

# Executive Summary

South Asia has sustained an average growth rate of 5.5 per cent per annum over the past two decades, despite many external and domestic shocks such as East Asian crisis, slow down of the world economy, Afghan and Iraq wars, oil price hikes, failure of monsoons, ethnic conflicts and threats of terrorism, among others, making it one of the most dynamic regions in the world. With more than a decade of reforms behind them, the region's economies are more intensively integrated with the global economy, growth of income and exports display promising outlook and inflation rates are in check. Despite such achievements in terms of economic performance, however, the region continues to be home for more than two-fifths of the world's poor. The region also fares very poorly in terms of different indicators of human development such as education, health, nutrition, among others. Therefore, the region needs to further accelerate its growth process with an emphasis on human development and strengthen competitiveness to deal with the daunting challenges of alleviation of poverty, hunger, illiteracy, and disease.

The *South Asia Development and Cooperation Report 2004 (SADCR 2004)* argues that the region can face these challenges much more effectively as a group rather than individually. The regional economic integration can, by exploiting the synergies, expand the economic opportunities available and strengthen the growth prospects. The recent experiences with economic integration in the region suggest that it leads to expansion of trade and development in a balanced and sustainable manner. In the light of these experiences and against the backdrop of mushrooming regional trading blocs in different parts of the world, the Report finds a compelling case for the region effecting its transition into an economic and monetary union by implementing SAFTA, forming a SAARC Customs Union and introducing a South Asian parallel currency, as an intermediate step to a single currency, in an expeditious manner.

Among the key sectors presenting opportunities for mutually beneficial cooperation, *SADCR 2004* selects transport infrastructure for a detailed analysis. Transport infrastructure is not only an important determinant of economic development but is also critical in exploiting the gains of economic integration resulting from geographical proximity. Earlier *SADCR 2002* focused on energy sector for a detailed analysis of the potential and challenges of cooperation. Among the core technologies that have emerged as the key drivers of development, the present Report selects biotechnology for detailed analysis in view of its tremendous promise for promoting food security and hence alleviation of poverty and hunger in the region. *SADCR 2002* has already covered the potential and challenges for cooperation in the other core technology, viz. information and communication technologies.

These are some of the issues addressed by the Report. In what follows we recapitulate some major highlights arising from the contents of the Report.

## Improved global economic outlook but challenges remain

The global economic outlook turned optimistic towards the end of 2003, after a hesitant recovery in 2002 and early part of 2003, from the slowdown that had set in motion towards the third quarter of 2000. Helped by robust recovery of the US economy and strong growth in China and India, among other Asian economies, the world economy is likely to grow at 3.2 per cent in 2003 and at 4.1 per cent in 2004. The long-term growth outlook of the region also

appears robust and India and China are likely to emerge among the world's three largest economies by 2050 enabling Asia to regain her place in the world economy that it had until the beginning of the nineteenth century.

However, risks and challenges remain including those arising from currency realignments, resulting from a sharp decline of the US dollar against Euro, creeping protectionism especially in the western world in the context of failure of the Cancun Ministerial Conference of WTO, and the rise of

terrorism in different parts of the world. The past decade has seen the emergence of strong regional trading blocs in different parts of the world nearly 60 per cent of the world trade being conducted on a preferential rather than on an MFN basis. The countries that are not part of any trade blocs face the risk of discrimination of their exports and loss of competitiveness. Thus, in the light of the global trends, an immediate challenge for South Asia is to expedite the move towards its own FTA and further vision of deeper economic integration.

## South Asia's Reforms and Global Economic Integration

South Asian countries have carried forward the process of reforms started during the early 1990s. The trends suggest that the focus of reform initiatives in the recent years has shifted to domestic sectors of the economies which aim at bringing about greater competition in the domestic economy and also on fiscal management.

As a result, the South Asian economies today are much more open and deeply integrated with the world economy than in 1990s. While this has given them an opportunity to take advantage of the trends in international specialisation and absorb the spillovers of knowledge-creation in different parts of the world, it has also made the region's economies more vulnerable to external economic shocks, as is clear from the growing synchronisation of business cycles.

## Macroeconomic Performance and Outlook of South Asian Economies

The growth performance of the region suffered over the past few years on account of both difficult external environment as well as domestic problems. However, the growth outlook in 2003/04 and 2004/05 appears promising with South Asian GDP expected to grow at 6.9 and 7.2 per cents respectively. This growth performance makes the region the second fastest growing in the world after China. Another interesting development is the broad based nature of growth with all the economies displaying growth dynamism. In particular, the least developed economies in the region like Bangladesh showed markedly superior industrial dynamism in terms of development of manufacturing industries and improved competitive industrial performance. In other words, there is an evidence towards a convergence of economic structures in the region.

Service sector has emerged as the key driver of growth in the region

contributing nearly half of its income and more than half of its growth. The region's economies have also built-up substantial foreign exchange reserves to provide exchange rate stability and have been successful in bringing down inflation rates even though more needs to be done in the area of fiscal management.

## Trade Performance and Competitiveness

The export performance of the South Asian countries has suffered over the past few years on account of falling global demand resulting from the East Asian crisis and the world economic slow down. In the first two years of the millennium, the export growth rates of most of the countries in the region turned negative. With the recovery of the world economy, the export prospects in the near-term have turned optimistic and region's exports are likely to grow at a robust rate of about 12 per cent in 2003/04 and 2004/05. Furthermore, the trade growth rates across the countries of the region are converging. While the developed countries continue to be the principal markets, the integration of the region with East Asian countries over the past decade is quite visible. Trade in commercial services of the region has also increased substantially over the past decade. However, South Asia's performance in terms of product and market diversification has been relatively poor. South Asian countries have also not been able to upgrade the skill and technology profile of their exports which has implications in terms of value addition and competitiveness. The region needs to pay attention to innovative activity to upgrade the technology profile of exports.

The Report underlines the role of regional cooperation in strengthening the export competitiveness of the region for third country exports. For instance, in the context of sustained decline in commodity prices, the Report calls for promotion of joint ventures of regional

commodity exporters to undertake packaging and marketing on behalf of joint venture partners to increase the value-addition in traditional commodity exports such as tea, coffee, jute, cardamom, rice, etc. which are currently exported in bulk and are subject to low unit value realisation.

For South Asian countries, one of the major challenges is to prepare their textiles and garment industry for the phase-out of MFA quota regime by 2005 which would expose them to competition from, among others, China, and Southeast Asian countries. The Report finds the role of regional cooperation in improving the competitiveness of the South Asian garment industry by increasing vertical integration, capturing economies of scale, horizontal specialisation, incorporating innovative designs and taking a stake in the global marketing networks. The South Asian countries should consider setting up of South Asia level textiles and clothing groups to foster an integrated South Asian textiles sector. This approach could avoid the intense *inter-se* competition that prevails today. In order to secure their markets overseas and to realize a greater proportion of value added, the consortia of South Asian exporters should also consider taking over a few marketing and distribution chains in their lines of production in developed countries.

Regional cooperation can also be fruitful for dealing with emerging environment and food safety related non-tariff barriers in developed countries, such as sanitary and phytosanitary (SPS) measures and technical barriers to trade that are potentially very damaging for South Asian exports. South Asian countries could consider launching a regional eco-label to make their products more visible and acceptable than individual labels besides conserving resources on its promotion. Regional cooperation could also be fruitful in compliance with new emerging standards.

### **Regional Cooperation with respect to WTO**

The Report also finds substantial scope for regional cooperation in areas such as building a world trading system responsive to region's development needs. The Cancun Ministerial Conference has demonstrated the importance of coordinated positions by developing countries in achieving their objectives. South Asian countries have played a key role in evolving and strengthening the coalitions of developing countries. The failure of Cancun also provides an opportunity for the WTO membership to seek a redressal of the emerging asymmetries in the world trading system before they move forward. Drawing from the *World Trade and Development Report 2003* by RIS, the Report proposes an agenda for reform of the world trading system that developing countries in general and South Asian countries in particular may take up in the interest of building a development-friendly world trading system. The main elements of this agenda include development assessment of the multilateral trading system by an independent commission, reform of the decision-making process, broadbased and more representative Secretariat, setting up of a WTO Watch Dog of developing countries, strengthening the provision of technical assistance, emphasis on outstanding implementation issues rather than expansion of negotiating agenda, proactive framework agreements on special and differential treatment, movement of natural persons and on transfer of technologies. It also presents an agenda for cooperation among South Asian countries in the implementation of WTO commitments.

### **Foreign Direct Investment and Global Production Networks**

FDI inflows to South Asia have grown over the past decade in response to policy liberalization. South Asian countries have also been able to increase

their share in FDI inflows received by developing countries especially since the year 2000. However, their share is still rather marginal which is attributed to a number of factors such as low-income levels, poor quality of infrastructure and geographical and cultural distance with major sources of capital in the West or the East. They have also not exploited the potential of intra-regional FDI inflows that account for the bulk of FDI inflows received by the Southeast Asian countries.

South Asian countries have also not been able to integrate themselves with global production networks of multinational corporations and emerge as bases for export-oriented production for them in a significant manner except for growing participation of India in business process outsourcing and global R&D activity of MNCs. Participation in regional economic integration schemes emerges as a major determinant for hosting such offshore production bases by MNCs. In this context, South Asia could take lessons from experiences of ASEAN that are trying to attract export-oriented FDI through ASEAN FTA and ASEAN Investment Area. Regional economic integration in SAARC will enable the region not only to emerge as a more attractive destination for FDI inflows in general but also for export-oriented FDI besides promoting intra-regional FDI.

### **Regional Economic Integration: Lessons from Recent Experiences**

The South Asian region has attempted to intensify regional economic integration over the past decade through regional, sub-regional and bilateral approaches. The progress of SAPTA in terms of tariff liberalization has been rather slow because of product-by-product or positive list approach adopted. Trade liberalization in the region has also been attempted under bilateral FTAs such as between India-Sri Lanka, besides India-Bhutan and India-Nepal. Several new bilateral FTAs

are currently underway involving Maldives, Pakistan, Bangladesh, Sri Lanka and Nepal. In addition a number of South Asian countries and Southeast Asian countries are participating in BIMST-EC that is moving towards an FTA.

Even the limited experience with trade liberalization under SAPTA has produced encouraging results in terms of trade expansion. The bilateral FTAs in the region appear to have led to equitable expansion of trade flows with exports from smaller and lesser developed partners growing faster. The FTAs have also led to investment flows and trade-creating joint ventures which facilitate development of supply capabilities of lesser developed partners. These experiences have prompted the governments to expand the scope of India-Sri Lanka FTA to cover trade in services and investments in the framework of a Comprehensive Economic Partnership Agreement. The studies suggest that SAFTA could lead to substantial expansion of mutual trade and efficiency-seeking investment in the region.

The research shows that the region satisfies many of the criteria for an optimal currency area and could benefit from adoption of a single currency. However, the Report recommends that a single currency may be evolved in a phased manner beginning with a parallel currency (South Asian Rupia or SAR) as a unit of account backed by a SAARC Reserve Fund. This step will not only facilitate intra-regional trade but will also create a mechanism for funding of joint infrastructural development projects. Eventually, the SAR could replace national currencies.

In light of the existing experiences with economic integration in the region and in view of the global trend of adoption of regionalism as a strategy for growth, the Report recommends that SAARC completes its transition towards SAFTA, the SAARC Customs Union and the South Asian Monetary and Economic Union in an expeditious

manner. The region should also adopt a SAARC Agreement on Promotion and Protection of Investments and move towards harmonised investment policies across the region to facilitate intra-regional investments. It has been argued that these steps will help facilitate efficiency-seeking restructuring of industry in the region, thus, enabling them to exploit economies of scale and specialisation. Thus, Sri Lanka may emerge as the region's hub for rubber-based industries, Bangladesh for energy-intensive industries and Bhutan, forest-based industries, and so on. The regional economic integration will also make member countries, especially the smaller ones, more attractive destinations for third country investments by obviating the constraint of small domestic market.

### **Cooperation in Transport Infrastructure**

Given the primacy of infrastructure in promoting economic development on the one hand and regional integration on the other, the Report undertook a detailed analysis of the present state of infrastructure development and the potential for cooperation among different South Asian countries. It has been shown that adverse impact on account of the relatively low level of infrastructure development in the region is compounded by limited interlinking of transport infrastructure across different countries in the region. This in turn has the effect of increased transportation cost and undermining competitiveness and growth in a context of integration with the world market. Much could be gained by regional cooperation and a concerted effort to learn from each other in all the modes of transportation.

The Report calls for an active approach towards infrastructure development at the national levels and a 'Common Transport Policy' in South Asia for optimum utilisation of existing utilities as well as expansion of new facilities in the region. The possible

elements of a Common Transport Policy could be harmonization of technical standards such as truck size and weight regulations; railway gauge and rolling stocks across the region; simplification of documentation and clearance procedures; standardisation of cabotage rules and regulations on the movement of certain goods. In addition, the Report calls for an Open Sky Policy in South Asia for airlines originating from within the region, facilitation of movement of container trains and goods vehicles within the region subject to fulfillment of individual countries' road transportation rules and regulations. Report also discusses a number of possibilities for improving transport linkages through development of inland waterways, shipping links, highways and railway lines.

Finally, the Report suggest that South Asian countries also need to pay more attention to their telecommunications infrastructure and readiness for electronic commerce (e-commerce) that is becoming a critical factor in international competitiveness.

### **Biotechnology and Development in South Asia**

Biotechnology's potential in addressing food security concerns, poverty reduction and development at large is now well recognised in South Asia. In spite of the constraints of resources, facilities and talent, almost all the countries in the region have initiated some programmes in biotechnology over the past decade. The focus of these programmes is generally on agriculture and food security. South Asian countries also face a major challenge in terms of evolving the regulatory norms for biotechnology. A number of countries have evolved biosafety norms but some times they are not consistent with international treaties such as Cartagena Biosafety Protocol. There are also challenges in dealing with trade, in genetically modified organisms and products (GMOs).

The Report proposes an agenda for regional cooperation in harnessing biotechnology for development. The elements of the agenda include member countries using the forum of SAARC for evolving the guidelines for biosafety norms, for regulations governing trade in genetically modified organisms and products in addition to exchange of experiences, knowledge and expertise. The Report also calls for a common position concerning the conservation of biodiversity and the Convention of Biological Diversity (CBD), IPRs regime with respect to biotechnology, among other issues. It calls for joint research to address issues like increasing vitamin A, iron and other nutrients in the edible portion of various plants and crops, and for integrated nutrient management and development of biofertilizers and biopesticides. Joint research could also address salinity and drought resistance in some important crops as many parts of South Asia are affected from these problems. Cooperation in human resource development could also be instrumental in removing constraints faced by some South Asian countries in harnessing even the first generation of biotechnology. The cooperation could also extend to pooling of resources for joint facilities and databases for common use. In order to facilitate regional cooperation between enterprises of the region including provision for inputs for policy-making, a South Asian Forum of Biotechnology Enterprises could be formed. Finally, the Report recommends establishment of a South Asia Biodiversity Conservation Fund (SABCF) for meeting the long felt need of a financial mechanism required for the conservation and management of biodiversity.

### **Human Development**

Finally, the Report discusses challenges and prospects for regional cooperation in the area of human development. Along with liberalized policy reforms and greater integration with the world

economy, South Asian countries have recorded considerable progress in human development indicators like poverty reduction, educational attainment, improved health facilities, etc. Yet, the levels of achievement have varied across countries and the challenging task of further improving the quality of life of people still remains. Given the fact that the growth of

investment in human development in most of the countries has not been commensurate with their economic growth, the Report underlines the need for greater focus on social sector investments such that the countries are able to achieve the UN Millennium Development Goals. On the optimistic side, the Report highlights some of the initiatives undertaken by different

countries in the region to improve the living conditions of targeted groups and calls for scaling up and sharing of such successful experiences among the South Asian countries. Strengthening of regional cooperation efforts towards human development in general and poverty reduction in particular, initiated under the aegis of SAARC, have also been emphasised by the Report.