable revenue for the governments.

** Pre-empting a South Asian Central Bank, which will facilitate further economic integration.

Discussion In Light of European Union & Euro

As discussed in the introduction, political and economical factors are the stimulus for pushing countries towards regional integration. European Union is the precise example in this case. After the Second World War, the whole Europe was left, by economic and human destruction. The then European political leaders realized that the only way to recover from this devastating situation was to go for a greater cooperation among the European Countries. Many organizations were formed, including the European Economic Community (EEC), which eventually emerged as the organization that would bring together the countries of Europe into the most powerful trading bloc in the world. The EEC, later called the European Community (EC), and finally the European Union (EU), set about to abolish internal tariffs in order to more closely integrate European Markets and allow economic cooperation to help avoid further political conflict. EU ultimately succeeded in pursuing its goal and currently EU is the only monetary union in the world.

History of Euro

The Treaty of Rome (1957) declared a common European market as a European objective with the aim of increasing economic prosperity and contributing to "an ever closer union among the peoples of Europe". The Single European Act (1986) and the Treaty on European Union (1992) have built on this, introducing Economic and Monetary Union (EMU) and laying the foundations for a single currency. The third stage of EMU began on 1 January 1999 when the exchange rates of the participating monetary policy; the euro was

introduced as a legal currency. The steps through introducing the Euro are described below in brief:

8 October 1970: Werner Report

The Werner Report proposed a three-stage plan to create an economic and monetary union within a decade. The three stages to achieve EMU were set out as follows:

1. Reduction of the fluctuation margins between Member States' currencies, broad guidelines for economic policy at Community level, co-ordination of budgetary policy, preparation of Treaty changes to facilitate later stages of EMU.
2. Integration of financial markets and banking systems to create free movement of capital, progressive elimination of exchange rate fluctuations, closer co-ordination of short-term economic policies and budgetary and fiscal measures.
3. Irrevocable fixing of exchange rates between participating national currencies, convergence of economic policies, establishment of a Community 'system of central banks.

5 December 1978: European Monetary System

Following a Franco-German initiative, the Community decided to re-launch monetary integration at the Brussels European Council by creating a European Monetary System (EMS), with the objectives of stabilizing exchange rates, reducing inflation, and preparing for monetary integration. The EMS entered into force on 13 March 1979. The system consisted of three elements:

1. Currency basket (European Currency Unit or ECU);
2. Monetary stabilization mechanism (Exchange Rate Mechanism or ERM);
3. Mechanism for financing monetary interventions (European Monetary Co-operation Fund or FECOM).

The ERM gave each currency a central exchange rate against the ECU, which also gave them central cross rates against each of the other participating currencies. Participants were then required to maintain their exchange rates within a 2.25% fluctuation band above or below each bilateral central rate, except Italy, which had a margin of

6%, and the United Kingdom, which initially remained outside the system.

17 and 28 February 1986: Signature of the Single European Act

The Single European Act was signed with the aim of creating "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty." In practice, this meant an ambitious program of legislation to eliminate the ongoing barriers to internal trade between Member States. It would also end the fragmentation of the Community market, which had been considered a hindrance to Europe's competitiveness at international level. Monetary cooperation was included as a new area of Community competence.

12 April 1989: Delors Report

The Delors Report set out a plan to introduce EMU over three stages, including an institutional framework to allow policy to be decided and executed at the Community level in economic areas of direct relevance for the functioning of EMU. It included the creation of a monetary institution, namely a European System of Central Banks (ESCB), which would become responsible for formulating and implementing monetary policy as well as managing external exchange rate policy. Unlike the Werner Plan, it did not propose a new body to co-ordinate economic policy, but rather that these functions could be carried out within the existing institutional framework. The three stages for the development of EMU were:

1. Stage One: Increased co-operation between central banks with relation to monetary policy, removal of obstacles to financial integration, monitoring of national economic policies, and co-ordination of budgetary policy.
2. Stage Two: Preparatory stage for the final phase of EMU, establishment of the ESCB and progressive transfer of monetary policy to European institutions, narrowing of margins of fluctuation within exchange rate mechanism
3. Stage Three: Fixing of exchange rates between national currencies and their replacement by a single European currency, responsibility for monetary policy would be transferred to the ESCB. Most of the ideas set out in the Delors report later formed the basis for the EMU provisions agreed in the Maastricht Treaty.

8-9 December 1989: Strasbourg European Council

The Member States meeting at the Strasbourg European Council decided to convene an Intergovernmental Conference (IGC) to prepare changes to the Treaty of Rome for the development of EMU.

7 February 1992: Treaty of Maastricht signed

The IGC culminated in the new Treaty on European Union, signed at Maastricht, which established EMU as a formal objective. Treaty set out a number of economic convergence criteria for member states to participate in EMU, concerning the inflation rate, public finance (relating to deficits and debt), exchange rate stability and long term interest rates.

1 January 1994: Second stage of EMU: Launch of EMI

European Monetary Institute (EMI) was established as the forerunner to the European Central Bank, with the objective of helping establish:

"the conditions necessary for the transition to the third stage of economic and monetary union by strengthening the co-ordination of monetary policies with a view to ensuring price stability; making the preparations required for the establishment of the European System of Central Banks, and for the conduct of a single monetary policy and the creation of a single currency in the third stage."

(Article 2 of the Protocol on the EMI).

This included the tasks of strengthening co-operation between the national central banks; strengthening the co-ordination of national monetary policies with the aim of ensuring price stability; and supervising the technical preparation of ECU banknotes. The banker and economist Alexander Lamfalussy was appointed as President of the EMI.

1 June 1998: Creation of the European Central Bank (ECB)

The European Central Bank was created when the Member States adopting the euro, replacing the EMI, appointed the Members of its Executive Board. The bank continued the EMI's work on preparations for the new currency to be launched on 1 January. The first president would be Wim Duisenberg, former president of the Dutch central bank.

31 December 1998: Conversion rates fixed

Conversion rates between the participating national currencies and the euro were irrevocably fixed, and become the official rates to be used for all conversions from national currencies to the euro. The value of one euro was equal to one ECU. Regulation fixing the conversion rates for the euro.

1 January 1999: Birth of the euro

The euro became the new currency for eleven Member States and a single monetary policy was introduced under the authority of the ECB, heralding the third and final stage of monetary union. Legally, the participating national currencies had ceased to exist and became 'non-decimal subdivisions' of the euro. Euro area financial markets switched to the euro, including foreign exchange, share and bond markets. New euro area government debt was exclusively issued in euro as from that day. The three year transition period before the introduction of euro notes and coins began, with the principle of 'no compulsion no prohibition' meaning people and businesses had the freedom to carry out transactions in euro, but were under no obligation to do so.

The Euro system's primary objective is the maintenance of price stability. It meets its objectives through: (a) deciding and implementing monetary policy; (b) conducting foreign exchange operations; and (c) operating payment systems'. The NCBs' of the participating Member States played a key role in the smooth transition to the euro. Their responsibilities have included: (a) introducing the euro in their respective countries; (b) managing the changeover from national currencies to the euro; (c) creating the necessary systems to effectively circulate the euro banknotes and coins; (d) withdrawing national currencies; and (e) providing advice about and promoting the use of the euro.

Steps Needed to Introduce a Common Currency

Economic cooperation is an integrated process. To achieve economic integration such as introduction of common currency, a certain level of integration is necessary. Otherwise it will never be possible to introduce a common currency in any such region. Before economic integration there are three levels of cooperation exists. In the following they are described in brief:

Free trade area

Free trade area is the least level of integration. In a free trade area, all barriers to the trade of goods and services among member countries are removed. In the theoretically ideal free trade area, no discriminatory tariffs, quotas, subsidies or administrative impediments are allowed to distort trade between members. Each country however is allowed to determine its own trade policies with regard to non members. Thus for example the tariffs placed on the products of nonmember countries may vary from member to member. The integration of the European Union started as the free trade area.

Customs union

The customs union is one step further down the road for complete economic integration. A customs union eliminates trade barriers between member countries and adopts a common external trade policy. Establishment of a common external trade policy necessitates significant administrative machinery to oversee trade relations with, non members. The European Union has been able to establish customs union and has moved beyond this stage.

Common market

The next level of economic integration is common market. A common market has no barriers to trade between member countries, includes a common external trade policy, and allows factors of production to move freely between members. Labor and capital are free to move because there are no restrictions on immigration, emigration, or cross border flows of capital between member countries. Establishing a common market demands a significant degree of harmony and cooperation on fiscal, monetary and employment policies.

Economic union

Economic union is the level of integration that we are seeking in this report in South Asia. Like the common market, an economic union involves the free trade flow of products and factors of production between member countries and the adaptation of a common external trade policy but it also requires a common currency, harmonization of members' tax rates and a common monetary and fiscal policy. Such a high degree of integration

demands a coordinating bureaucracy and the sacrifice of significant amount of national sovereignty to that bureaucracy. The European Union is an economic union, although an imperfect one since not all members of the European Union have adopted the Euro, the common currency of the region and differences in tax rates across countries still remain.

Rationale behind Common Currency

In this report we are trying to develop a hypothesis. This hypothesis we are calling the rationale behind economic cooperation that is introducing a common currency. The introduction of common currency will be beneficial up to highest point if there is interdependency between the member countries that are going for a common currency. For example the inter trade among the European Union countries was a significant amount. For this reason the transaction cost of converting currencies was huge. Since they were heavily independent and the inter trade cost them a lot, they went for introducing a common currency.

So if we can show that there is great deal of interdependence among the South Asian countries then, it can be viable basis for introducing a common currency. In the following, a statistics is given in percentage terms of inter trade among the South Asian nations. In the following statistics India is considered to be the base country. Then we have tried to compare that how much each of the other six countries is dependent on India in terms of Trade.

Economic indicator: Trade

Table 01: Inter regional export (Major partners)

Country	BNG	BHU	IND	MAL	NEP	PAK	SRL
BNG	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig
BHU	Nsig	Nsig	35.50%	Nsig	Nsig	Nsig	Nsig
IND	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig
MAL	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig	13.40%
NEP	Nsig	Nsig	54.40%	Nsig	Nsig	Nsig	Nsig
PAK	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig
SRL	Nsig	Nsig	07.20%	Nsig	Nsig	Nsig	Nsig

Nsig=insignificant

The above table shows the percentage figures of inter regional export of South Asia. The blank space indicates either insignificant export or no

export relationship with "the countries. From the table it is evident that 35.55% of Bhutan's total export is to India.

Similarly Nepal exports 54.4% of its total export to India. Sri Lanka on the other hand exports only 7.2% to India. Maldives export 13.4% of its total export to Sri Lanka. Bangladesh and Pakistan have no significant export trade relationship with any of the South Asian countries.

Table 02: Inter regional import (Major Partners)

Country	BNG	BHU	IND	MAL	NEP	PAK	SRL
BNG	Nsig	Nsig	14.70%	Nsig	Nsig	Nsig	Nsig
BHU	6.70%	Nsig	85.60%	Nsig	Nsig	Nsig	Nsig
IND	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig
MAL	Nsig	Nsig	9.60%	Nsig	Nsig	Nsig	10.00%
NEP	Nsig	Nsig	48.40%	Nsig	Nsig	Nsig	Nsig
PAK	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig	Nsig
SRL	Nsig	Nsig	14.40%	Nsig	Nsig	Nsig	Nsig

The above table shows inter regional import trade relationship. From the table it is evident that except Pakistan, all the countries have import relationship with India and they are quite significant. Bangladesh imports 14.70% of its total import from India and in fact India is the highest import partner of Bangladesh. Same thing goes for most of the countries.

So from the above two tables it is evident that though all the countries are not that much dependent to each other in terms of export, they are very much dependent on India terms of import. Since these countries are importing significant amount from India, it involves a transaction cost during currency conversion. So if a common currency can be introduced then, this transaction cost of currency convertibility can be eliminated and all the member countries will be benefited.

Comparative Analysis of Economic Indicators (Refer to Appendix)

The inflation rate of the South Asian countries is quite unstable. The rate has been 1994-2003 significantly. Instead of being members of a common region, their inflation rates do not follow the similar trend. The only exception is India where the inflation rate is almost stable for the last five years.

No wonder, India has the highest GDP among the SAARC countries, as it possesses the largest population as well as largest country size and resources. The GDP growth rate of the seven SAARC countries during the period 1994 - 2003 lacks steadiness. Although, India and Bhutan show a stable growth rate in GDP, other countries suffer from significant fluctuations. Specially, Nepal and Sri Lanka had an experience of negative growth rate and Pakistan had its least growth of 1.0% in 1997 from 4.8% in 1996.

All the seven SAARC countries have trade deficit. Taking the individual country size, population and the deficit trade amount under consideration, we see that Pakistan has shown a better performance in the last few years of that period. Obviously India and Bhutan have the largest and lowest trade deficit respectively because of their population size.

The foreign reserve amount of India has a steady growth since 1994. India experienced a sharp increase in reserve fund from 2002. Opposite scenario is found for Sri Lanka. It had a decreasing trend from the year 1994 to 2000, and afterwards the reserve has been increasing gradually. Pakistan had a very much fluctuating reserve condition up to the year 2000. Then it has started increase its reserve significantly. Bangladesh had its best reserve in 1994 and then reserve went through some fluctuations up to 2001. Since then, Bangladesh has been increasing its reserve amount.

At the end, by observing all the relevant economical features of the seven SAARC countries, we can come to a conclusion that these countries lack homogeneity. They differ from each other at a large scale in terms of inflation rate, GDP growth rate, trade balance and foreign exchange reserve.

Disadvantage of Common currency & Impediments to Economic Union

The biggest disadvantage of economic integration is that there has to be a regional central bank and that bank will be the sole authority in making regional monetary policies. Like the European Central Bank, a similar South Asian Central Bank has to be created in order to supervise the common currency. Now this means individual countries cannot make their own monetary policies. This is where the problem begins. The considerations, of sovereignty have traditionally weighed heavily on South-Asian Countries. They have been averse to

surrendering their decision-making powers on a wide range of issues.

Collective decision-making is a slow affair in the SAARC network. Even matters of vital importance lie in balance for decades without any decision being made. The issues of the creation of SAPTA and SAFTA are good instances. The creation of both would have enabled all countries of the region derive vital producer and consumer surpluses. But decisions on this issue have been notoriously slow.

Another awkward block is the peculiar geography of the region. India is bigger than all the other countries of the region put together. This has driven the smaller countries to believe that India is the 'dominant big brother'. Consequently, any meaningful effort on India's part is looked upon with suspicion.

This region also lacks in homogeneity in terms of economic variables like inflation, GDP growth rate and some other. This lacking in homogeneity is a big impediment in introducing common currency. South Asia is also weighed down by its weak economic fundamentals. For the creation of the monetary union, controlling inflation within a fixed range is a pre-requisite. But in the South-Asian region, different countries are at different levels of economic development.

Present Political Problems in South Asia

Intra-state conflicts

There is no single factor as main cause of conflict in South Asia. It involves many issues and provides a disappointing picture in every social, economic and political context. This is due to the fact that South Asia is almost perpetually burdened by various inter and intra-state conflicts and crisis stemming from the careless approach of the ruling forces toward resolution of such problems which are based on narrow considerations of caste, religion, ethnicity, language, community, and the like. This distorts the, national integrity and the overall law and order situation of the affected states.

Furthermore, South Asia is an area of tremendous political complexities. States like Pakistan have been largely ruled by authoritarian military rulers. India, as such faces several unresolved issues that stem from internal as well as external sources.

These include ethnicity, border disputes, separatist demands, terrorism and subversive activities, communalism, religious problems and so on.

In Nepal, for example, the series of democratically elected government failed to produce any better result than the old royal regime due to widespread corruption and crisis of good governance. The political fundamentalists such as Maoists and mainstream political parties are posing major threat to democracy in Nepal. In addition to creating law and order problems, increased human rights violations and a heavy reliance on security forces have undermined the question of legitimacy of governance in Nepal. Moreover, the problem of civil violence in recent years has emerged as a more serious security issue than the problem of inter-state warfare in South Asia. India has been variously preoccupied with separatists and religious conflicts such as in the state of Punjab and Kashmir, an issue that remains controversial between India and Pakistan. Also the conflict with separatists of Mizoram, Assam, and Nagaland (Eastern India) for autonomy and in Gujrat, Mumbai and other parts have certain religious, ethnic, psychological and economic underpinnings.

Sri Lanka has also had its own set of problems. Democracy in this tiny island-nation remains overshadowed by the civil war originating from Tamil-Singhalese ethnic conflicts. These conflicts in Sri Lanka have pushed successive governments on the edge of collapse. Ruling parties in Sri Lanka failed to reform economic policies due to polarized political debate. In Pakistan, the society faces periodic bursts of violence derived from ethnic, sectarian and religious differences in its diverse community. For instance, conflict in the Sindh province between ethnic Sindhis and those residents who migrated from India following partition has made the province, especially its capital Karachi, ungovernable. Conservative religious elements are also very powerful in Pakistan leading to tensions and conflicts over religious differences, which has also played a major role in sustaining the Indo-Pakistan disagreement over Kashmir. Religious fundamentalism is also evident in Bangladeshi society manifesting itself in attacks on cultural groups, judges, prominent non-governmental organizations (Bangladesh Rural Advancement Committee and the Grameen Bank). Recent series of bomb blasts in Bangladesh are the evidence of fundamentalism which terrorized the whole nation.

Similarly Bhutan and Maldives - the two smallest members of the SAARC also have their own arrays of internal problems. The emerging internal political problems in Bhutan and the fallout of attempted coup in Maldives in 1987 have varying affects in uniting the country for the cause of development. All this can largely be attributed to the fact, that political and governing institutions in most of the South Asian countries are weak while the political parties themselves lack strength, organization, discipline, and commitments. Taken individually, each of the South Asian states suffer from some kind of instability and consequently projects varying intensities of human deprivation.

Inter-state conflicts

South Asia is one of the critical regions with complex security in the world primarily due to the fact that most of the South Asian states are engulfed with varying degrees of conflicts and disputes. Inter-state conflicts in South Asia probably are highest compared to any other regional blocs. Bilateral relations are defined by hostility and mistrust. The differences between India and Pakistan over Kashmir, between Sri Lanka and India; over the nationality of Tamilian, where Sri Lanka accused India, especially state government of Tamil Nadu for supplying arms and providing trainings to the Tamil terrorists in its Southern areas are only two of the most outstanding examples in this regard. Dispute exists between India and Bangladesh over illegal migration from the Chittagong Hill Tracts (CHT) and the demarcation of boundaries involving fertile islands and enclaves and also in sharing the water of river Ganges. Recently when a series of bomb blasts occurred in Mumbai, India directly accused Pakistan and Bangladesh for facilitating; the attack.

The most pronounced security dilemma, however, stems from escalating arms race in South Asia, particularly between the two military powers - India and Pakistan. These disputes among countries further complicate the scenario and have created a lot of problems among the leaders for friendly talks.

Similarly the cultural diversity based in languages, religions and ethnicities is another factor that disables the region to unite. Rather it frequently exerts a negative impact on inter-state relations in South Asia due to religious differences. Countries with widely differing political systems -

democracies, military dictatorships and monarchies, characterize the area. Though most of the South Asian states have emerged with shared colonial pasts, similar political experiences, common social values divergences, however, are still significant. India and Sri Lanka are said to have performed better than other functioning democracies with varying degrees of success. Pakistan and Bangladesh at the beginning of the 1990s witnessed a sweeping democratic transition in their domestic scenarios. Nepal's transition to democracy is at the crossroad following the Maoist movement. Bhutan retains the authority of monarch as the dominant institution while the Maldives has yet to experience multiparty political systems.

The troubles in South Asia, its widespread tensions, mutual distrust and occasional hostilities are largely considered products of the contradictions of India's security perception with that of the rest of the countries of the area. India's neighbors perceive threats to their security coming primarily from India whereas India considers neighbors as an integral part of its own security system. The supremacy of India in the South Asian power configuration given its geography, demography, economics, and ecology is something about which neither India nor its neighbors can do nothing but accept. But, the image of India in South Asia is that of a power that demands habitual obedience from its neighbors. Thus, the main theme of this doctrine is that South Asia is to be regarded as an Indian backyard. No wonder then, that there has always been certain psychological doubt on the part of the smaller states about their all-powerful neighbor India.

Recommendation

The first and immediate step that can be taken is to introduce a parallel currency and utilize that instrument effectively to promote regional cooperation in trade and investment, which can eventually prepare the ground for a common currency.

The parallel currency will be fully convertible into any international currency and will be fully backed by reserve fund. It will be legal tender for cross country transactions within South Asia and will be increasingly used as unit of account for trade and investment transactions within the region. The issue of stability of the parallel currency will of course be important. However, it should be

noted that relative values of currencies in South Asia in the last ten years have been more stable than those between the three major world currencies, US\$, Euro and Yen which dominate the SDR.

South Asian countries can create a pool of foreign exchange reserves in an institution. Backed with these reserves, the parallel currency, equivalent of a multiple of basic reserves, can be created to be used for giving loans or buying bonds issued by South Asian governments or corporations as appropriate. The lending rates on these loans will be higher than the interest paid on reserves which will be higher than what most reserves banks in the region are getting today from their dollar reserves. As the parallel currency gets accepted the reserve fund can earn profits, which will be distributed among members as grants for development purposes. The principle of creation and utilization of SDRs¹ for development purposes has been advocated by a long line of economists.

Provision of regional public goods and concessionary assistance for the lagging regions will help to build confidence in the region and facilitate bolder programmers such as open borders, labor mobility and common currency. The manner in which the bigger countries in Europe won the confidence of the smaller countries and helped to accelerate development of lagging will be a model for South Asia to learn from. The steps involved in the proposed process are: (a) creation of a parallel currency and associated agreements for its stability, (b) setting up of a reserve fund, (c) funding of regional public goods to promote trade and investment, (d) special and differential treatment of lagging parts of the region to help the convergence process in the region, and (e) building of mutual trust and confidence among the partners in the region. These steps will create conditions, which are usually necessary for a common currency area. SAARC Summit could take steps to set up a Working Group comprising of Central Bank Governors to evaluate; the feasibility of the proposal and take it forward.

CONCLUSION

The formation of SAARC was a landmark step taken by the leaders of the region. The main rational behind was to develop a friendly environment through summit diplomacy where all

nations could interact peacefully with each other, cultivate sustainable peace and promote mutual economic well being by harnessing available resources in the region through the process of economic integration. Nevertheless, after 20 years' of establishment, neither South Asian nations have been able to push the process of integration into full swing nor the organization itself has become viable that could promote peace and harmony or prevent conflicts in the region. South Asia has emerged as a regional entity in the international political system with the creation of SAARC but it failed to strengthen regional cohesiveness. Regional cooperation in South Asia cannot be said to have evolved into a complete bloc in terms of regionalism and economic integration due mainly to the prevalence of conflict over the desire of peace and stability.

Hence right at this moment, SAARC countries have to improve their relationships and attitudes towards each other and they need to take initiatives to eliminate the existing conflicts among them. In order to introduce a common currency in the region, economical homogeneity is the prime factor, which has some deficiencies in the SAARC countries. Any move towards introducing a common currency for SAARC countries in recent time will not be viable unless a good neighborly relationship and economic homogeneity in the region are achieved.

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10. http://europa.eu.int/comm/economy_finance/euro/our_currency_en.htm
11. http://europa.eu.int/comm/economy_finance/euro/transition/transition_main_en.htm
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Appendix

Table-1: Inflation Rate

Country	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Bangladesh	3.30	8.90	6.70	2.50	7.00	8.90	3.40	1.60	2.40	5.10
Bhutan	7.00	9.50	8.80	6.50	10.60	6.80	4.00	3.40	2.50	1.60
India	10.20	10.20	9.00	7.20	13.20	4.70	4.00	3.90	4.10	4.00
Maldives	3.40	5.50	6.20	7.50	-1.40	3.00	-1.20	0.70	0.90	-2.90
Nepal	9.00	7.60	8.10	8.10	8.30	11.40	3.50	2.40	2.90	4.80
Pakistan	11.20	13.10	10.70	11.80	7.80	5.70	3.60	4.40	3.50	3.10
Sri Lanka	8.40	7.70	15.90	9.60	9.40	4.70	6.20	14.20	9.60	6.30

Table-2: GDP at current market Price (\$)

Country	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Bangladesh	33.670	37.870	39.800	41.170	42.680	44.760	45.470	45.430	47.190	51.690
Bhutan	0.274	0.310	0.333	0.394	0.403	0.445	0.488	0.536	0.598	
India	322.809	366.364	386.138	419.281	421.961	449.846	464.936	483.644	508.033	591.455
Maldives	0.343	0.399	0.434	0.484	0.529	0.570	0.595	0.591	0.600	0.647
Nepal	4.034	4.224	4.391	4.836	4.560	5.012	5.338	5.481	5.422	5.959
Pakistan	51.072	58.968	58.765	59.442	59.442	59.360	70.709	67.219	73.701	83.483
Sri Lanka	11.720	12.924	13.897	15.795	15.795	15.657	16.332	15.746	16.544	18.237

Table-3: Annual Percentage Change in GDP

Country	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Bangladesh	4.10	4.90	4.60	5.40	5.20	4.90	5.90	5.30	4.40	5.30
Bhutan	6.10	7.40	5.20	7.20	6.40	7.70	5.50	7.10	6.70	6.60
India	7.30	7.30	7.80	4.80	6.50	6.10	4.40	5.80	4.00	8.10
Maldives	7.50	7.40	9.10	10.40	9.80	7.20	4.80	3.40	6.50	8.40
Nepal	8.60	3.30	5.30	5.30	2.90	4.50	6.10	4.70	-0.60	3.70
Pakistan	3.70	5.00	4.80	1.00	2.60	3.70	4.30	1.90	3.20	5.10
Sri Lanka	5.60	5.50	4.00	6.40	4.70	4.30	6.00	-1.50	4.00	5.60

Table-4: Trade Balance (ml US\$)

Country	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Bangladesh	-1657.0	-2361.0	-3063.0	-2113.0	-1669.0	-1934.0	-1865.0	-2011.0	-1708.0	-2207.0
Bhutan	-29.5	-27.3	-13.2	-32.0	-24.8	-57.6	-70.7	-96.8	-82.9	-75.9
India	-7224.0	-10724.0	-14644.0	-14747.0	-15660.0	-13673.0	-17882.0	-12747.0	-12041.0	
Maldives	-119.6	-150.8	-185.6	-214.5	-215.9	-262.4	-233.3	-236.1	-212.4	-258.0
Nepal	-796.4	-922.3	-989.8	-1244.9	-994.5	-765.3	-851.0	-814.3	-787.8	-958.9
Pakistan	-2000.0	-2537.0	-3704.0	-3145.0	-1867.0	-2085.0	-1412.0	-1269.0	-294.0	-444.0
Sri Lanka	-1558.0	-1504.0	-1344.0	-1225.0	-1091.0	-1369.2	1797.5	-1157.5	-1406.5	-1539.0

Table-5: International Reserve (ml US \$)

Country	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Bangladesh	3165.9	2366.6	1862.6	1606.7	1927.7	1623.3	1515.6	1305.7	1722.4	2624.2
Bhutan	115.2	124.3	184.0	181.2	249.7	274.4	295.3	284.7	320.6	315.8
India	23053.0	21591.0	23784.0	27568.0	29833.0	35069.0	40155.0	48200.0	70377.0	102260.0
Maldives	31.3	48.0	76.8	99.0	118.5	127.1	122.8	93.1	133.1	159.5
Nepal	700.1	592.9	577.8	632.7	762.7	851.5	951.9	1044.2	1024.1	1558.9
Pakistan	3721.0	2453.0	1238.0	1830.0	1646.0	2054.0	2056.0	4235.0	8762.0	11674.0
Sri Lanka	2051.7	2093.7	1966.5	2028.6	1983.9	1639.3	1042.5	1289.8	1705.1	

Table-6: Exchange Rate (per US \$)

Country	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Bangladesh (Tk)	40.212	40.278	41.794	43.892	46.906	49.085	52.142	55.807	57.888	58.150
Bhutan (Ngultrum)	314.374	32.427	35.433	36.313	41.259	43.055	44.942	47.186	48.610	46.581
India (Rupee)	31.373	32.427	35.433	36.313	41.259	43.055	44.941	47.186	48.610	46.580
Maldives (Rufiaa)	11.586	11.770	11.770	11.770	11.770	11.770	11.770	12.242	12.800	12.800
Nepal (Rupee)	49.398	51.890	56.692	58.010	65.976	68.239	71.094	74.949	77.877	76.141
Pakistan (Rupee)	30.566	31.642	36.078	41.111	45.046	49.501	53.648	61.927	59.723	57.752
Sri Lanka (Rupee)	49.415	51.252	55.271	58.995	64.450	70.635	77.005	89.383	95.662	96.521