

Macroeconomic Dynamics of South Asian Economies: Prospects and Challenges

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Abstract

The paper presents a critical analysis of the nature of macroeconomic dynamics of South Asian economies, concentrating on seven member countries of SAARC. Along with the macroeconomic analysis, the essence of dynamics of human development has also been analyzed focusing on poverty and human security in a broader sense. The relevant analyses have been done using overtime data on indicators commonly used to assess macroeconomic and human development scenarios. It is argued that the average growth performance in South Asia hides both variations across countries within the region and overtime within countries. General trend in current account balance is negative. Foreign direct investment in the region is modest, and not satisfactory. High fiscal deficits as proportion of GDP have been sustained overtime. In spite of slight increases overtime, no trend can be found in annual change of export and import in this region. Overall tendency of trade balance shows larger deficits. Inflation remains a serious issue. External debt depicts a negative trend. The share of major sectors in GDP shows Service sector as the dominant sector with upward trend. Most of the revenue comes from tax revenue, and expenditure exceeds the revenue. South Asia has been one of the most militarized regions of the world, though one of the poorest one too. In most South Asian countries, the rural to urban migration has been a consequence of rural poverty without concomitant industrialization. Unemployment has been an acute problem. A huge number of people in this region are forced to have the inhuman fate of refugee. There has only been a modest success in extending the coverage of electricity in South Asia. Human

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development situation in South Asian countries is not satisfactory. South Asian Free Trade Area (SAFTA) has been questioned both theoretically and empirically. But it can improve regional co-operation amongst members and political frictions may be smoothed by strengthening regional trade. Peace dividend for its members could outweigh the economic benefits. The key challenges have been identified which need to be managed efficiently to materialize the prospects of South Asian economies. It is most likely that to accelerate the process of economic development, strengthen pro-poor growth, and to further human development in South Asia, a politico-economic reform, rather than a conventional macroeconomic reform, is warranted.

1. Prologue

This paper attempts to critically analyze the macroeconomic dynamics of South Asia, focusing seven countries, namely Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Macroeconomic analysis includes GDP, foreign trade, industry, infrastructure, financial, and social sectors. Along with macroeconomic trends, dynamics of human development in this region is also analyzed. Besides, relationships between the macroeconomy and human development have also been sought. Country-wise data in Tables and Figures are presented maintaining alphabetic order of the countries.

2. Growth: High and stable average performance hides reality

In the 1980s and during 1990-2001, the average annual growth rate of real GDP in South Asia was, respectively, 5.6% and 5.5%, which exceeded that of low income countries, at 4.5%, and 3.4%, respectively, during the same periods. In fact, in terms of average growth performance during the last two decades, South Asia was next to East Asia. The most visible change after 2000 is that the growth rate always exceeded 7% with one dramatic fall in 2002 (which was only 3.7%; most likely, it can be attributed to the consequence of the recession in 2000).

This exemplary high and stable average performance hides both variations across countries within the region and over time within countries. For example, Pakistan's performance deteriorated significantly from 6.3% in the 1980s to 3.7% during 1990-2001. In 2001, it even came down to only 2.0%. Though it recovered slightly to 3.1% in 2002 and rose further to over 5% in the next two years, and then to over 7% since 2004. Although Sri Lanka did relatively well until 1999-2000, since then it has experienced a drastic fall in growth, which was negative in

2001 (-1.5%). Growth rate of India peaked at 7.8 % in 1996-97, but with fluctuations reached a low of 4.4% in 2000, though it revived to more than 7.5% after 2003. Nepal's growth was 6.0% in 2000 and 4.8% in 2001. But, in 2002, it turned into negative (-0.4), and though it revived, the rate still is low and not stable at all. GDP growth rate of Bhutan is exceptionally high among the SAARC countries (even it reached 2-digit) for the last couple of years. Maldives had a high (18.7% in 2006) but very volatile GDP growth rate, and once it (was even negative (-5.2%) in 2005. Compared with other SAARC countries, although the GDP growth rate of Bangladesh is not very high, but it has more or less remained stable. In spite of a slight decrease in GDP growth rate, it stabled at around 6% (despite the two floods and Sidr cyclone in 2007).

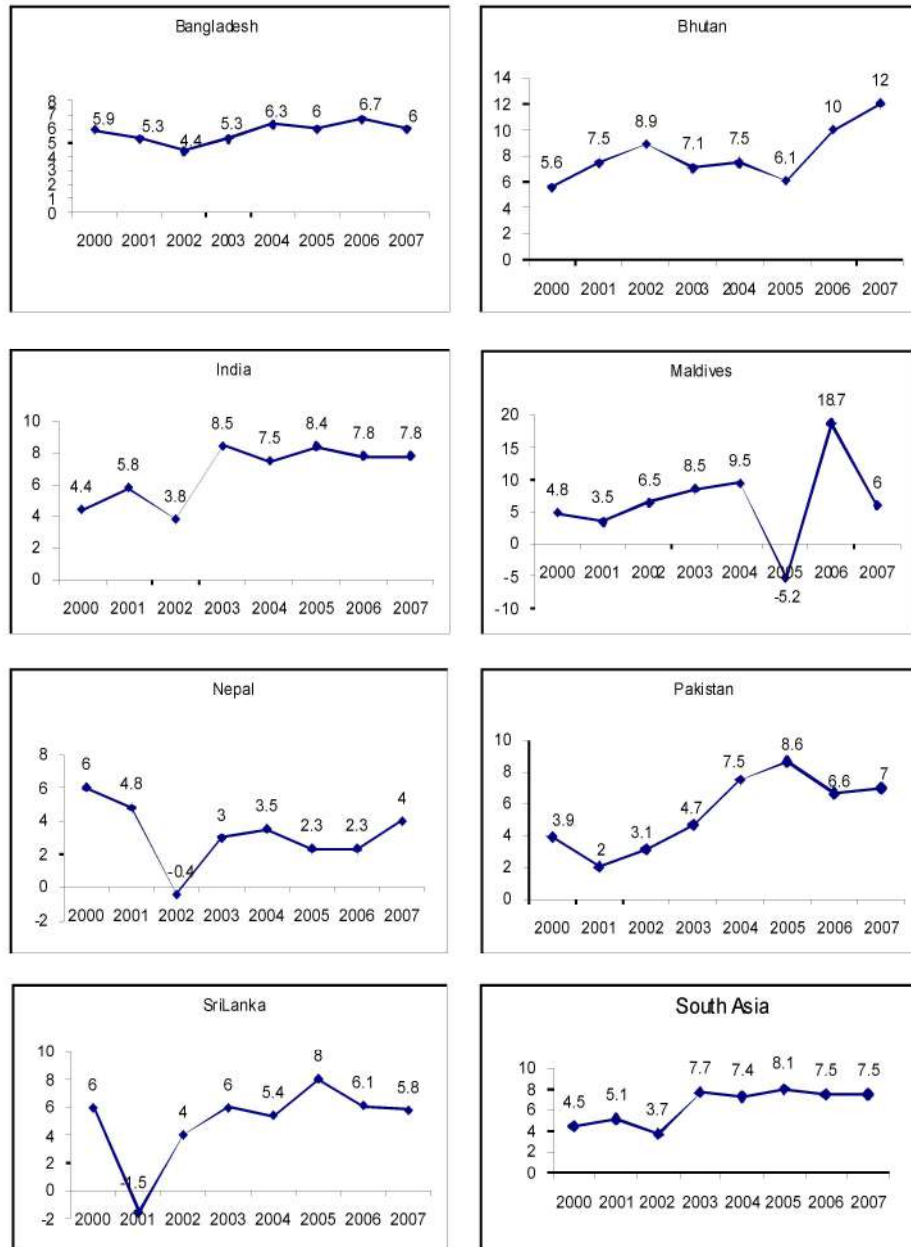
In the industrialized countries, the recession in 2000 caused a decline in economic growth. Growth rates of relatively smaller and more open economies such as Sri Lanka, Nepal and Maldives' were affected and declined to a greater extent than the less open larger economies such as India, Pakistan, and Bangladesh. However, the decline in growth in India before the world recession (in 1997-98) and Pakistan's poor performance was of a longer duration (Figures 1, 2).

3. External sector: Negative trend

On the economies of South Asia, trade and investment liberalizations has had noteworthy effects. The common trend in current account balance is negative in South Asian countries except in Nepal. Nepal is running on surplus though a downward trend is evident. All large economies of South Asia, namely India, Pakistan and Bangladesh have maintained current account surpluses in 2002, 2003, and 2004 (except India). For developing countries to run such surpluses is not only unusual but also inappropriate if sustained overtime (Srinivisan 2004). The accumulation of relatively large foreign exchange reserves in the region except in Nepal, Maldives and Bhutan is an outcome of current account surpluses.

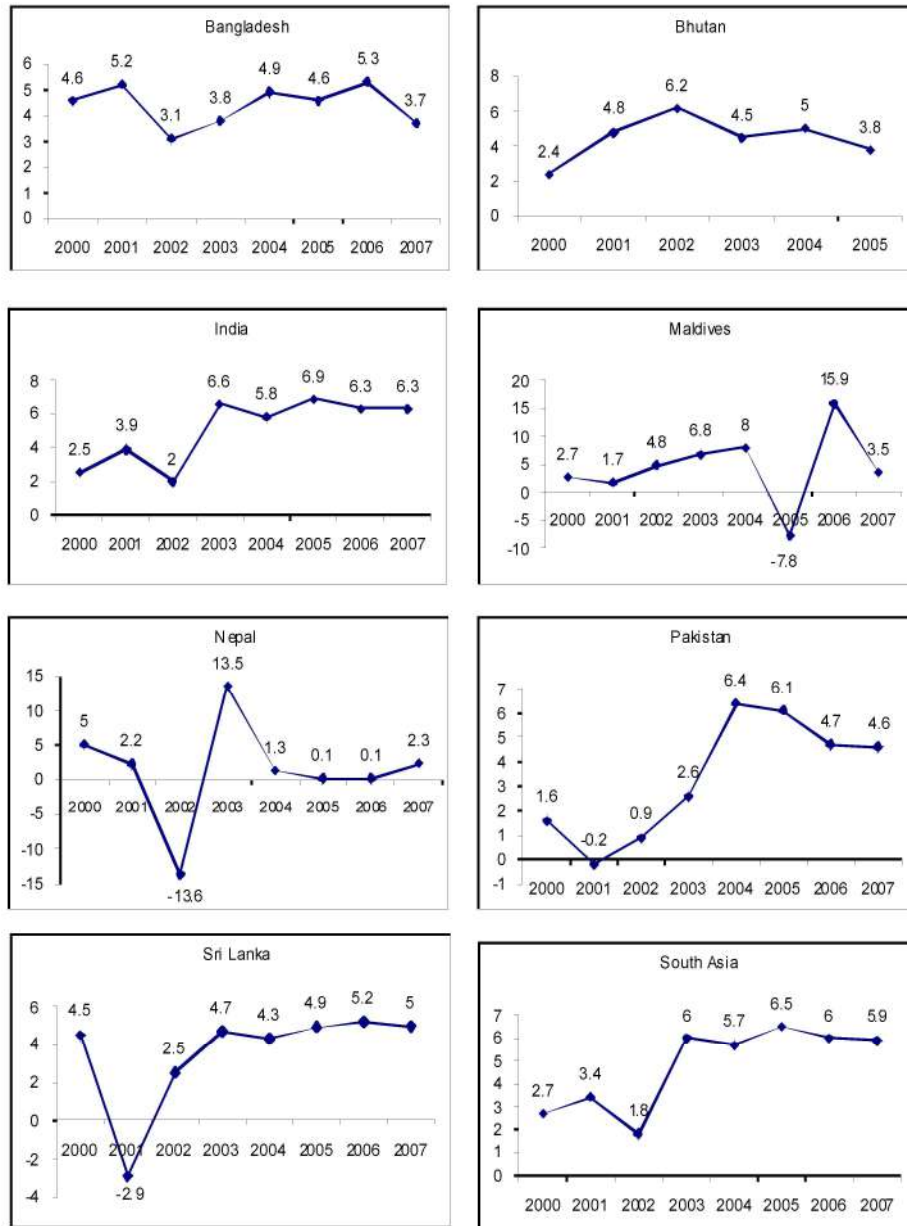
The gross international reserve in South Asia has increased from US\$ 4.7 billion in 2000 to about US\$ 17 billion in 2005 with India sharing about 90%. A lot of workers in this region, except Maldives and Bhutan, work in foreign countries and they remit significant amount of foreign exchange to their home countries, which plays a major role in South Asian economies. The overall trend in remittances shows an increasing trend in South Asian region: from US\$17 billion in 2000 to over US \$ 35 billion in 2005. The inflow of foreign direct investment (FDI) to the region seems modest at US\$10 billion in 2005 (from US \$ 5 billion in 2000) but not at all satisfactory. Even the largest economy, India, received only \$ 7.7 billion

Figure 1 : Growth Rate of GDP (annual change. %



Source: Figures prepared by authors based on data in South Asia Economic Report, 2006, Asian Development Bank

Figure 2 : Growth Rate of Per Capita GDP (annual change. %)



Source: Figures prepared by authors based on data in South Asia Economic Report, 2006, Asian Development Bank

of FDI in 2005, which was \$ 87 billion for China. The unsatisfactory state of FDI in South Asia might be a consequence of poor infrastructural facilities, low quality law and order situation, and political instability, among others.

4. Fiscal situation : Deficit has become a common phenomenon

High and sustained fiscal deficits as proportion of GDP could have deleterious consequences. And, fiscal deficit has become a common phenomena of South Asian economies (Figure 3). The unhealthy consequences of fiscal deficits are

Table 1 : Some selected macro economic indicators in South Asia

		2000	2001	2002	2003	2004	2005	2006	2007
South Asia		-0.8	0.3	1.2	2.3	-0.5	-1.4	-2.1	-2.1
Current	Bangladesh	-0.9	-2.3	0.3	0.3	0.3	-0.9	0.9	0.3
Account	Bhutan	-10.4	-5.6	-9.9	-12.4	-8.9	-25.7	-9.0	-
Balance	India	-0.6	0.7	1.3	2.3	-0.8	-1.3	-2.1	-1.9
(% of GDP)	Maldives	-8.2	-9.4	-5.6	-4.6	-17.2	-43.1	-21.4	-16.9
	Nepal	4.5	4.9	4.3	2.5	2.9	2.2	2.4	2.0
	Pakistan	-1.5	-0.7	1.9	3.8	1.3	-1.6	-4.4	-5.5
	SriLanka	-6.4	-1.4	-1.4	-0.4	-3.2	-2.8	-3.6	-2.8
South Asia		5,062	7,080	6,091	5,682	7,145	10,237		
Foreign	Bangladesh	383	550	391	376	385	776		
Direct	Bhutan	-	-	2	2	3	9		
Investment	India	4,031	6,125	5,036	4,322	5,589	7,691		
(US\$ million)	Maldives	-	-	-	-	-	-		
	Nepal	3	-	4	12	-	2		
	Pakistan	472	323	485	798	951	1,525		
	SriLanka	173	82	181	171	217	234		
South Asia		17,198	19,980	23,015	31,575	30,445	35,118		
Workers'	Bangladesh	1,949	1,882	2,501	3,062	3,372	3,848		
Remittances	Bhutan	-	-	-	-	-	-		
(US\$ million)	India	13,106	15,856	16,838	22,162	20,844	24,276		
	Maldives	-	-	-	-	-	-		
	Nepal	-	-	-	700	794	908		
	Pakistan	983	1,087	2,389	4,237	3,871	4,168		
	SriLanka	1,160	1,155	1,287	1,414	1,564	1,918		

Source: South Asia Economic Report, 2006, Asian Development Bank

Table 2 : Gross international reserve and months of import coverage in South Asia

Countries	US\$ Million		Months of Import Coverage	
	2000	2005	2000	2005
South Asia	47,266	169,121	5.4	8.2
Bangladesh	1,602	2,930	2.1	2.5
Bhutan	291	367	16.3	9.4
India	42,281	151,622	7.0	9.3
Maldives	124	187	3.3	2.7
Nepal	927	1,476	6.9	7.4
Pakistan	991	9,805	0.9	4.1
SriLanka	1,049	2,735	1.5	3.3

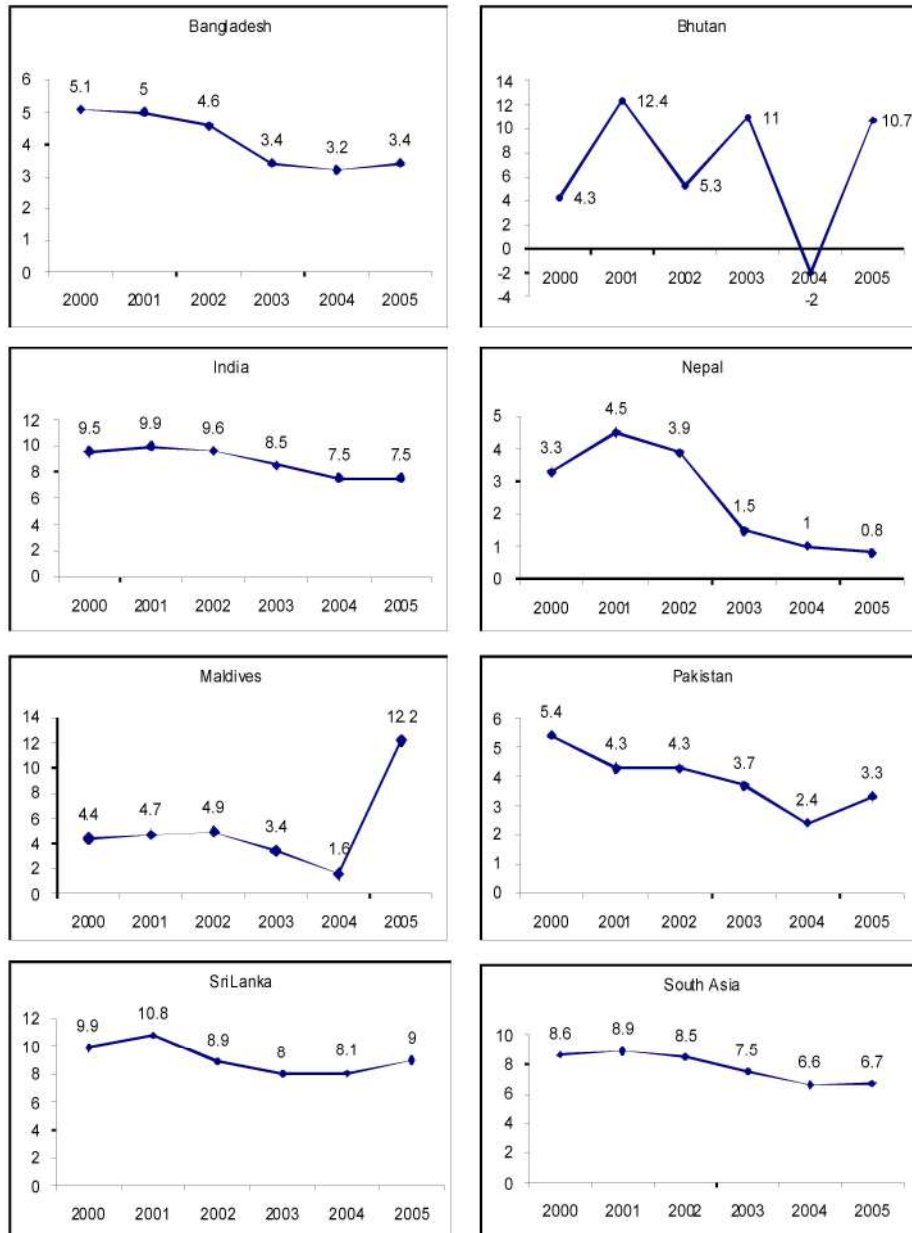
Source: South Asia Economic Report, 2006, Asian Development Bank

evident, among others, on crowding out of private investment, spill-over into unsustainable current account deficits, and constraining worthwhile public investment and consumption expenditures. When India started her systematic economic reforms in 1991, a very important component of the reform agenda was fiscal consolidation. Indeed, in the first five years of reforms, there was a significant improvement in the fiscal situation with the combined deficits of central and state governments falling from 9.4% in the crisis year of 1990-91 to 6.4% in 1996-97. However, much of the adjustment was due to the reduction in capital expenditure. Since then, the deficit went up to 9.5% in 2002-03. This fiscal deficit would be much higher if the impact of the losses of public sector enterprises, off budget items, and contingent liabilities were added. The dynamics of the financial deficit situation in Sri Lanka is almost similar to that of India. The budget deficits of the other countries are lower, but they are by no means low. The adverse effects of high fiscal deficits to economic growth, development and poverty reduction should not be underestimated.

5. Export and import scenario: Improves slowly

The annual changes in export trade in South Asian countries show a positive stable trend (except 2001). But, the trend in import trade is not at all stable, rather volatile. No specific trend is seen in the annual change of export and import among the South Asian countries (Tables 3, 4). But, this situation should not be correlated only with the local issues or capacities, rather as rest of the world is the

Figure 3 : Fiscal Deficit (% of GDP)



Source : Figures prepared by authors based on data in South Asia Economic Report, 2006, Asian Development

inevitable part of export-import business, so the whole world situation plays a determining role in this game.

6. Trade balance: Deficit overtime

In South Asia, the trend of trade balance is negative (deficit) overtime. Though the trade balance scenario in South Asia is not stable, the overall tendency is somewhat increasing (larger deficit). It is to note that for Bangladesh, the deficit in trade balance is somewhat stable. It is around in the range of -5 to - 4. percent

Table 3 : Export-import scenario of South Asian countries

		2000	2001	2002	2003	2004	2005	2006	2007
South Asia		18.0	0.1	12.9	20.4	21.4	24.3	18.8	18.6
Exports:	Bangladesh	7.9	12.6	-7.6	9.5	15.9	14.0	21.6	18.0
Goods	Bhutan	9.1	-12.9	4.1	8.9	39.7	18.0	-	-
	India	21.1	-1.6	20.3	23.3	23.9	27.5	20.0	20.0
(annual	Maldives	18.8	1.4	20.1	14.9	19.1	-10.7	-	-
change, %)	Nepal	-	11.7	-20.3	-13.8	14.8	11.0	6.8	12.5
	Pakistan	8.8	9.1	2.3	19.1	13.8	16.8	14.0	13.0
	SriLanka	19.8	-12.8	-2.4	9.2	12.2	10.2	8.0	7.5
South Asia		5.4	-1.7	7.9	21.4	40.4	30.3	25.0	19.3
Imports:	Bangladesh	4.8	11.4	-8.7	13.1	13.0	20.6	12.1	12.0
Goods	Bhutan	14.0	-8.3	9.9	1.7	29.2	67.6	-	-
	India	4.6	-2.8	14.5	24.1	48.5	31.6	26.2	21.0
(annual	Maldives	-3.4	1.3	-0.5	20.2	36.9	15.5	-	-
change, %)	Nepal	-	6.7	-15.3	7.1	15.9	12.1	15.5	20.0
	Pakistan	-0.1	6.2	-7.5	20.1	20.0	39.6	31.3	15.0
	SriLanka	22.4	-18.4	2.2	9.3	19.9	10.8	9.0	6.5

Source: South Asia Economic Report, 2006, Asian Development Bank

of GDP. Nepal, Bhutan and Maldives are facing very large amount of trade deficit. India's deficit in trade balance was relatively low in the beginning of the millennium, but, overtime the deficit depicts an increasing trend. This scenario is not exclusive for India alone, this trend holds true for all the economies of South Asia (Figure 4).

Table 4 : Shares of exports and imports as % of GDP in South Asian countries

Countries	Exports		Imports		Net Export	
	2000	2005	2000	2005	2000	2005
South Asia	14.1	18.8	15.8	21.6	-1.6	-2.8
Bangladesh	14.0	16.6	19.2	23.0	-5.2	-6.5
Bhutan	29.4	28.2	46.9	41.5	-17.5	-13.3
India	13.2	19.0	14.1	21.0	-0.9	-2.0
Maldives	89.5	92.4	71.6	85.9	17.9	6.5
Nepal	23.3	16.1	32.4	32.6	-9.1	-16.5
Pakistan	13.4	15.5	14.7	19.3	-1.2	-3.8
SriLanka	39.0	33.5	49.6	42.8	-10.6	-9.3

Source: South Asia Economic Report, 2006, Asian Development Bank

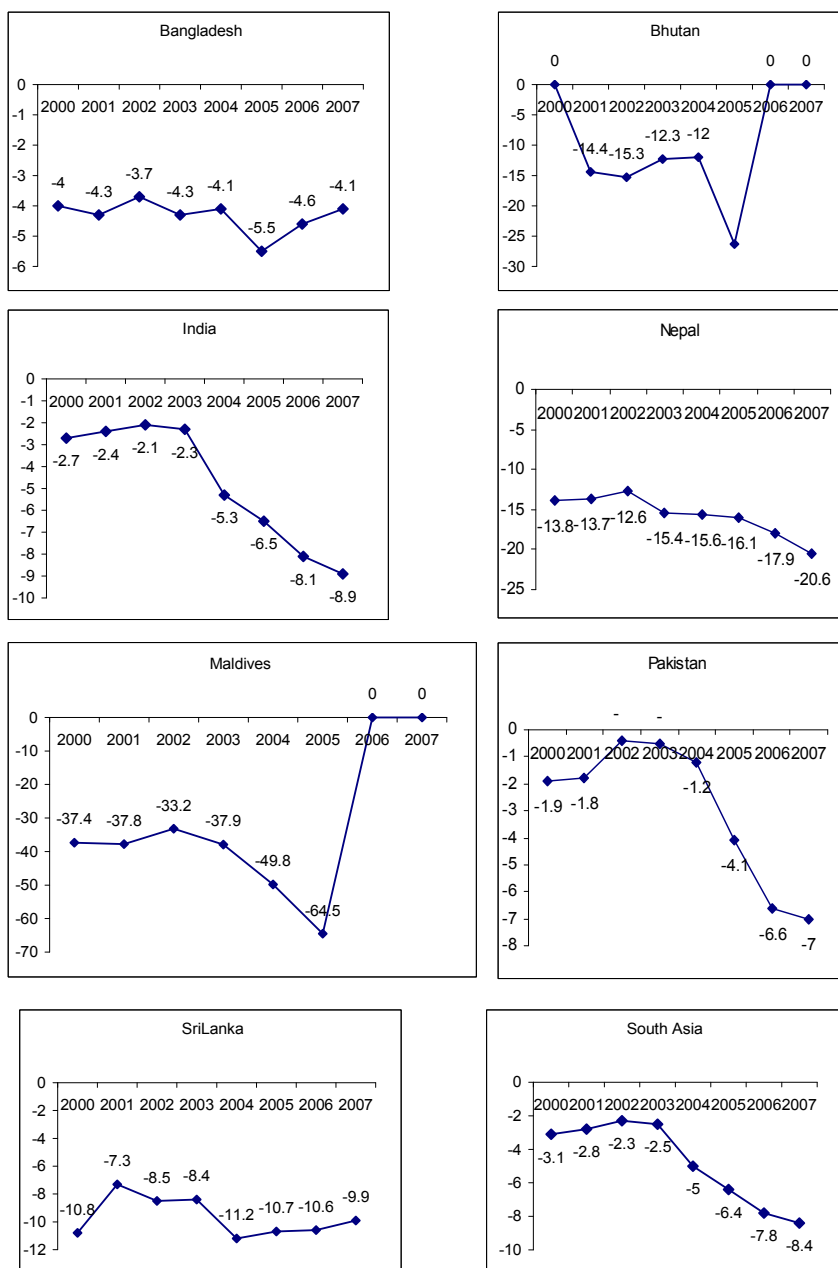
7. Inflation: Rising sharp

The overall trend of inflation in South Asia has been more or less stable over the last couple of years. Though, the recession in 2000 caused a sharp fall in the inflation rate in 2001 and 2002, the inflation scenario shows a stable trend in this region. But in South Asian region, where purchasing power is relatively low among the majority of the population, particularly, inflation is a serious concern for the policy makers. In Bangladesh, the last couple of years shows an increasing trend in the inflation rate, which caused serious damage to economic security of the majority population of Bangladesh. In India, considering the last couple of years, the trend is rather stable or decreasing to some extent. Sri Lanka faces a relatively higher rate of inflation (two-digit) than other South Asian countries. Other South Asian countries face a moderate rate of inflation, but they are not at all stable (Figure 5).

8. External debt: Overtime negative trend

In South Asia, external debt shows an overtime negative trend. All the South Asian countries – except Bhutan and Maldives - have reduced their external debt modestly during 2000-2005. The rate of reduction on external debt is exceptionally high especially in India and Pakistan. Sri Lanka, Bangladesh and Nepal are also in the path of reducing external debt ratio, however the pace is slow (Table 5). Overall debt service ratio has declined in South Asia: from 17% in 2000

Figure 4 : Trade Balance (% of GDP)



Source: Figures prepared by authors based on data in South Asia Economic Report, 2006, Asian Development Bank

to 10.2% in 2005. Improvement has been significant in case of large economies such as India, Pakistan and Bangladesh. However, the situation worsened in Nepal, Bhutan and Maldives.

9. Consumption, savings and investment: Change positive

Though in overall pattern of consumption, gross domestic savings and gross domestic investment in South Asia no significant change could be identified, a

Table 5 : External debt dynamics in South Asia

Countries	External Debt (% of GDP)		Debt Service (% of exports of goods and services)	
	2000	2005	2000	2005
South Asia	26.5	19.4	17.0	10.2
Bangladesh	33.4	30.5	7.3	4.8
Bhutan	41.8	83.2	4.9	7.0
India	22.0	15.7	16.6	10.2
Maldives	33.9	56.6	4.2	6.5
Nepal	46.8	41.9	6.0	9.4
Pakistan	43.6	30.7	31.5	14.9
SriLanka	54.4	48.3	14.7	7.9

Source: South Asia Economic Report, 2006, Asian Development Bank

five year gap analysis shows some decreasing share in consumption and slight increase in both gross domestic savings and gross domestic investment. All countries of South Asia show this similar trend, except some erratic changes in Bhutan. Comparison of consumption, gross domestic savings and gross domestic investment (as % of GDP) depicts that consumption predictably grabs the largest share, and gross domestic savings and gross domestic investment show a similar trend to some extent, which is predictable too (Table 6).

10. Revenue and expenditure: Slightly increasing

Majority of revenue is constituted with tax revenue in South Asia, and expenditure exceeds the revenue significantly (as % of GDP). And, all these three components show a slightly increasing overall trend. Though the gaps between 2000 and 2005 do not signify any noteworthy change, the overall trend is increasing, except some

Table 6 : Consumption, savings and investment dynamics in South Asia (as % of GDP)

Countries	Total Consumption		Gross Domestic Savings		Gross Domestic Investment	
	2000	2005	2000	2005	2000	2005
South Asia	77.8	73.0	22.2	27.0	23.4	29.1
Bangladesh	82.1	80.0	17.9	20.0	23.0	24.5
Bhutan	68.0	55.6	32.0	44.4	47.7	61.0
India	76.3	70.3	23.7	29.7	24.2	31.0
Maldives	55.8	51.9	44.2	48.1	26.3	36.0
Nepal	84.8	87.6	15.2	12.4	24.2	28.9
Pakistan	83.2	85.7	16.8	14.3	17.2	18.1
Sri Lanka	82.6	82.8	17.4	17.2	28.0	26.5

Source: South Asia Economic Report, 2006, Asian Development Bank

erratic changes in Maldives and negative change in Bhutan; and Pakistan and Sri Lanka show very low rate of changes in these three indicators (Table 7).

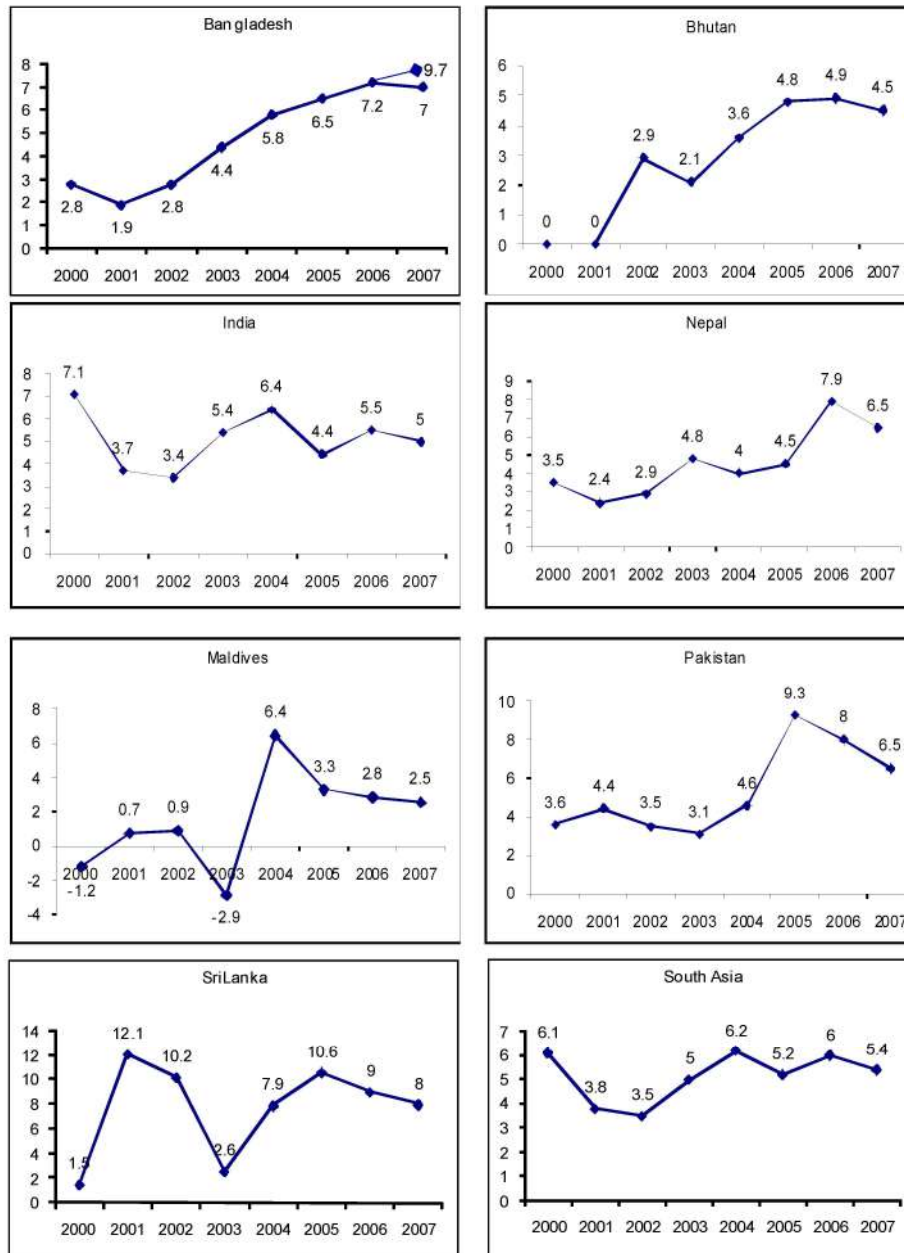
11. Agriculture, industry and service: Development skipping

Table 7 : Dynamics in revenue and expenditure in South Asian countries (as % of GDP)

Countries	Tax Revenue		Total Revenue		Expenditure	
	2000	2005	2000	2005	2000	2005
South Asia	13.3	15.3	16.7	19.1	25.3	25.9
Bangladesh	6.7	8.2	8.4	10.3	13.5	13.7
Bhutan	9.8	9.2	43.8	36.5	48.1	47.1
India	14.5	16.8	18.1	20.8	27.6	28.2
Maldives	-	-	32.3	46.4	36.7	58.6
Nepal	8.8	10.2	12.2	15.6	15.5	16.5
Pakistan	10.6	10.0	13.4	13.7	18.8	17.0
SriLanka	14.5	14.2	16.8	16.1	26.7	25.2

Source: South Asia Economic Report, October 2006, Asian Development Bank

Figure 5 : Inflation Rate (annual change, %)



Source: Figures prepared by authors based on data in South Asia Economic Report, 2006, Asian Development Bank; 2007 data for Bangladesh is drawn from most recent official statistics.

industrialization!

Services sector has been emerging as the dominant sector (comprise around half of the GDP) in South Asia and it shows an increasing trend. The remaining half of the GDP is shared almost equally by agriculture and Industry, where agriculture represents a declining trend and industry shows a slightly increasing trend. With some exceptions in Bhutan, Maldives and Nepal, all the countries can be fitted with this pattern. The concern is somewhere else: Where development history shows – the pathway of development road map from agriculture to services, via industry, the South Asian countries (except India, to some extent) have skipped the industrialization phase of the road map of economic development. This pattern of by-passing industrialization and the predominance of the services sector puts a big question mark in the sustainability of this kind of ‘development’ in South Asian countries (Table 8).

12. Employment dynamics: Unemployment reigns

Table 8 : Shares of major sectors in South Asian economies (as % of GDP)

Countries	Agriculture		Industry		Service	
	2000	2005	2000	2005	2000	2005
South Asia	24.6	20.4	25.6	26.2	49.8	53.3
Bangladesh	25.6	22.3	25.7	28.3	48.7	49.4
Bhutan	28.2	23.3	34.9	38.8	36.9	37.9
India	24.3	19.9	25.9	26.1	49.8	54.0
Maldives	9.0	9.7	13.9	16.8	77.1	73.5
Nepal	37.8	39.1	23.8	22.2	38.4	38.8
Pakistan	25.9	22.5	23.3	26.2	50.7	51.3
SriLanka	20.5	17.2	27.6	27.0	52.0	55.8

Source: South Asia Economic Report, 2006, Asian Development Bank

South Asia, the most populated region in the world, has been facing a severe problem – unemployment. Though agriculture contributes to GDP only by 24% (Table 10) in South Asia, it provides the largest share of employment in the region except in Maldives. If the whole South Asian situation is analyzed, the overtime trend of sector wise employment in the last two decades shows almost a similar pattern with the highest share in agriculture sector, and a much pronounced decreasing and slight increasing trend, respectively in industry and services

sector. But country-wise analysis shows some sharp decline of employment in agriculture, especially in Bangladesh, Nepal and Maldives (Table 9). Country-wise data also show rising preponderance of employment in the informal sector as opposed to formal sector, which is also indicative of rising poverty.

13. Poverty and income distribution: Rising inequality

Table 9 : Sectoral distribution (%) of employment in South Asia, 1980-1995

Countries	1980			1990			1995		
	Agriculture	Industry	Services	Agriculture	Industry	Services	Agriculture	Industry	Services
Bangladesh	72.6	8.7	18.7	66.4	13.0	16.2	63.2	9.6	25.0
Bhutan	94.4	1.4	4.2	94.2	0.9	5.0	—	—	—
India	69.5	13.1	17.4	69.1	13.6	17.3	66.7	12.9	20.3
Maldives	49.3	29.3	21.3	25.2	22.4	48.5	22.2	23.9	50.4
Nepal	93.8	0.5	5.7	83.3	2.3	13.7	78.5	5.5	16.0
Pakistan	52.7	20.3	26.8	51.1	19.8	28.9	47.3	17.1	35.6
Sri Lanka	45.9	18.6	29.3	47.8	20.6	30.0	41.6	22.5	33.4

Source: Mahbub ul Haq Human Development Centre, 2006

South Asia continues to be one of the poorest regions, with an overwhelming majority of the world's poor. In spite of taking initiatives and policies towards eradication of poverty and sustainable development, the poverty alleviation (reduction!) record is not satisfactory at all. Poverty reduction status has been uneven across countries of the region and overtime within the countries.

While the poverty situation may be improving viewing from \$1-a-day or \$2-a-day measures, the absolute numbers are rising. Viewing from the \$2-a-day poverty line, the percentage of poor has decreased from 90% in 1981 to 78% in 2001. This 78% poverty itself is very high (in-fact, highest among world regions) and shocking in the sense that in the most populous region in the world (i.e. South Asia) the actual number of poor people has increased a lot though the percentage of poor has been on the decline. And, even the \$1-a-day poverty line shows high poverty in the South Asian region. And, if the poverty situation of South Asia is compared with other world regions, except Sub-Saharan Africa and to some extent East Asia & Pacific, the picture becomes absolutely gloomy (Table 10). At present, over 300 million South Asians are chronically malnourished – the figure was 290 million in 1990-92. Most countries in South Asia have experienced either stagnation or increase in poverty levels as defined by the headcount ratio : rural

poverty has been consistently on the increase in Sri Lanka; Bangladesh and Pakistan both experienced a dramatic rise in urban poverty (during late 1990s) (World Bank 2005). And rising inequality is distinctly the key reason why South Asia has failed to make progress in reducing poverty.

There are differences in poverty measurement techniques and status of poverty among South Asian countries. In India, poverty records based on household expenditure surveys are available from the 1950s on an annual basis until 1973-74 and every five years thereafter. The data show that until 1977-78 the incidence of poverty fluctuated around 50% with no downward trend. While per capita GDP growth rose almost three times from an average rate of 1.5% per year during 1950-80 to 4.0% per year during 1980-2000, poverty ratio declined nearly 25% in 2000. In Pakistan, economic growth and poverty reduction were closely associated, too. From 1985-86 to 1995-96 poverty ratio fell from around 45% to about 30% though it rose a bit (around 32%) in 1999-2000. The steep decline in

Table 10 : Poverty situation in various world regions

Region	% of poor					
	‘\$ 2-a-Day’ Poverty Line			‘\$ 1-a-Day’ Poverty Line		
	1981	1990	2001	1981	1990	2001
East Asia & Pacific	84.6	69.6	46.4	56.7	29.5	14.3
Europe & Central Asia	4.7	4.5	19.1	0.8	0.5	3.5
Latin America & Caribbean	27.4	29.0	25.2	10.1	11.6	9.9
Middle East & North Africa	28.9	21.4	23.2	5.1	2.3	2.4
South Asia	89.1	85.5	77.7	51.5	41.3	31.9
Sub-Saharan Africa	73.3	75.0	76.2	41.6	44.5	46.4
High income	0.0	0.0	0.0	0.0	0.0	0.0
World	54.3	50.4	44.3	32.6	23.2	17.7

Source: *The New Economic Foundation, January 2006, World Bank's World Development Indicators online*

real GDP growth in 1990s compared to 1980s contributed to the slow rate of poverty decline. In Bangladesh, the proportion of population below the upper poverty line has fallen from 58.8% in 1990 to 49.8% in 2000, and the lower poverty from 47.7% to 33.7%. Bangladesh, a least developed country according to the UN / World Bank classification, in 1990s, experienced relatively faster income growth than low and middle income countries. In this period a low and

stable inflation rate associated with the stable GDP growth caused a decline in poverty at about 1% per year during the 1990s. However, in a populous country like Bangladesh, with a plateaued Total Fertility Rate (TFR), and more so with increasing TFR among the poor, and most recently with slightly reduced TFR coupled with declining CPR (BDHS 2007) – there always remains a danger that poverty will not decline further unless accelerated and sustained economic growth is ensured. The case of Sri Lanka is exceptional, not only in South Asia, but also among all the countries in the developing world, in achieving high literacy and low infant and adult mortality rates. Sri Lanka has been continuing to provide universal health and education coverage coupled with high commitment towards gender equality and social development. Currently, human development indicators of Sri Lanka are comparable to those of high-income countries. With all these achievements, Sri Lanka's 25% poverty rate is much lower than that in other countries of the region. However, a resolution of the ethnic conflict and a return to peace and restoration of security are *sine-qua-non* for sustainable poverty reduction, growth and development. But still the differences and non-cooperation between the two negotiating parties [President and Prime Minister on the peace process and the negotiations with the Liberation Tigers of Tamil Elam (LTTE)] have been dampening the hopes for peace dividend. Similarly, in Nepal, insurgencies are continuously going on. The political instability and tensions that resulted from the assassination of the King and several members of the royal family are not yet fully recovered. Nepal continues to be one of the least developed and poorest countries in South Asia. Comparable household survey data for assessing trends in poverty in Nepal are unavailable. The earliest survey in 1976-77 estimated 33% poverty ratio and the next survey in 1984-85 estimated it at 42%. A survey in 1991 covered only rural areas. These surveys were not comparable to each other or to the National Living Standards Survey (NLSS) of 1996-97 (based on the World Bank's Living Standards Measurement Surveys) and its repeat in 2003. NLSS estimate of poverty in 1995-96 was 42%. An extrapolation to 2000 based on economic growth since 1995-96 puts it at 38% (Srinivasan 2004).

The growth rate, though not very high or stable overtime, still, the very low rate of poverty reduction can not be explained with the moderate GDP growth rate in this region. One reason behind this may be the very unequal income distribution in this region. In all of the South Asian countries the poorest 20% population gets less than 10% from the total income of the country, whereas, the richest 20% gets more than 40% of the income (Table 11). The characteristic feature of most South Asian countries is that the income/ consumption share of the poorest 10% is less

than 4% of the aggregate income/ consumption. Conversely, above 25% of the income/consumption is snatched away by the richest 10% (this extent of snatching would be much higher if black economy is taken in to account: for details see Barkat 2006a).

The increase in inequality causing further aggravation of poverty in South Asia is associated with and evident in many critical dimensions: high inequalities in income; growing inequalities of income by sub-regions (“poverty pockets”)³; highly skewed land ownership and access to other assets negatively affecting human security including food security⁴; pervasive unemployment and large-scale underemployment implying continued proliferation of low productivity jobs in

Table 11 : Income share in some of the South Asian countries

Countries	Data year	Income share (%)	
		Poorest 20%	Richest 20%
Bangladesh	2000	9.05	41.35
India	2000	8.89	41.63
Nepal	1996	7.60	44.80
Pakistan	1999	8.75	42.29
SriLanka	1995	8.02	42.80

Source: *The New Economic Foundation, January 2006, World Bank's World Development Indicators online*

the services sector and informal sector; rising poverty and inequality attributable to the *Structural Adjustment Programme* (adopted in the late 1980s) mediated through weak institutional context which failed employment generation; globalization mediated poverty and inequality which pushes real wage rate downward both in formal and informal sectors; deleterious effect of import

³ In India, by 2002-2003, the net per capita state domestic product (NSDP) of Punjab (the richest state) rose to about 4.7 times that of Bihar (the poorest state). In Nepal, the difference between Kathmandu and the rest of Nepal is very marked. The industrialized Western Province of Sri Lanka fares the best on most human development indicators as compared to war-torn north and east. In Bangladesh, the northern districts are endemically famine-prone. Both in Pakistan and Bangladesh urban poverty is rising with predominance of informal sector low-wage low-end jobs.

⁴ Both in Pakistan and Bangladesh 40% farm land is owned by less than 10% farming households. In Bangladesh, 3.2 million acres of Khas land and waterbodies are illegally occupied by the land grabbers (Barkat, Zaman and Raihan 2001).

penetration on small producers – displacement of labour-intensive employers by capital-intensive techniques, and so on.

14. Human Development Index: Increasing but not satisfactory

In spite of an overtime increasing trend of human development in South Asian countries, the human development situation is not at all satisfactory. It is rather dark and gloomy. Economic security measure does not correlate significantly with the concept of human security in this region. Though, overtime slow but modest growth in macroeconomic indicators is very often positively related with the human development, there has not been found any significant proof to it. Even if some positive relationship exists between macroeconomic growth and human development, the effects of macroeconomic growth does not significantly affect human development positively, which can be shown by very low Human Development Index among the South Asian countries. Bangladesh and Nepal have a low but stable increase in their Human Development Index. India and Pakistan also experience almost similar kind of human development scenario, but a bit more fluctuating than others. Both Bhutan and Maldives are experiencing almost fixed Human Development Index value overtime (Figure 6).

Sri Lanka and Maldives are significantly ahead of the other South Asian countries in Human Development Index. India's development is next to them, though some instability is found in this case. Pakistan and Bangladesh are almost similar in the Human Development Index overtime. But, Pakistan's growth in the value of Human Development Index shows some more instability than Bangladesh. If we compare the GDP per capita (US\$) with the Human Development Index, then it seems that there is some kind of positive relationship, but it is not clear at all, and the extent is still to be calculated. Human Development Index for Sri Lanka and Maldives shows a very high score especially in terms of adult literacy rate. Among the rest of the countries, India is behind these two in the indicator of adult literacy. Life expectancy at birth is almost similar among the countries, except Sri Lanka, which is far ahead of others (Table 12).

15. Urbanization or *Slumization*?

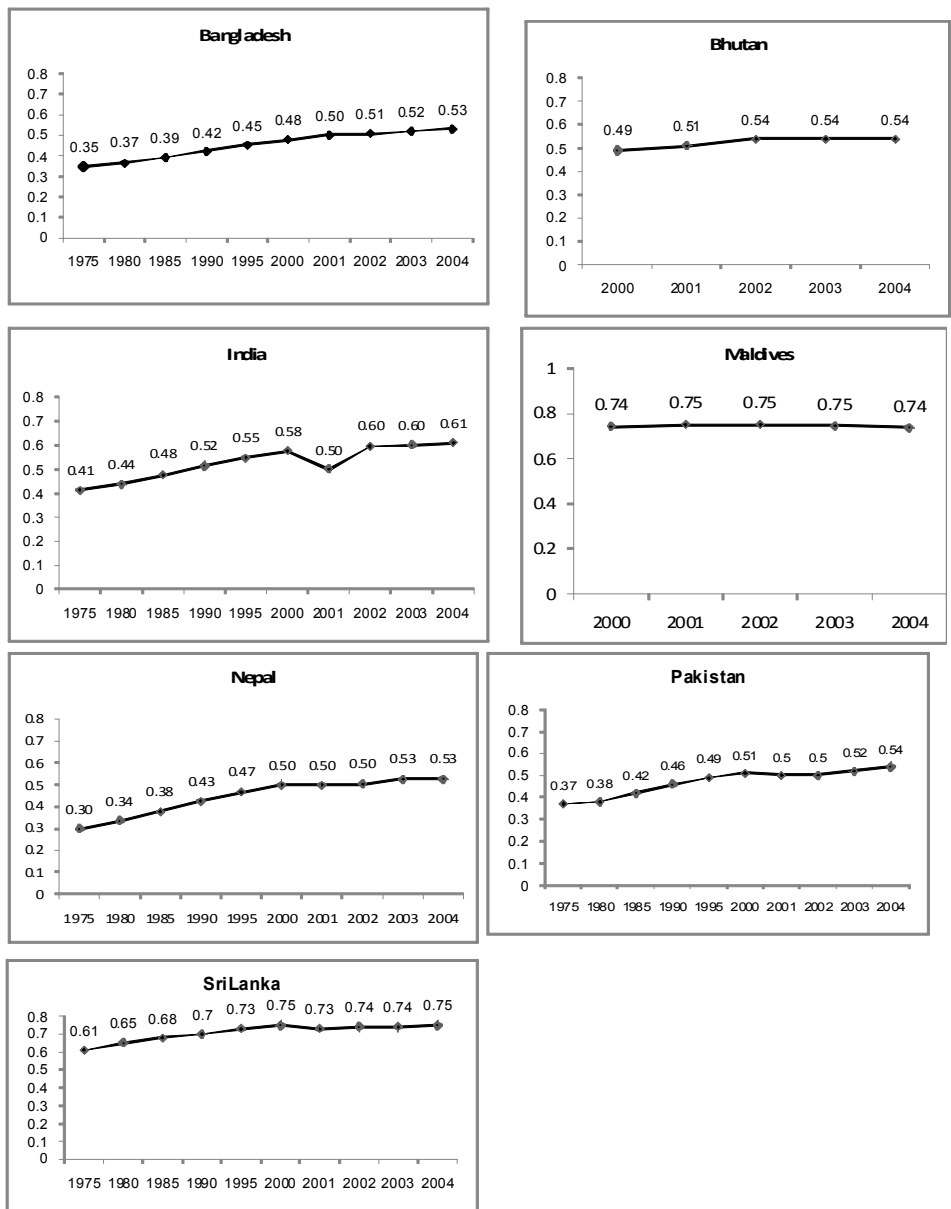
In most of the South Asian countries, in spite of a high rate of urbanization (Figure 7) in the last two decades, the overall development scenario has not attained any satisfactory level. While, very often urbanization is being considered as the proxy of development, in most South Asian countries, the rural to urban migration has been a consequence of rural poverty without any concomitant industrialization. In

Table 12 : Human Development Indices in South Asian countries, by indicators used

Countries/ Year	Life expectancy at birth (years)	Adult literacy rate (% age 15 and above)	Combined primary, secondary and tertiary gross enrollment ratio (%)	GDP per capita (PPP US\$)	Life expectancy index	Education Index	GDP index	Human Development Index (HDI) value	GDP per capita (PPP US\$ rank minus HDI rank)	
Bangladesh	2000	59.4	41.3	37.0	1,602	0.57	0.40	0.46	0.478	-5
	2001	60.5	40.6	54.0	1,610	0.59	0.45	0.46	0.502	7
	2002	61.1	41.1	54.0	1,700	0.60	0.45	0.47	0.509	1
	2003	62.8	41.1	53.0	1,770	0.63	0.45	0.48	0.520	-1
	2004	63.3	41.0	57.0	1,870	0.64	0.46	0.49	0.530	7
Bhutan	2000	62.0	47.0	33.0	1,412	0.62	0.42	0.44	0.494	7
	2001	62.5	4.0	33.0	1,833	0.62	0.42	0.49	0.511	5
	2002	63.0	47.0	49.0	1,969	0.63	0.48	0.50	0.536	0
	2003	62.9	47.0	49.0	1,969	0.63	0.48	0.50	0.536	0
	2004	63.4	47.0	49.0	1,969	0.64	0.48	0.50	0.538	2
India	2000	63.3	57.2	55.0	2,358	0.64	0.57	0.53	0.577	-1
	2001	63.0	58.0	56.0	2,840	0.64	0.57	0.56	0.590	-12
	2002	63.7	61.3	55.0	2,670	0.64	0.59	0.55	0.595	-10
	2003	63.3	61.0	60.0	2,892	0.64	0.61	0.56	0.602	-9
	2004	63.6	61.0	62.0	3,139	0.64	0.61	0.58	0.611	-9
Maldives	2000	66.5	96.7	77.0	4,485	0.69	0.90	0.63	0.743	9
	2001	66.8	97.0	79.0	4,798	0.70	0.91	0.65	0.751	7
	2002	67.2	97.2	78.0	4,798	0.70	0.91	0.65	0.752	13
	2003	66.6	97.2	75.0	-	0.69	0.90	0.65	0.745	2
Nepal	2004	67.0	96.3	69.0	-	0.70	0.87	0.65	0.739	3
	2000	58.6	41.8	60.0	1,327	0.56	0.48	0.43	0.490	6
	2001	59.1	42.9	64.0	1,310	0.57	0.50	0.43	0.499	8
	2002	59.6	44.0	61.0	1,370	0.58	0.50	0.44	0.504	11
	2003	61.6	48.6	61.0	1,420	0.61	0.53	0.44	0.526	15
Pakistan	2004	62.1	48.6	57.0	1,490	0.62	0.51	0.45	0.527	13
	2000	60.0	43.2	40.0	1,928	0.58	0.42	0.49	0.499	-7
	2001	60.4	44.0	36.0	1,890	0.59	0.41	0.49	0.499	-7
	2002	60.8	41.5	37.0	1,640	0.60	0.40	0.49	0.497	-7
	2003	63.0	48.7	35.0	2,097	0.63	0.44	0.51	0.527	-5
Sri Lanka	2004	63.4	49.9	38.0	2,225	0.64	0.46	0.52	0.539	-6
	2000	72.1	91.6	70.0	3,530	0.79	0.84	0.59	0.741	19
	2001	72.3	91.9	63.0	3,180	0.79	0.82	0.58	0.730	13
	2002	72.5	92.1	65.0	3,570	0.79	0.83	0.60	0.740	16
	2003	74.0	90.4	69.0	3,778	0.82	0.83	0.61	0.751	17
	2004	74.3	90.7	63.0	4,390	0.82	0.81	0.63	0.755	13

Source: Prepared by authors based on data in Human Development Report, 2006, 2005, 2004, 2003 and 2002, UNDP

Figure 6 : Overtime HDI value in South Asian countries

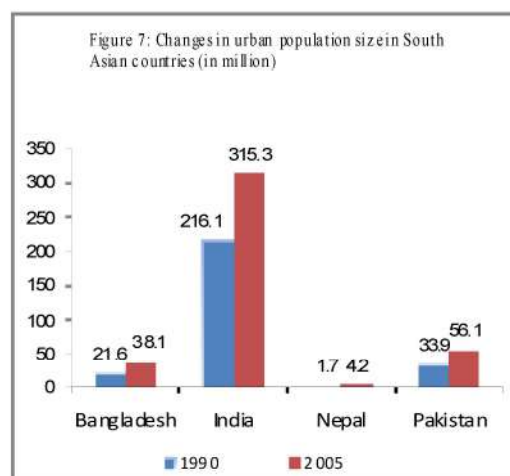


Source : Figures prepared by authors based on data in South Asia Economic Report. 2006. Asian Development Bank

this situation, the push factors (from rural areas) are much stronger than the pull factors (of urban areas). This kind of migration simply can be termed as ‘poverty-driven migration’, and this is a common phenomenon in South Asia. In most of the time, except the very few lucky ones among the migrants, most of them have to settle in slum or in shanty towns, where human poverty situation is generally worse than its rural counterpart. This phenomenon of poverty driven rural-push migration without concomitant industrialization and expanded informal sector has been termed as ‘slumization’ instead of urbanization (Barkat and Akhter 2001).

16. Defense expenditure: Undermining potentials of peace dividend

In spite of being one of the poorest regions in the world, South Asia is the most militarized region too. Thus when any amount of money in this region is allotted in the name of defense or military expenditure, it must have been taken away from a poor person’s healthcare sector or from the children’s education sector. The impact of increased military spending threatens more directly to the individual security and human rights, when the ultimate goals of defense or military are taken into consideration. And, of course, the large government expenditure (there are some large disguised defense expenditures too, which are not included in the defense budget, like *cadet colleges* in Bangladesh, and defense budget is notoriously non-transparent in this region) itself begets a lot of questions and critics in a very poor region like South Asia. But, despite massive poverty situation in South Asia, the countries of this region are continuously investing heavily in this non-productive sector undermining the real potentials of peace



Source: Mahbub ul Haq Human Development Centre, 2006

dividend. Regional military expenditure estimates show a fifty percent increase in South Asia between 1995 and 2004. While India and Pakistan are respectively the second (after China) and tenth largest arms importers in the world, the human development situation and overall poverty situation is undoubtedly very unsatisfactory in both the countries.

In addition to overall military expenditure, the pattern of per capita defense expenditure vis-à-vis health and education is almost similar in Bangladesh, Sri Lanka, and Nepal (Table 13 and Figure 8). It is worth noting that a battle-tank usually costs US \$4 million but this amount of money is more than enough to immunize 4 million children or to provide arsenic free safe/clean drinking water filters to serve 500,000 people. In this situation and in view of the rising number of the chronically malnourished people in the region, is the rising military expenditure justified in South Asia?

17. Refugee: Serious issue

People become refugees or internally displaced due to direct consequences of threats to life and physical security fear and active persecution, destruction of homes and means of livelihoods, and collapse of state provision and control. Since the partition of the Indian sub-continent in 1947, South Asia has constantly been facing war and human rights violations, which have forced a huge number of people in this region to have the inhuman fate of a refugee. During the partition, more than 14 million people had to leave their homes. 10 million people of Bangladesh had to be displaced during the liberation war of Bangladesh in 1971. 400,000 rural families of Nepal were forced to be displaced internally due to

Table 13 : Trends in military expenditure in South Asia

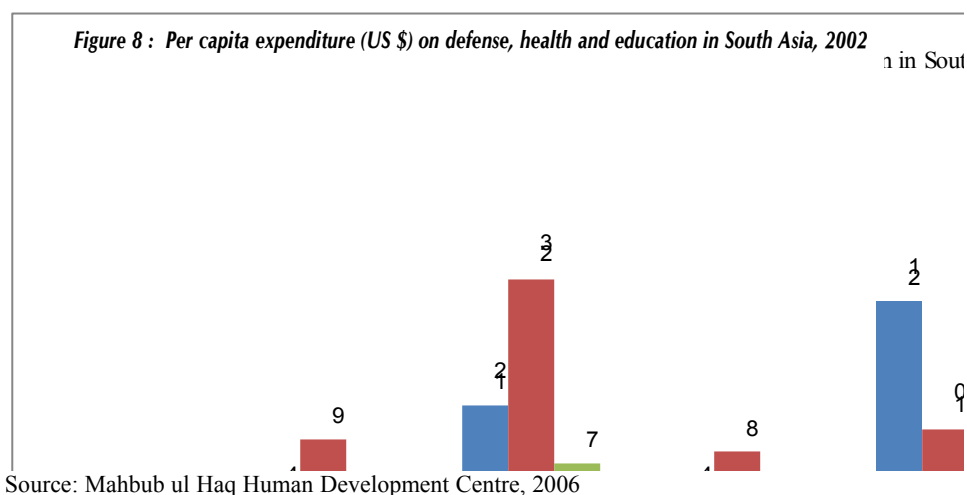
Countries	As % of central government expenditure			As % of GDP		
	1994	1999	2003	1994	1999	2003
Bangladesh	17.6	11	n/a	1	1	1.2
India	15	15	14.2	2	2	2.3
Nepal	7	6	n/a	1	1	1.5
Pakistan	27	23	23.9	5	5	4.1
SriLanka	12	15	13.6	3	4	2.5
South Asia	16.32	15.24	13.557	2.21	2.22	2.359

Source: Mahbub ul Haq Human Development Centre, 2006.

Maoist insurgency. Civil war of SriLanka has displaced an estimated 650,000 people, comprising one-third of the population living in the affected areas. About 14% of the total refugees in the world (9.236 million) are in South Asia, and three-quarters among the refugees live in Pakistan (Table 14).

18. Energy situation: Majority yet unserved

Electricity and economic growth are correlated, and rural electricity has a



significant and sustained impact on the reduction of both economic poverty and human poverty (Barkat 2005). It has been proved through high standard research works, that electrification is significantly helpful in human development, and the rate of development among poor-households connected through electricity is much more pronounced than the non-poor. Therefore, when pro-poor growth is considered, then electrification means a jump toward development. Despite a substantial expansion of electricity generation in South Asia over the last two decades, there has only been a modest success in expanding the coverage of electricity. In Pakistan, Bangladesh and India, about a half to two thirds of the population are still out of the electricity coverage. If situation of the rural areas is analyzed, the picture would seem much miserable in South Asia. And, in this region lack of people’s access to electricity, serious power shortages and outages have been affecting the process of development.

IEA (International Energy Agency) projects that the region will have the highest growth rate of energy consumption in the world by 2010. A significant proportion

of population in the region still does not have access to modern means of energy and continues to depend on traditional sources, such as biomass and fuelwood, for most of its energy needs. High use of biomass fuels is not only depleting natural resources but also causing serious environmental and health concerns. Consumption of commercial energy is dismally low, ranging from 160 kgoe

Table 14 : Number of refugees in South Asia, 2004

Country of Asylum	Number of refugees*	Origin of the refugees
Bangladesh	20,449; 300,000	Myanmar (99.7%); Biharies
India	162,687	Afghanistan (6%) China (58%), SriLanka (35%)
Nepal	124,928	Bhutan (84%), Tibetans (16%)
Pakistan	3,047,225	Afghanistan (99.9%)
SriLanka	63	
Azad Kashmir (Pak)	50,000	Disputed Kashmir
South Asia	1,268,744	
World	9,236,521	

*Note: * The figure includes the refugees registered to UNHCR and do not include the asylum seekers during that year.*

Source: Mahbub ul Haq Human Development Centre, 2006.

(kilograms of oil equivalent) for Bangladesh to 494.03 kgoe for India. Electricity access in the region is one of the lowest in the world. Access to electricity in Bangladesh is mere 30%. Seventynine percent of Bhutan's total population still live in villages and continue to be dependent on biomass for meeting their energy needs. Only 11% of Bhutan's population have access to electricity. With 26.1% of its huge population living below the poverty line, India too faces challenges posed by increasing population and economic growth. In 2001–02, only 46% of India's population had access to electricity. As per the 2001 census, Nepal's rural population was 85.77%. Access to electricity in Nepal is dismally low at 15.4%. Rural–urban disparities within these countries also pose a challenge. Rapidly growing power demand coupled with inadequate power supplies is a challenge throughout the region. Electricity shortages have acted as a constraint on economic growth.

This is so even as some countries in the region have a relatively abundant potential electricity supply, hydroelectricity in particular. Considering the dispersed nature of rural population in the region and difficult terrain, distributed generation based on locally available renewable resources also merits consideration and needs a planned approach. Significant prospect of developing huge hydropower potential of Nepal and Bhutan could help meeting a significant portion of the growing electricity needs of the SASEC (South Asia Sub-regional

Table 15 : Trends in electricity production in South Asia (billion kwh), 1990-2002

Countries	1990	2002	Average annual growth (%) 1990-2002
Bangladesh	7.7	18.4	11.6
India	289.4	596.5	8.8
Nepal	0.9	2.1	11.1
Pakistan	37.7	75.7	8.4
Sri Lanka	3.2	7.0	9.9

Source: Mahbub ul Haq Human Development Centre, 2006.

Economic Cooperation) region but that would call for huge investments.

Resource mobilization for T&D (transmission and distribution) investment poses a huge challenge. Power losses due to poor quality transmission and distribution and theft are high. The high technical losses in the region reflect lack of investment in the distribution sector and its inability to mobilize adequate financial resources. Most countries in the region are looking at private and foreign investments for power sector development, which calls for stable and predictable policy regimes conducive to the investors. According to an estimate, Bangladesh requires an investment in the range of 5 to 6 billion dollars over next 10 years for power sector development. By 2010, India requires an investment of 172 billion dollars in energy supply and infrastructure. According to a World Bank study, Nepal's combined investment need for generation and transmission for the next 10 years is estimated at 1.77 billion dollars. The proposed projects under Bhutan's power system master plan will require an investment of 3.36 billion dollars over the 20-year period from 2003 to 2022. These massive investment requirements clearly pose a challenge not only for respective countries but also for development of the region as a whole.

Steadily increasing oil import dependency of the region is another crucial concern from the overall security standpoint. Oil imports have implications both in terms of physical supply of crude oil and various petroleum products and also in terms of their impact on the balance of payments. The high oil prices are reinforcing energy vulnerability of the region. As per IEA estimates, loss of GDP averages 0.8% in Asia and 1.6% in very poor highly indebted countries in the year following a \$10 oil-price increase. In 2003-04, India imported 90.8 MT with a massive foreign exchange outgo of around US\$ 20.4 billion. The situation in Nepal is also precarious because it is a landlocked country with no proven oil or gas reserves. Dependence on energy import has put a burden on the foreign currency reserves of Nepal. Fuel imports absorb over one-fourth of Nepal's foreign exchange earnings. Petroleum is also the single largest imported item in Bangladesh. World energy outlook projects South Asian oil import dependency to increase from 72% in 2000 to 95% in 2030.

Given the similar socio-economic structure of countries in the region and convergence of the challenges faced by their energy sector, there is a scope for exploring strong integration. To meet the increasing pressures of growing energy needs of the region it is vital to have significant investments in the energy infrastructure. Regional sharing and planned use of available resources would address many of the growing energy security concerns and accelerate economic development of the region. In addition, this would open a window of new opportunities through greater levels of cross border trade and investments, larger markets and higher social stability in the region as a whole.

19. Prospect for Regional Cooperation: Focusing SAFTA

In the last decade, the prevailing stalemate in multilateral trade negotiations within the framework of World Trade Organization (WTO) provided impetus to the signing of regional trade agreements world over and South Asia is not an exception to this trend.

In South Asia, the regional integration process started off under the South Asian Preferential Trade Agreement (SAPTA) in 1995 with Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. But, limited coverage of commodities, political disagreements, bilateral issues, and non-cooperation among members made SAPTA ineffective.

The South Asia Free Trade Agreement (SAFTA) signed in early 2004, which came into force on 1st July 2006, was expected to overcome these problems. The SAFTA is a parallel scheme to the multilateral trade liberalization commitments

of the South Asian Association for Regional Cooperation (SAARC) member countries. SAFTA aims to reduce tariffs for intraregional trade among the seven SAARC member countries. It has been agreed that for the South Asian countries, Pakistan and India will eliminate all tariffs by 2012, Sri Lanka by 2013 and Bangladesh, Bhutan, Maldives and Nepal by 2015. SAFTA extends scope of SAPTA to include trade facilitation elements and switches the tariff liberalization process from a positive to a negative list approach. A special consideration in SAFTA is the compensation for revenue losses for small countries in the event of tariff reductions (Baunsgaard and Keen 2005).

In addition to SAFTA, countries in the region are members of other regional / bilateral trade agreements. Bangladesh, India, and Sri Lanka are members of two other regional groups: the Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation (BIMST-EC) group, and the Indian Ocean Rim Association of Regional Cooperation (IOR-ARC). The latter includes many members of the Indian Ocean Rim, including South Africa and Australia. Besides, India and Sri Lanka are parties to a bilateral free trade agreement: the Indo-Sri Lanka Free Trade Agreement (ILFTA).

It has been argued that the regional economic integration in South Asia can generate significant intraregional trade and welfare gains for the South Asian countries. But benefits from the SAFTA and other regional trading arrangements in South Asia are little. One reason behind this is that major trading partners of the individual South Asian countries are located in the west. It is also argued that Regional Trade Agreements (RTA) in South Asia will lead to substantial trade diversion than trade creation and it may work as a stumbling bloc to multilateral trade liberalization.

However, the level of regional integration in South Asia, especially among its largest members, remains low, and trade barriers continue to be relatively high for any region in the world. The proportion of trade originating in the region has increased in the last decade but still lags behind ASEAN levels. While Bangladesh, India and Pakistan sustain 5% of their exports and 2.5% of their imports with regional partners, the smallest members (Bhutan, Nepal, Maldives, and Sri Lanka) exhibit a higher reliance on local trade relations averaging 20% and 9% for imports and exports, respectively. In terms of trade barriers the region has undertaken an overall liberalization program with India reducing its average tariff level by around 20 percentage points during the last 8 years.

Political tension between the two large countries in the region, India and Pakistan, remains as a major constraint to regional integration. In addition, internal conflict

in Sri Lanka, illegal trade along Indo-Bangladesh and Indo-Nepal borders are frequent causes of political discord amongst the countries of the region. Until and unless SAARC countries are able to develop cordial political relations it would be extremely difficult to achieve the actual gains from SAFTA.

Studies suggest that the existence of complementarity is needed to enhance the probability of a regional trade arrangement to be net trade-creating, rather than net trade-diverting. Kemal *et al.* (2000) have estimated the complementarity indices for all five leading South Asian countries using time series trade data and found that there is a lack of strong trade complementarity in the bilateral trade structures of South Asia. The prospect of increasing regional trade depends on the existence of product complementarities and export efficiencies (*i.e. comparative advantage*) and other characteristics such as the degree of concentration and diversification of trade profiles amongst the regional partners. But in this region, countries are producing and trading similar commodities. The lack of trade complementarity in bilateral trade flow and the similarity of the pattern of comparative advantage in the region have been the main constraints to the growth of intraregional trade (Kemal *et al.* 2000). South Asian countries need to develop comparative advantages especially in the products which they are trading with non-members to make the SAFTA successful.

India being large, the impact on its trade of the RTA with the small neighbors cannot be proportionately large. Srinivasan and Canonero (1995), using the gravity model shows that the effect of removing all tariffs would be to increase total trade between 3% of GDP for India and 59% of GDP for Nepal, and in between for other countries.

Basyan, *et al* (2006) argued that trade diversion would be dominant as a result of SAFTA. This point is reinforced by the presence of high levels of protection in the region. They suggest to ensure more effective intra-regional trade, minimizing the likely trade diversion costs and maximizing potential benefits. Study of Raihan and Razzaque (2007) shows that a full implementation of SAFTA will lead to welfare gains for India, Sri Lanka and rest of South Asian countries, though Bangladesh suffers from welfare loss, mainly driven by the negative trade diversion effect. Kumar and Kumar (2007) suggest that SAFTA does not result in welfare gains for all the member countries (Table 16). SAFTA results in small welfare gains for all the South Asian countries except Bangladesh. While India gains by about US \$204 millions and Sri Lanka by just US\$89 millions only, Bangladesh suffers welfare loss of about US\$225 millions. Bangladesh loses in terms of allocation efficiency and terms of trade by US\$104 and US\$106 millions,

respectively. But, they suggest that intra-regional trade will rise significantly.

It is important to explore other policy options that might be economically beneficial to all the member countries even without compromising increased intra-regional trade and the non-economic benefits that it might bring along. Thus, it is required to critically analyze the impacts of the integration between SAFTA with other major trading blocs. According to Kumar and Kumar (2007) SAFTA–ASEAN free trade bloc is expected to have a negative impact on the region’s welfare; trading arrangement between SAFTA and NAFTA is expected to bring welfare gains for all South Asian countries except India; under preferential trade bloc between SAFTA and EU27, while Sri Lanka gains, Bangladesh, India and RSA suffer welfare loss than under SAFTA, though it is improving for RSA when compared with the base case. It is to note that Kumar and Kumar used a standard static GTAP model, a global computable general equilibrium model in the analysis, which has its own limitations and results may underestimate welfare gains since the model does not capture possible dynamic effects (e.g. capital accumulation and technology changes) of trade policy changes.

**Table 16 : Welfare (US\$ millions) and GDP Impacts
(% change from base) due to SAFTA**

Parameter	Countries			
	Bangladesh	India	Sri Lanka	Rest of South Asia
Allocative efficiency	-104	-3	10	91
Terms of Trade	-106	209	78	416
Investment/Savings	-16	-3	1	15
Total welfare change	-225	204	89	521
GDP quantity index	-0.22	0	0.06	0.11

Source: A. Ganesh Kumar and Gordhan Kumar Saini (2007)

20. Experiences

All the South Asian countries have pursued various reform measures towards economic growth, development and poverty reduction in the last two decades. Attaining accelerated macro-economic stability and economic growth overtime was the key objective of the reforms, and these were viewed as means to poverty reduction in a sustainable way. Outcomes are mixed. Human development was sought to be achieved by economic growth via poverty reduction. The reforms –

within the framework of globalization – were being initiated in trade, industrial policy, fiscal policy, monetary policy and exchange rate management. The priority social sectors were somewhat neglected by the governments, which were somehow addressed by the NGOs, civil society, and other development partners. Almost all reforms were aimed at trade reform to equip South Asian countries to face the market challenges of globalization. Basically, trade reforms in the form of free market open economy were being initiated in this process. Analysis of country-wise data shows that macroeconomic stability might be an important player for growth, but there is space and high probability that various important country wise variables play in the growth dynamics.

Revisiting development strategies is required for South Asian economies. The common traits of development strategy of South Asian economies include the dominant role of state (mainly in infrastructural sectors); import substituting industrialization; public sector's dominance in financial sector; moving away from inward orientation and integration with world economy (with goods, services, capital movements) through lowering tariff and non-tariff barriers and easing restrictions on inflow of foreign capital; currency pegging and/or managed float arrangements to reduce the risks of volatility in the exchange rates. South Asian countries emphasized import substituting industrialization, where public sector played a key role especially in infrastructural development. In spite of the country-wise variation of reform agenda, the main thrust of the reform in this region was more or less the same. All the countries were substituting the inward looking national policy with outward looking policies, through various components of trade liberalization. Capital and financial markets were becoming more and more flexible for utilizing the benefits from capital movement, and to ensure the boost of service sectors; though, most of the countries in this region were unable to deal successfully with the 'industrialization phase' of development, rather they have by-passed it.

Real wage, both in formal and informal sector, has fallen in South Asia. Employment situation has been worsening over the last two decades with rising informal market. Increasing poverty and inequality retard human development. Experience shows that the issue of poverty eradication and overall human development is more a serious politico-economic issue, rather than a conventional economic one.

The benefits from preferential regional trade agreement compared to multilateral liberalization were more likely to be higher for Sri Lanka, Bangladesh and Nepal, than their big neighbors like India and Pakistan. Although, on the basis of Most

Favored Nations (MFN), all the countries in this region could not share the benefits equally, the probability of larger benefits is high among the bigger countries. Under the Multi Fiber Arrangements (MFA), the boost of the textiles and apparel industry of this region has been restrained to some extent. But, still the countries of South Asian region have been capable of facing the world competition (Srinivasan 2004).

South Asian Free Trade Area (SAFTA) is an attempt to accelerate cooperation amongst member countries. SAFTA has been questioned both theoretically and empirically. SAFTA may not result in a win-win situation for all its member countries. However, intra-regional trade does rise significantly, which is likely to improve regional co-operation amongst members and political frictions may be smoothed through strengthened regional trade. “Peace dividend” for its members could outweigh the economic benefits.

In South Asian countries donor dependency is in a reducing swing (at least, as share of foreign loans and grants in GDP), but policy levels are still being highly influenced by the big powers. And, it has been evident that the benefits of free market economy could not be reaped properly in this region due to the international pressure. FDI flow, for many reasons (physical, social, political), is not satisfactory at all. The experiences of the FDI-financed enterprises in this region are not problem-free, rather problematic.

Rigid political relations especially between India and Pakistan have influenced negatively on the whole human security issues in this region. Moreover, regional trade and intra-country benefits are still at its lowest level due mainly to the political relations.

‘Privatization’ or ‘disinvestment’ process was not dealt rightly in the political framework in this region. And, it can be argued that socio-economic sectors handling through the public sector in this region is a must for even attaining the minimum level of human development.

Faster growth must be complemented with other policies aimed at fighting poverty. While acceleration in growth is an essential precondition for poverty reduction, it is never the sufficient one. Growth with distributional justice will necessitate a paradigm shift in the whole development mind set, in which among others, the issues of land-agrarian-aquarian reforms, right to food as constitutional right, public-private partnership and regional cooperation based on mutual trust and respect should be high on agenda.

Compared to 1980s, South Asian economies are much more open to external

competition, but trade barriers in South Asia are much higher than those in East Asia.⁵ This makes South Asia comparatively insulated from world markets, which is evident in its continuing small share in world exports. While China's share in world export rose from 1.3% in 1978 (when it opened up) to 5.2% in 2002, the same for India rose from only 0.5% in 1990 to only 0.8% in 2002. Therefore, integration of South Asian economies and strong ties with global economy are necessary to mitigate economic insecurity and to accelerate growth.

21. Prospects and Challenges

The prospects of the South Asian economies lie behind the challenges; in fact, prospect will depend upon how well the challenges are faced and managed. Prospects can only be materialized by tackling the challenges. Key challenges ahead including, among others, the development of South Asian economies, are as follows:

1. Trap of domestic insurgencies and conflicts inhibiting peace dividend has been contributing in lower pace of development in most countries of South Asia. In most cases these domestic insurgencies and conflicts have spillover effects on other countries. The benefits of reform can even be reversed if conflicts continue and are not resolved peacefully. Therefore, peaceful resolution of domestic insurgencies and conflicts should be placed high on the real agenda of development and poverty reduction of South Asia.
2. To pave the pathway of internal conflicts resolution, peace dialogues and policies need to be designed in a more dynamic way. In local levels, equitable economic and development policies (taking into consideration the ethnic, religious, linguistic issues) are very important for local conflict resolution. In this process, good governance and political dialogues with open mind will be of high utility.
3. Development strategies towards poverty eradication (reduction!) should be revisited. In which, poverty should be viewed in a broader sense as a complex interrelated domain of the following: income poverty; poverty due to hunger; poverty due to low wage; poverty due to

⁵ The key issues of trade liberalization in South Asia include those pertaining to the Doha round of multilateral trade negotiations under WTO, role of preferential trade liberalization, and impact of phasing out of bilateral export quotas on textiles and apparels under MFA (for details see Srinivasan 2004)

unemployment; poverty due to lack of shelter; poverty due to lack of access to public resources including rights to khas land; poverty due to lack of education; poverty due to ill health; poverty mediated through environmental hazards; political poverty (due to lack of political freedom); poverty due to lack of transparency guarantee; poverty due to lack of protective security; poverty mediated through various forms of marginalization (e.g., among religious minorities, indigenous peoples, low caste, poor women, old age person, slum dwellers, char people, rickshaw-van pullers etc.); poverty of culture; and poverty of mindset (Barkat 2006b).

4. Though it appears that under the current geo-political scenario in this region, reducing arms imports and military expenditure is the synonymous of the word “impossible”, strong regional-political initiatives are warranted to re-direct more resources for social development and employment generation. In order to sustain the public entitlements like basic health measures, education and other rights issues to ensure ultimate human development, reduction in military expenditure is a must. Policy makers’ and politicians’ mind-set of measuring “efficient resource allocation” has to be changed.
5. In South Asia, rural poverty is at its gravest situation. Especially, the rural-push migration and food security situations are deplorable. This is not only a production-relation consequence, but more of an entitlement issue. In order to eradicate rural poverty in this region, governments need to undertake not only expenditure re-allocation, but also measures respecting poor people’s ‘rights’. And, there is no space to think that poverty is only a rural issue in this region. It should be noted that urban poverty situation is also deplorable; in Bangladesh and Pakistan prevalence of poverty is higher in urban than in rural areas, which should be dealt with commitment, in which, among others, land-agrarian-aquarian reforms should be high on the development agenda.
6. Poverty and large number of population are yet to be correlated significantly, but control of population growth in this region surely ensures some social and economic security. And, when some countries in South Asia are facing plateaued Total Fertility Rate (TFR) much above the replacement level fertility, and more so, increasing TFR among the poor (e.g., Bangladesh) – this is the high time to deal with the issues pertaining to the reproductive health including family

planning.

7. Majority sectors of South Asia, in the era of liberalization, were not equipped with structures that might boost the employment generation and increase in real wage; rather this region had to face and still is facing severe adverse effects of trade liberalization on employment and real wage. Variable tariff structure, protective measures for small and medium producers, implementing the labor laws etc. are vital. And in this most populous and poverty-stricken region, in deciding choice of technology (labor-intensive or capital-intensive?), employment situation needs to be considered.
8. Policies regarding privatization must be judged and scrutinized strictly by measuring its impact on poverty, employment generation, and on vulnerable and marginalized people. Privatization – in the process of globalization through liberalization – should be monitored and must have a human face.
9. Globalization should be addressed keeping in view the local ethical and socio-economic considerations of this region. The gap between the ‘beneficiaries of trade liberalization’ and ‘non-beneficiary of trade liberalization’ should be minimized through alternative policies, which should not be fully doctored by the traditional concept of liberalization, in the name of globalization.
10. South Asian economies must be equipped with market instruments, like internalizing environmental costs, environmental tasks etc. And, the environment and natural disaster issues should be dealt regionally, rather than domestically, as it has substantial long-term spill-over effects on the neighbors.
11. Regional trade through SAFTA has been questioned both theoretically and empirically. SAFTA may not result in a win-win situation for all its member countries. However, as intra-regional trade does rise significantly, which is likely to improve regional co-operation amongst members and political frictions may be smoothed through strengthened regional trade. “Peace dividend” for its members could outweigh the economic benefits. These are real research issues and need to be explored.
12. National economic policies should be made compatible to all international laws, conventions and standards; local economic policies

should be harmonized to maximize mutual benefits in regional level. Civil societies and professional groups should be engaged in the policy making actively, not from 'outside the system' rather 'within the system'.

13. Last but not the least, the social engineers including the economists, research-academicians and civil society of the region very often meet and discuss relevant issues in seminars and workshops, both in national and international levels. But, the genuinely mutually beneficial outcomes usually do not get translated into real actions. Also, the progress on the outcomes are not being updated, which results in stagnation of the total procedure. And, it is the reality that no active professional body or group of the region is working together for the mutual benefits of the countries in South Asia. A proper liaison mechanism is yet to be developed, through which, the policy recommendations could be translated into regional practice.

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