

EFFECT OF POLICY CONVERGENCE ON THE TRADE POTENTIAL OF SOUTH ASIA

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South Asia being a developing region several trade models were introduced to expand intra-regional trade. For instance, the South Asian Preferential Trade Agreement, the South Asian Free Trade Area Agreement, and the SAARC Agreement on Trade in Services. However, the trade among these member countries hardly improved even though they have the potential. Policy isolation might be a possible reason for this slow growth in intra-regional trade. Thus, this study investigates the effect of policy convergence on intra-regional trade in South Asia. In this regard, both the effects of internal policy convergence and external policy convergence on the trade policy were measured for the period from 2000 to 2021. The trade policy was proxied through intra-regional trade. Meanwhile, monetary policy and fiscal policy were represented through inflation, money supply, interest rate, government expenditure, and tax revenue accordingly. Internal policy convergence was measured through the Generalized Method of Moments (GMM) model while external policy convergence was measured through the Vector Error Correction Model (VECM). Even though the internal policy convergences are statistically significant, they depicted a lower catch-up ratio resulting in a higher length of time for the full convergence. Meanwhile, external policy convergence also plays a significant role when deciding the level of intra-regional trade in South Asia because results depicted that the trade is higher for the country pairs whose external policy convergences are strong and vice versa. Thus, this study confirms that the lack of internal policy convergence and external policy convergence is a trickle of significant hindrances to intra-regional trade in South Asia. Therefore, policymakers need to concentrate more on policy convergence so as to reach the optimum outcome of the trade policies in South Asia.

Keywords: *External policy convergence, Internal policy convergence, intra-regional trade, South Asia*