Globalisation and Challenges for South Asia *

Mr. Chairman and friends,

At the outset, I would like to pay homage to the memory of late Bishweshwar Prasad Koirala who dedicated his life to the cause of democracy, liberty, social justice and human rights. His distinguished contemporaries respectfully but affectionately described him as “BP” and as Mr. P.V. Narasimha Rao, one of our Prime Ministers mentioned : “BP belonged, in the truest sense, to both our peoples of India as well as of Nepal”. Another Prime Minister of India, Mr. Gujral acknowledged his stature in the Asian context while delivering a BPKF talk on “South Asia : The Coming Decade” in December 1999, at Kathmandu. I am honoured by your kind invitation to me to deliver the BPKF lecture this year. In fact, it is not often that central bankers are invited to deliver such lectures involving intense diplomatic skills. I am grateful to the Foundation, and in particular my dear friend, H.E. Mr. Deb Mukherjee for giving me this opportunity to focus on a complex subject of contemporary and mutual interest viz., globalisation and challenges for South Asia.

It is possible to question the appropriateness of the subject of globalisation to South Asia since it is admittedly one of the least globalised. Precisely because it is not globalised so far, there is a need to understand the implications of the process and explore ways of continuing or otherwise with the current policies and meeting the challenges of globalisation as they evolve. The address is mainly oriented to analysing in detail, economic aspects of globalisation and identifying challenges for public policy, essentially at the national and to some extent the regional levels in South Asia.

While the term globalisation has been fashionable in the past two decades, the process is neither new nor anywhere near being complete. It would, therefore, be useful to appreciate, as a first step, the concept or features, the historical as well as the economic context, and the current concerns regarding this complex process. The second part gives a profile of South Asian Region in comparison with others, covering macroeconomic, infrastructural, social and institutional indicators. The third part focuses on the characteristics of countries within South Asia with reference to similar indicators. Detailed data along with sources will certainly be shared so that different inferences as appropriate can be drawn by various analysts. The fourth part devotes itself to select aspects of South Asia critical to the current process of globalisation. In the light of the above, the fifth and concluding part highlights some of the issues concerning actions at national and regional levels to meet the challenges of globalisation.

Globalisation

The term ‘globalisation’ is widely used but seldom defined in precise terms, and in any case, there is no agreed definition. At the same time, it has acquired considerable emotive force, perhaps because different people use the word to mean different aspects or causes or consequences of globalisation. In fact, antagonists of globalisation tend to protest against different aspects viz., market integration, consumer culture, unfair trade, environmental impact of modernisation, dehumanisation due to technology, effect of mass-media, dominance of markets, etc. In brief, globalisation is a process with several dimensions such as social, political, economic, environmental, cultural and religious all of which affect each of us in some way or the other.

Process and Policy of Globalisation

The concept of globalisation, in the sense in which it is used now, can be traced to the phenomenon of nation-states. In the distant past, there were just human communities. For long, most people remained confined to their communities or villages or local areas. With developments in communication and economic activity, it has gradually become easier to move from local to regional and then regional to national, and finally across nations also. Conceptually, therefore, there are two extremes of connectivity among people. One is a small tribal unit where everyone knew everyone else for lifetime and it did not aspire to interact with people in other units or groups. Second is an integrated globalised existence or a global village where everyone can aspire to interact with anyone else in the globe. Globalisation is a historical process of moving from the tribal unit but it is a process that is palpably incomplete. Clearly, it is a phenomenon enabled by developments in technology related to transport and communications among people as well as over geographical distances. Of course, it will be inappropriate to ignore the human element while considering the role of technology in the process. For example, technology opens the prospect of making available a commodity (say a meat burger or chicken tikka or a healthy apple) in a remote corner but the spread of the commodity or service (say classical music or Beatles music) will depend on tastes of people. Perhaps, it is a process that has been, in some senses, constrained by the authority of nation-states, particularly in the twentieth century.

It may be useful to elaborate the role of public policy in the context of the concept of globalisation. After the emergence of nation-states, citizens of each nation-state perceived that it is in their collective self-interest to promote or restrict their involvement with citizens of other nation-states. In fact, till the early part of twentieth century, there was no need for a passport or visa to move from one country to another, and there were no restrictions on currency conversions since gold was the universally accepted medium. Thus, while developments in technology enabled and accelerated movement of goods, people and services, policies of many nations tended to impose restrictions. Currently there are some voluntary efforts among some countries to liberalise such restrictions among select countries such as European Union or ASEAN or even SAARC. In some instances, as in Europe, referendum among the citizens of select countries enabled, delayed or stopped greater integration with some other countries. Similarly, there have been multilateral initiatives to ease restrictions imposed on economic integration, while at the same time, some initiatives are taken to enable technological cooperation, say in broadcasting or telecommunications or air travel. A serious problem arises when there is a perception of persuasion or coercion by some nation-states on others to ease some restrictions, either directly or through what are called multilateral initiatives. In brief, at a conceptual level, a distinction can be made between technology enabled or induced globalisation and public policy induced restrictions or easing of restrictions.

As explained earlier, a nation-state is presumed to put restrictions on its citizens in their involvement with other nation-states only in collective self-interest of its citizens. However, it is not easy to define what is in collective self-interest of all its citizens. For example, restrictions on imports may benefit a few businessmen while *prima facie* restricting the freedom of many consumers. More important, there is an issue of value for freedom of any citizen to interact with the rest of humanity in terms of exchange of goods, services, ideas, or even physical movement. No doubt, such freedom across the borders of nation-states gets exercised only when the concerned citizens agree voluntarily. Yet, the basic freedom of a citizen to involve with others should perhaps be constrained only, and only on grounds of overall collective self-interest of all concerned. Hence, in the context of public policy relating to globalisation, a critical issue is the trade-off between individual freedom and collective self-interest as also where the burden of proof lies, namely, with the individual or the national authorities.

Economic Integration

It is obvious that the process of globalisation relates to connectivity among individuals and such connectivity in cross-border terms is subject to public policy of nation-states. Thus, globalisation has several dimensions arising out of what may be called enhanced connectivity among people across the borders. While such enhanced connectivity is determined by three fundamental factors viz., technology, tastes and public policy, the cross-border integration can have several aspects; cultural, social, political and economic. However, for purposes of this analysis, only economic integration is considered. Broadly speaking, economic integration occurs through three channels viz., movement of people, movements of goods and services, and movements in capital and financial services.

First, on movement of people, it is now widely accepted that all modern humans are descendents of ancestors living in Africa roughly one million years ago. Till a few years ago, all movement of people from one place to another was predominantly by foot. Later it must have been with the help of cattle or horses, or by boats and so on. More recently, travel by air has become quite affordable. In other words, along with opportunities for gainful economic activity, technology encompassing cost, time, comfort etc., plays a dominant part in the movement of people and connectivity among them. Some people prefer movement more than others and different people have different preferences. Thus, a second factor is tastes or cultural preferences coupled with economic opportunities. The third factor relates to public policy, which may facilitate or inhibit movement across the borders. In understanding movement of people, a distinction should be made between globalisation by means of slave trade or sword and voluntary movement of people in search of better opportunities. The most notable achievement of recent globalisation is the freedom granted to many, if not all, from the tyranny of being rooted to a place and opportunity to move and connect freely. At the same time, in reality, there are several non-economic but cultural or emotional reasons for people not globalising but being local or national.

Secondly, in regard to trade in or movement of goods and services across the borders of countries, there are two types of barriers, viz., what are described as natural and artificial. Natural barriers relate to various costs involved in transportation and information over distances. For instance, development of ocean-going vessels made of steel, railways, automobile, telecommunication, internet etc., represent significant milestones in enhancing connectivity and enabling cross-border trade in goods and services. Artificial barriers are those that are related to public policy, such as import restrictions by way of tariff or non-tariff barriers, which are justified on grounds of generating revenue or protecting domestic industry apart from national security, environment, etc. More recently, multilateral agreements are encouraging reduction in such artificial barriers, while developments in technology are making it difficult for national authorities to enforce artificial barriers. In brief, in any debate relating to public policy, a distinction should be made between technology induced globalisation and public policy induced globalisation that is either voluntary or perceived to have been under outside pressure. The pace and nature of globalisation will depend on the combined effect of technology and public policy, both at the national and the international levels.

The third set of factors relates to capital movements. In regard to capital movement also, the interplay between technology and public policy becomes relevant. There are, however, some special characteristics of capital flows in recent years. In the past, a large part of capital flows were in the nature of direct investments, though debt flows were not uncommon particularly in Europe and America. In the post-second war period of the 20th century, capital flows on government account played an important role. However, technological, demographic and some economic factors led to changing the nature of such flows by the 1980s and especially the 1990s. New financial instruments were developed and portfolio flows enlarged. The linkages between different capital flows have been strengthened, and they can now take place in large quantifies and with great speed in view of enabling technology and huge drop in transaction costs. These characteristics have highlighted the issue of what is described as contagion, namely, a country is affected by developments totally outside of its policy though domestic policy may to some extent influence the degree of vulnerability to the contagion. In any case, the cross-border flows of capital have wider macro-economic implications, particularly in terms of exchange rate that directly affects the costs of movement of people as well as goods and services; of conduct of monetary policy and the efficiency as well as stability of financial system. Further, capital flows by definition involve future liabilities or assets and could involve intergenerational equity issues.

It must be recognised that developments in technology and innovation in financial services impact both domestic and cross border transactions. The implications for public policy of such developments in domestic area are different in as much as domestic financial markets are in some ways subject to governmental regulation by national authorities while cross border flows are not susceptible to governmental regulation. Finally, in the context of cross-border capital flows, in the absence of procedures for international bankruptcy and facilities of lender of last resort, the liabilities incurred on private account can devolve on public account. In brief, at this juncture, in respect of global economic integration through movement of capital, several risks devolve on domestic public authorities, especially in the case of developing countries.

For analytical purposes, it is possible to take a slightly more disaggregated view of the nature of economic integration. Thus, movement of people can be classified as temporary and permanent. Similarly, movement of goods may be differentiated between physical goods and services (though in some cases they are integrated). Movement of money may take different forms, such as capital movements, or to meet transaction needs, long or short-term movement of debt capital, and non-debt movement of finance linked to goods and services as distinct from pure finance capitalism. There may also be spread of technology or media with or without accompanying movement of goods or capital. Such a disaggregated approach to economic integration could be of use in appreciating public policies.

Current Context

It is necessary to appreciate the difference between economic integration as it existed in the past, and more recently, say in the current context. It had been explained that the globe was far more integrated at the beginning of the nineteenth century than it is a century later, now, in the sense that people, goods and capital could move without public policy restrictions i.e., those imposed by nation-states on economic integration. In reality, however, there is significantly more interaction now than a century ago, in the sense that technological developments have made movement of people, goods and capital far more widespread, frequent, deeper and speedier.

Secondly, the trade across countries in the past was usually in generic products viz., export wheat and import cloth or export steel and import spice. Currently, there is significant intra-industry trade. Often, there are both export and import of a commodity, say garments or computers. Trade in what are called intermediate goods is significantly higher than before. This implies more intensive global competition now than earlier. As Michael Mussa, the well known economist said: “surprisingly, however, the extent of global integration through international trade today, is by some key measures, not much greater than it was a century ago”.

Thirdly, though the share of services in world output has increased noticeably, a predominant part of the services sector still remains non-tradeable across the borders. Information Technology has made some services more tradeable on a cross border basis but it is still a very small part.

Fourthly, nineteenth century witnessed large mobility of capital, but it also witnessed an equally large mobility of labour. In other words, the international factor mobility was much more symmetric a century ago when one did not even need a passport to go from one country to another.

Finally, even today, citizens of most countries, and even in the most advanced countries like the United States, invest overwhelming proportions of their savings within their own country. The qualitative difference, however, lies in the processes that govern international capital flows or to put it differently the cross-border movement of what has been described as pure finance capital in an international environment that is totally unregulated in contrast with domestic financial markets generally subject to regulation. The international portfolio capital flows are far larger in size now and infinitely mobile, often governed by what has been described as animal spirits of the markets and highly susceptible to herd mentality.

Several features of the current status of globalisation as a process of economic integration among countries must also be recognised. First, though a large number of countries are part of the process, they are at different stages or degrees of integration. Second, economic integration may also vary as between some countries compared to the rest. In fact, there can be more of bilateral economic integration between two countries compared with the rest. Third, integration among countries also varies as between different markets, namely, products, capital, labour etc. Fourth, impact of globalisation varies as between countries depending on its geography, demography, stage of development, size, etc. In fact, impact of globalisation may vary significantly among different parts of a country. Thus, it is very clear that case for or against process of globalisation is contextual and complex even in the limited arena of economic integration.

Current Concerns

There are several concerns regarding the process of globalisation and it is difficult to capture all of them comprehensively in this presentation. An attempt is made here to highlight major ones related to economic integration, and merely for convenience of explanation, these are divided into peoples' concerns and policy concerns. The peoples' concerns can be summarised as follows:

First, the benefits and burdens of globalisation are uneven. For example, while highly skilled persons like computer professionals may get better wages, others in traditional occupations are likely to lose their livelihood. Likewise, while women in some countries may get better employment opportunities through garment factories for export, women employed in subsistence agriculture may be adversely affected due to commercialisation of agriculture. Even in the developed countries, there is a perception that inexpensive imports from developing countries are hurting wage levels and resulting in unemployment of some people.

Second, there is also a perception that the overall levels of unemployment, particularly among unskilled or blue-collar workers are increasing due to global competition in many countries, and in some cases, for prolonged periods.

Third, empirical evidence shows that there is greater income inequality as a result of globalisation, both in developed and developing countries. The evidence also indicates that globally while the rich are getting far richer, the poor either remain poor or at best become less poor. The serious issue of growing inequalities due to globalisation has been brought to the fore recently by Robert Hunter Wade (The Economist, 28 April 2001) who incidentally lived for sometime in Karimuddulla village of Rayalaseema region to which I belong. I am not elaborating this aspect now since it is being currently debated widely.

Fourth, there is perceptible increase in job insecurity since competition often results in downsizing, closures, etc. In most developing countries, there are inadequate, or indeed no social welfare systems or income security, which result in human suffering. Even where some unemployment benefits are provided, they are painful substitutes for job security.

Fifth, the patent rights regime is resulting in exorbitant prices for some commodities like medicinal drugs, particularly unaffordable in developing countries and among poorer sections.

Sixth, there is standardisation of values and culture resulting in loss of identity for many communities. This is a result of combined onslaught of market and media with global presence on local communities and traditional culture.

Seventh, global competition is driving enterprises to be insensitive to environmental concerns, which are intensely harmful to the poorer and more vulnerable sections of the population. Such environmental deregulation is noticeable in developing countries where public policies are either not very sensitive or not very effective.

Many of the policy concerns are in many ways related to peoples' concerns. Policy makers do discharge several responsibilities in macroeconomic management and especially maintaining social order. Sound public policies are perceived to be severely constrained by the process of globalisation, and some of the specific concerns expressed predominantly though not solely by developing countries are summarized below.

First, any process of globalisation introduces constraints on the conduct of domestic policy and to this extent, there is a loss of national sovereignty. Of operational significance for policy makers is the fact that while gains of globalisation may be enjoyed by some in any country, the adverse social consequences have to be managed by the governments. For example, trade liberalisation does threaten many domestic activities, though some consumers and some more competitive activities may prosper. The very process of globalisation reduces fiscal, financial and some other discretions available to government, thus reducing the effectiveness of governance in managing disruptive or downside risks of liberalisation of trade and services.

Secondly, exchange rates or interest rates get influenced by volatile capital flows and these are not conducive to long-term development in developing countries. Furthermore, when such volatile capital flows on private account affect the economy seriously, the governments in developing countries are forced to take actions with implications for the public sector.

There are occasions when volatility is transmitted to a country for reasons that are entirely outside the domain of domestic policy, and yet, the governments concerned have to face the consequences. In other words, the gains from perceived efficiency on account of freer cross-border capital-flows often do not match the costs of increased volatility coupled with erosion in autonomy in domestic economic policy making. This is particularly noticeable in regard to portfolio flows and to some extent debt flows.

Thirdly, the foreign direct investment often treats the recipient country concerned as a base for exports thereby reducing the citizens to being mere employees, especially when there are little spillover benefits to domestic firms or activity. The spread of ideas, technology, and management techniques may not always take place and there may even be cases of outdated technology being used in developing countries. Therefore, the beneficial consequences of foreign direct investment should be demonstrable, especially if incentives or subsidies are extended by governments concerned.

Fourthly, it is noticed that developed countries resort to protectionism, especially in areas such as textiles, and subsidise agriculture, thus making the process of globalisation one sided. In reality, the poor in most parts of the globe are denied opportunities to participate and benefit from the process of liberalised trade precisely because of these actions of developed countries which benefit a few - very few - of their citizens at the expense of millions of poor citizens of other countries. Similarly, some of the provisions of Intellectual Property Rights tend to operate for the benefit of a few in the richer nations at the expense of many in poorer countries with no demonstrable overall gains at all.

Fifthly, the international arrangements and multilateral bodies are not adequately representative of or reasonably accountable to or even sufficiently sensitive to the problems of the poor and vulnerable people. In other words, briefly stated, while nation-states have representative and accountable institutions in the concerned government, there is no corresponding global institution or global government. In the absence of a global government and global governance, many nation-states argue that viable and universally beneficial process of globalisation is not feasible.

Finally, process of globalisation is inextricably linked with marketisation and dominance of markets. In the ultimate analysis, markets, however efficient, are not democratic institutions in the strictest sense, since customer's vote is proportionate to his/her purchasing power. Furthermore, labour is different from capital since the owner of capital can withhold if he/she thinks that the return is not adequate while labour cannot withhold because it will then not be able to survive. She or he has to work to live. The poor can give according to their ability but if such abilities cease to have markets, they cannot get what they need even if the need is minimal. Pro-poor oriented growth is thus possible when intellectual community and policy makers view the markets with the suspicion that they deserve and the poor with the respect that they need. The question is: how to build arrangements that integrate state or governments, corporates or markets, and voluntary organizations or concerned citizens in the fight against poverty while recognizing contribution of globalisation, technological progress and marketisation to prosperity.

Opportunities and Challenges

In the light of the current context and concerns of the process of globalisation, five important issues arise. How genuine are the concerns? Should public policy resist the process? To what extent can policy succeed in resisting it? To what extent should it be managed? If so, how should the public policy attempt to manage the process to maximise the gains and minimise the costs?

Undeniably, the peoples' concerns expressed are in varying extents genuine. It is, however, possible to argue that almost all the concerns are valid with any intensification of competition, technological progress and consequent rapid changes in economic as well as institutional set up, irrespective of whether these are induced by intensely domestic process or by global process. The policy concerns, on the other hand, arise out of the responsibilities imposed on the governments, especially though not exclusively of developing countries in coping with peoples' concerns. The policy autonomy available to governments is getting eroded by the combined effects of technologically induced and multilateral policy induced process of globalisation. It is perhaps this inadequacy of governments as institutional mechanisms to address peoples' concerns in all the countries that has led to widespread demonstrations in Seattle and justifiably increased the clout of non-governmental but global initiatives in highlighting peoples' concerns.

Yet, the case for policy intervention to significantly resist the process of globalisation does not seem to be very persuasive. For people, connectivity is by and large a source of freedom and generally desired rather than spurred. Again, the empirical evidence available so far in regard to countries which had prospered as well as those which have succeeded in reducing poverty does not favour isolationism. Moreover, it is true that inequality has increased during the recent bouts of globalisation but it has increased most in rural parts of China, India and Africa where there is less of connectivity of people to global developments. It must be noted that these parts of the world suffer from structural forms of acute poverty which is most challenging and enduring than poverty due to business cycles or volatility or contagion as in the case of East Asian crises or Latin America. It is also instructive that countries which have been relatively closed are seeking to join the mainstreams as illustrated by the case of China's entry into the World Trade Organisation.

Finally, the growth of output all over the world is occurring mainly in the services sector and connectivity of people both in terms of physical and technological terms appears critical for sharing in the output and employment in the services sector. No doubt, public policy could avoid downside risks involved in the process but resisting the process on a long-term basis does not seem advisable.

Even assuming that it is desirable for public policy to pursue a degree of economic isolationism in preference to opening up the economies, the effectiveness of such policy options need to be assessed in relation to the benefits. For example, potential for smuggling of goods, especially of high value but non-bulk items, limits the scope for artificial barriers to trade. Capital flight through unaccounted channels is not an entirely unknown phenomenon. Above all, technological progress and ease of movement of people across the borders makes for easy connectivity, at least for those who can afford. It is technically possible to erect barriers on all channels of connectivity, but if the domestic policies and environment are out of alignment with global factors, be it taxes or prices, it becomes difficult to enforce the barriers. In brief, in the present day world, there is only limited room for public policy to erect barriers against connectivity of people and goods.

To the extent a significant part of activity in a country tends to be affected by globalisation, and increasingly so over a period, and to the extent limited room is available for public policy to operate artificial barriers to connectivity, it stands to reason that the process should be so managed as to maximise the benefits and minimise the risks. The process of management obviously has three participants, viz. citizens concerned, national governments and supranational, but regional or global institutions as well as alliances.

Finally, it should be obvious that national governments cannot manage the process without reference to actions of other governments, in view of the interdependence. At the same time, each country has some freedom to manage the process in ways that it considers best. A few examples may illustrate the point. During the Asian crisis, Malaysia decided to manage the crisis by opting out of the mainstream International Monetary Fund's prescriptions and has by and large succeeded. China and India have been managing capital flows in their own unique way. Countries in Northern Europe have a larger share of their national output from public sector thus illustrating dominance of State over market relative to most other countries. The cross border movement of people is managed by different countries very differently, be it the United States of America or Europe or the Gulf region. It is reported that some countries are importing English teachers on a large scale to equip their citizens for handling business in information technology, thus illustrating methods by which public policy can strengthen citizens capabilities to benefit from opportunities provided by globalisation. In brief, the challenges to globalisation have to be met on several fronts, managing the process is a critical responsibility of public policy of national governments; and the process has to be governed by the country context and to some extent the regional context.

South Asia as a Region : A Profile

It is not surprising to note that South Asia is defined differently by various agencies. The South Asian Association for Regional Co-operation (SAARC) defines South Asia as Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. On the other hand, the World Bank definition of South Asia includes the seven SAARC countries and Afghanistan. The United Nations Development Progamme (UNDP) definition of South Asia is even broader and includes Iran. In this analysis, the composition of South Asia has to be interpreted depending on the source. Thus, in the narrative of inter-regional comparison, there is some unscientific element involved, but this gets explained in the details given in the Annexures and tables where specific definitions are given.

For East Asia also, there is the some element of uncertainty due to its different interpretations by the above agencies. In the World Bank's classification, East Asia and Pacific, comprising of countries east of South Asia and the Pacific islands including Japan, Australia and New Zealand, form one group, while in UNDP's classification, East Asia consists of only China, Hong Kong, South Korea and Mongolia.

For purposes of regional comparison with South Asia, among the various regional groups, the East Asia, Latin America and Caribbean, the Sub-Saharan Africa and the group of Low and Middle-income countries are of particular interest. However, in Annexure 1, further details on regional classification such as, South Asia, excluding India, East Asia excluding China, South Asia and the Pacific, the Arab States, Europe and CIS countries, the High Income countries are also given.

In Appendix 1 and Annexures 1 and 3, a comparison of South Asia as a region with others is made in terms of economic indicators, infrastructure facilities, social indicators and institutional factors.

In brief, the region translated itself from a position of slowest growing during the 'sixties and the 'seventies to one of the fastest growing regions in the world since the 'eighties. Also, in terms of inflation, South Asia performed the best among all the regional groupings within the developing countries. Yet, even at the end of the 'nineties, it remained one of the poorest in terms of per capita income, besides being the most densely populated region. Exports of goods and services have been one of the fastest in recent times, but the region's reliance on external trade, a measure of degree of integration to the global economy, continues to be the least. It must be recognised that these low positions inspite of recent impressive performance are due to the very low base from where the region began its commendable achievement in economic growth since the 'eighties.

In particular, the financial imbalances of the government in the region were and continue to be among the worst among all regions. The additional problem besides the large size of fiscal deficit was the revenue deficit that reduced the public sector savings. That the region recorded one of the lowest rate of saving is often a reflection of this dissaving of the government revenue account. The banking presence in terms of bank credit to GDP ratio in the region is also one of the lowest. The region is one of the least indebted region in the world in terms of external debt, but in view of its low base of export of goods and services the debt service ratio is not as comfortable. The official development assistance in the region has been declining despite it already being one of the least recipient regions. The long-term private capital and FDI inflows have been growing at a relatively slow rate and continue to be the least among the regions.

Furthermore, the region has significantly lagged behind in the field of infrastructure, social provisions and working of the institutional set-up. And this does not augur well for the medium and long-term growth prospects of the region. The provision of infrastructure facilities, including access to information flows is one of the least, if not the least. Similar is the situation in the literacy and education, health and nutrition of the people. Compounding the above are the institutional problems of lower level of governance. Thus, all the socio-economic indices place the region at the lower spectrum of the rankings. The higher ranking in terms of current growth prospects than future growth prospects appears to be reflective of shortcomings in infrastructure, social and institutional set ups.

South Asian Countries : A Profile

It would also be useful to compare some critical economic and social indicators within the region. Although the World Bank definition of South Asia is adopted, Afghanistan is excluded due to paucity of data, and only the performance of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka is compared in this section. These countries diverge significantly in terms of population and geographical size and level of income. Population in 1998 ranged from 0.3 million (Maldives) to 982 million (India), while land area for countries other than Bhutan and Maldives, ranged from 66 thousand sq. km. (Sri Lanka) to 3,288 thousand sq. km. (India). Population density for larger countries was much above the world average (46 people per sq. km.), Bangladesh being the highest with 981 people per sq. km. in 1999 to Nepal having the lowest (164 persons). The per capita GNP in 1998 in US $ ranged from 210 (Nepal) to 1,130 (Maldives), and in PPP terms, from US $ 1,157 (Nepal) to US $ 4,083 (Maldives). Therefore, average characteristics of the region may not reflect individual countries, except the large ones. Keeping these in view, Annexure II and Appendix II provide detailed account of profiles of each country in South Asia.

It may be seen that the region is characterized by large diversity of the constituting countries in terms of population size, income and in the socio-economic provisions that are in general low. The most common elements are the higher growth performance generally associated with growing external trade, a reasonable rate of inflation and high fiscal imbalance of the government. However, there are large differences in the saving and investment capacity and on dependence on external trade of the economy. The inflow of private capital in the region is mainly accounted for by few larger countries. There is also significant heterogeneity even in the generally low level of provision of infrastructure, health, education and nutrition facilities among these countries. That the countries individually, and as a regional group, continue to lag behind other regions reflect the enormity of challenges ahead of all the countries in the South Asian region to catch up with most of the other regions.

Critical Aspects of Economic Integration in South Asia

It would be useful to compare the extent of economic integration of each country in the South Asian region with the rest of the world as also a comparison of the extent of intra-regional integration. The most common measures of economic integration comprise three aspects: trade integration, financial integration and labour migration between countries.

Trade Integration

The simplest measure of trade integration uses the actual trade flows such as the share of trade (exports plus imports) in GDP. In 1990, the trade to GDP ratio for South Asia stood at 24.8 percent, which improved to 28.4 percent in 1998. In both the years, however, South Asia recorded the lowest among all regional groups. In general, trade to GDP ratio has an inverse relation with the size of an economy. Consequently, there are large divergences in the extent of trade integration among the South Asian countries. Smaller economies like Bhutan, Nepal and Sri Lanka had a much higher percentage, ranging between 57.6 percent (Nepal) to 78.4 percent (Sri Lanka) in 1998. Sri Lanka had a historically high ratio due to the importance of plantation crops such as tea, coffee and rubber in its economy. The trade to GDP ratio of Maldives, another small economy, was as high as 130.5 percent in 1990. Besides the overall trade, the share of technology related exports in the total exports also indicates trade integration as it reflects on how much a country is moving away from its traditional products. High technology exports as percent of manufacturing exports in South Asia in 1998 was only 4.0 percent, by far the lowest of all the regions. And, even this low percentage was significantly accounted for by India.

Another aspect of the trade integration could be that of intra-regional trade flows. The percentage of intra-regional exports to total exports of South Asia, which ranged from 3.59 percent to 4.41 percent during 1991-97 was the lowest among all the regions. Middle east with a range from 5.4 percent to 7.7 percent had the second lowest intra-regional exports. Africa had a range from 7.3 percent to 10.4 percent, as against 36.0 percent to 40.7 percent for Asia and 37.1 percent to 43.5 percent for developing countries. In terms of intra-regional imports also, South Asia with a range of 2.57 percent to 4.12 percent during 1991 to 1997 recorded the lowest share of all groups. In other regions, it ranged from 6.3 percent to 8.3 percent (Middle East), 7.4 percent to 10.8 percent (Africa), 33.4 percent to 36.7 percent (Asia) and 35.9 percent to 42.0 percent (Developing Countries).

Financial Integration

The second measure of economic integration, which is financial integration, is often captured by the private capital flows. These include foreign direct investment (FDI) and equity and portfolio investment, and the extent of access to international capital markets. First, the long-term private capital inflows in South Asia during the ‘eighties was on an average US $ 3 billion, the lowest among all the regions. This inflow improved to an average of US $ 5 billion during the 1990-96, higher than only Arab States and Sub-Saharan Africa region among the developing countries. As a percentage to the total inflow to developing countries during 1990-96, it declined from 8.0 to 4.0 percent during the same period, higher than only the two regions mentioned above.

Second, FDI inflows increased from US $ 351 million during 1987-92 to US $ 2873 million during 1993-98, again the lowest of all groups. Even the FDI inflows to Sub-Saharan Africa during the corresponding periods were US $ 1,797 million and US $ 3,638 million, while other regions were far ahead. Major chunk of the inflows during 1993-97 was accounted by India, followed by Pakistan and Sri Lanka in that order. As already indicated earlier, FDI inflows as percentage of gross capital formation among the South Asian countries ranged from a negligible level to 3.3 percent during 1987-92 and from 0.78 to 6.32 percent during 1993-97, also lower than all the regional groups. The stock of FDI inflows as a ratio to GDP which ranged from negligible level to 8.5 percent in 1985 and from 1.0 to 12.7 percent in 1997 among the South Asian countries was also significantly lower than the average of all the other regions.

Third, FDI outflows are equally important as measures of financial integration, though for developing countries with scarce resources, inflows are expected to be the predominant form of FDI flows. The FDI outflows from South Asia, which was mostly accounted for by India, increased from an average of US $ 20 million during 1987-92 to US $ 99 million during 1993-98. Even the outflows from Sub-Saharan Africa during 1993-98 were US $ 496 million, while the same from other regions were far ahead. Thus, FDI outflows from South Asia, whether as a percentage of gross fixed capital formation or its stock as a ratio to GDP, were the lowest of all the regions.

Fourth, portfolio investment also measures the extent of financial integration. Such flows increased manifold in South Asia between 1990 to 1998, from US $ 252 million to US $ 4,536 million. However, the flows were almost wholly accounted for by India, and among the major regions were higher than Sub-Saharan Africa only.

Fifth, credit ratings suggest the access to international capital and thus indicate financial integration. The composite International Country Risk Guide (ICRG) risk rating which was alluded to earlier is an overall index of investment risk in a country. In this South Asia had a score of 61.3 in 2000, with a range of 54.3 (Pakistan) to 64.3 (India). This rating was lower (signifying higher risk) than the average of Low and Middle Income countries (62.9), and was only better than the rating of Sub-Saharan Africa of 58.9 among the regional groups. The second rating is the institutional investor credit rating which indicates the probability of a country's default. Rating below 20 indicates low integration, above 50 indicates high integration and between 20 and 50 indicates medium integration. In 2000, South Asia had a rating of 26.1, higher than only Sub-Saharan Africa with rating of 18.7. Among the South Asian countries, the ratings ranged from 18.8 (Pakistan) to 45.3 (India).

Migration

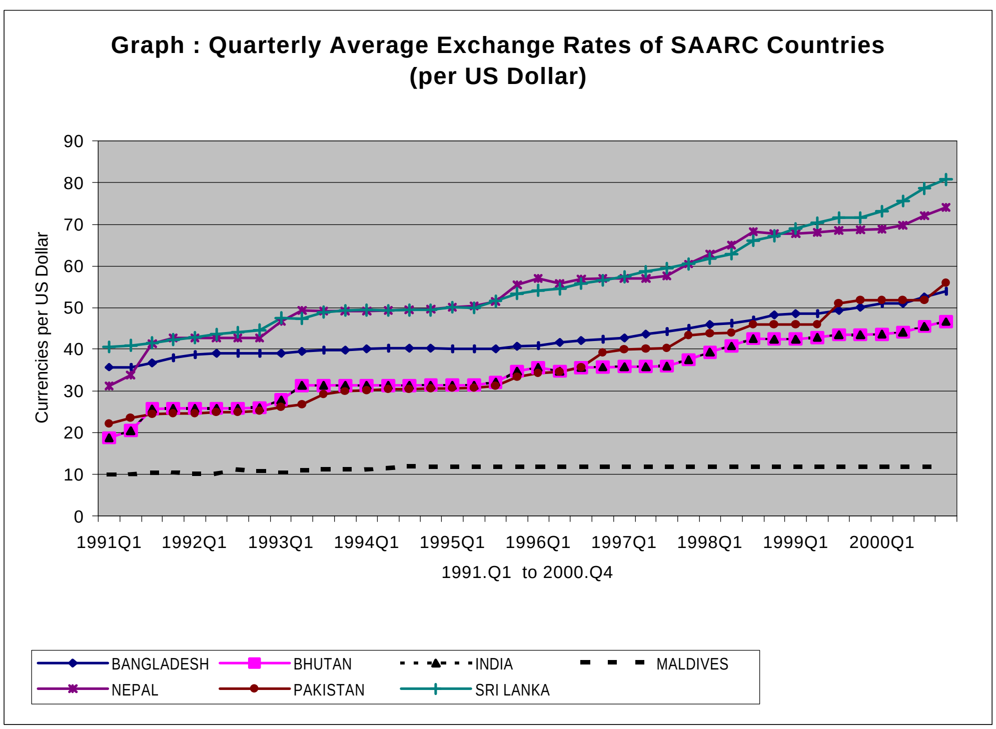
The third aspect of economic integration is the labour migration. Owing to paucity of data, this aspect is proxied by the worker's remittances flowing in the South Asian region. The worker's remittances as ratios to exports of goods and services and to GDP for five South Asian countries viz., Bangladesh, India, Nepal, Pakistan and Sri Lanka, is compared with Philippines which is known for her large share of migrants in the labour force. During 1991 to 1998, the average ratios to export ranged from 5.4 percent (Nepal) to 31.0 percent (Bangladesh), and to GDP they ranged from 1.3 percent

(Nepal) to 5.9 percent (Sri Lanka). Even Nepal, with the least in both the ratios, stood far higher than Philippines. One must, however, take note of the special arrangement between India and Nepal on the movement of labour from the latter to the former. Most of the remittances with the possible exception of Nepal appear to be from the Gulf and South-East Asia, indicating a weak intra-regional remittance flows in South Asia. However, the data on worker's remittances needs to be interpreted with some caution as it may not fully capture intra-regional flows.

<u>Exchange Rate Arrangements and Movements</u>

According to International Monetary Fund's (IMF) publication on Exchange Arrangements and Exchange Restrictions (2000) Bangladesh and Maldives peg their currencies to a trade-weighted basket of currencies. In Maldives, however, the currency has remained stable vis-à-vis US dollar since October 1994. Pakistan pegs its currency to the US dollar. On the other hand, Sri Lanka follows a system of crawling peg against the US dollar within a band of 2.0 percent. In respect of India, however, exchange rate is determined by demand and supply conditions in the market. The currencies of Nepal and Bhutan are pegged to the Indian Rupee.

It is useful to analyse the movement in the quarterly average exchange rates per US dollar of these countries during 1991 to 2000. The movements in the exchange rates are similar to a large extent, except perhaps Maldives that follows a relatively fixed rate to US dollar (Graph). The correlation coefficients between the quarterly average exchange rate per US dollar of Indian Rupee and the corresponding exchange rates of other six South Asian countries for the period is estimated to range from 0.95 (Bangladesh) to 1.0 (Bhutan and Nepal), barring 0.79 with Maldives (See Table-1). In other words, the movements in the exchange rates of South Asian countries vis-à-vis US dollar are noticeably similar.



Current and Capital Account Convertibility

In terms of current account, Bangladesh, India, Nepal, Pakistan and Sri Lanka have adopted Article VIII of the IMF while Bhutan and Maldives are still classified under Article XIV. Basically, a member country embracing Article VIII undertakes to avoid restrictions on current payments and discriminatory currency practices. Article XIV facilitates countries to avail of transitional arrangements that permit them to impose restrictions on the current account. Bangladesh and Bhutan, however, still have some bilateral payments arrangements.

As regards receipts from exports as well as invisible transactions, Bangladesh, Bhutan, India, Nepal and Pakistan have repatriation requirements (which refers to obligation of exporters to bring back into the country export proceeds) while only Bangladesh, Bhutan and India of these countries have imposed surrender requirements (refers to regulation requiring recipient of repatriated export proceeds to sell the foreign exchange proceeds to central bank or commercial bank or Authorised Dealers as the case may be).

The IMF publication also defines capital transactions as capital and money market instruments, derivatives and other instruments, credit operations, direct investment, personal capital movements, transactions specific to commercial banks and other credit institutions, and transactions specific to institutional investors. According to the IMF, all the South Asian countries have controls on the above categories in some form or the other.

Overall Assessment

Thus, it may be observed from the above analysis that South Asia as a region is one of the least globalised in the world in terms of trade and financial integration. The intra-regional integration is also very weak. In terms of worker's remittances, the substitute measure for labour migration, it is indicated that the region is perhaps well integrated to the global economy. Here too, the intra-regional integration appears to be lacking.

In trade, however, smaller economies (Bhutan, Maldives, Nepal and Sri Lanka) are globally much more integrated than the larger economies. In fact, South Asia's low level of trade integration is a reflection of India's relatively lower dependence on trade flows. With regard to financial integration, Maldives, Pakistan and Sri Lanka are globally more integrated as the FDI inflows in these three countries form quite a significant proportion of their economies, though in volume terms India is the largest. All the South Asian countries are characterised by large inflow of worker's remittances relative to the size of their economy. Though this remittance relative to exports is the highest in Bangladesh, in terms of GDP, it is most significant in Sri Lanka. Thus, by all the three aspects of economic integration, Sri Lanka, and perhaps Maldives as all the information available for this country indicate, are the most globalised South Asian countries. In the rest, some or most of the critical aspects of economic integration are not strong enough.

Issues

The World Bank has projected the growth in regional per capita GDP during 2000-10. The projections indicate that while growth in per capita GDP of South Asia is expected to be higher than all the regions except East Asia and Pacific, and Eastern Europe and CIS, the low base of South Asia ensures that the difference in per capita GDP in US dollar terms will widen in comparison with all the regions, except sub-Saharan Africa. South Asia's per capita GDP would continue to be about one-tenth of the world average and about one-third of the average of Low and Middle Income group countries even at the end of this decade (Table 2). Briefly stated, South Asia will have to perform far better than what the world currently expects if it has to make a significant dent on large scale poverty prevalent in the region and try to catch up with the rest of the world. The forces of globalisation provide both opportunities and challenges which have to be significantly managed by public policy.

South Asia has improved from being slowest growing till three decades ago to one of the fastest growing economies and there is evidence of noticeable reduction in incidence of poverty too. By and large, the region has displayed economic stability and no serious crisis visited the region during the turbulent nineties. In this sense, the globalisation pressures seem to have been met satisfactorily by the region. Yet, to face growing global competition, the major policy issues in most parts of the region relate to improvements in physical infrastructure especially in the area of transport and communications; social infrastructure in the area of education and health; and institutional infrastructure. All these are pre-requisites to improve the capacity of people to connect with others productively and public policy has to focus on these aspects. The standards of public administration and economic creativity should help the process while fiscal management appears to constrain the process. These issues are almost entirely within the ambit of national policy and need to be addressed as such keeping in view the fact that trade integration is growing but is still in many parts low and capital flows as well as external debt, by and large, are sustainable.

The region is characterised by large diversity in terms of saving and investment capacity, dependence on external trade, inflow of capital and social infrastructure. Common factors are the high growth in recent years, growing external trade, reasonable rate of inflation and high fiscal deficit. Hence, public policies need to assess both common features and unique features of each country to continue and intensify the process of benefiting from global trends while minimising the risks.

Trade integration shows a remarkable diversity, reflecting *inter alia*, the varying size and degree of openness of different countries, but the region as a whole is one of the least globalised in terms of trade integration. Intra-regional trade has also been conspicuous by its relatively low level.

Similarly, there is a large diversity in regard to financial integration but the region as a whole is still one of the least integrated in financial terms. No doubt, one could justifiably attribute some degree of macroeconomic stability of the region to this low level of financial integration.

The maximum economic integration with the rest of the world in respect of South Asia is in terms of movement of people, i.e., workers remittances which is a substitute measure for labour migration. Undoubtedly this mode of global integration has benefited the region and its people. By all accounts, the potential for greater benefits through this mode exists.

Finally, an interesting feature observed relates to movements in foreign exchange rates of the national currencies of the region. Except Maldives, the movement in the exchange rates of all the countries in South Asia seems to be synchronized to a large extent. This is an important pointer to the need for further study and policy coordination in South Asia in the context of globalisation. For a central banker, this is an important area for exploring the depth and dimensions of economic integration among economies of South Asia.

Conclusion

To conclude, globalisation is a complex phenomenon and a process that can perhaps be managed by public policies. In managing the process, developing countries face challenges from a world order that is particularly burdensome on them. Yet, as many other developing countries demonstrated, it is possible for public policy to manage the process with a view to maximising benefits to its citizens while minimising risks. The nature of optimal integration, however, is highly country specific and contextual. On balance, there appears to be greater advantage in well managed and appropriate integration into the global process, which would imply more effective interventions by governments. In fact, markets do not and cannot exist in a vacuum, i.e., without some externally imposed rules and such order is a product of public policy. The challenges of globalisation, particularly for poorer countries like South Asia are in essence at national level, at the level of sound public policies by governments.

The poor, the vulnerable and the underprivileged will continue to be the responsibility of national governments and hence of public policy. Unfortunately, globalisation does not appear to strengthen national governments in discharging this worthy cause. Yet, sound public policies at the national level in South Asia are very critical in the current context of levels of development, extent of globalisation, and degree of regional integration. There is a potential for benefit for all concerned, if the global challenges are met primarily at national level without losing sight of benefits of bilateral as well as regional cooperation among the countries in South Asia.

Thank you.

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