

The Rising Tide:

South Asia's Emergence as a Global Economic Power

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Presentation to the South Asian Diaspora Convention 2011, Singapore, 21 July 2011

South Asia: an Economic Overview

- South Asia is currently the second fastest-growing region in the world. It sustained an average growth rate of 8% in 2003-2008 (compared to 4.8% in the preceding five-year period). Scholars predict that growth will continue at 6-8% until approx. 2025 - Tan (2010).
- Trade and investment reforms implemented since the early 1990s have increased the region's level of global integration: trade and FDI have grown consistently since then.
- In recent years, attention is increasingly being paid to promoting greater regionalism – this creates opportunities to harness the spillover benefits of India's growth success.
- Closer affiliation with China via multilateral frameworks such as SAARC and APTA creates further opportunities for economic benefits through increased trade, FDI, infrastructure-building etc.
- The pernicious effects of the 2008-2009 global financial crisis have been less marked in South Asia than in many other economies (e.g., several of the G8 economies), due in part to its reasonably balanced growth path (relying on the twin growth engines of exports and consumption)



Challenges

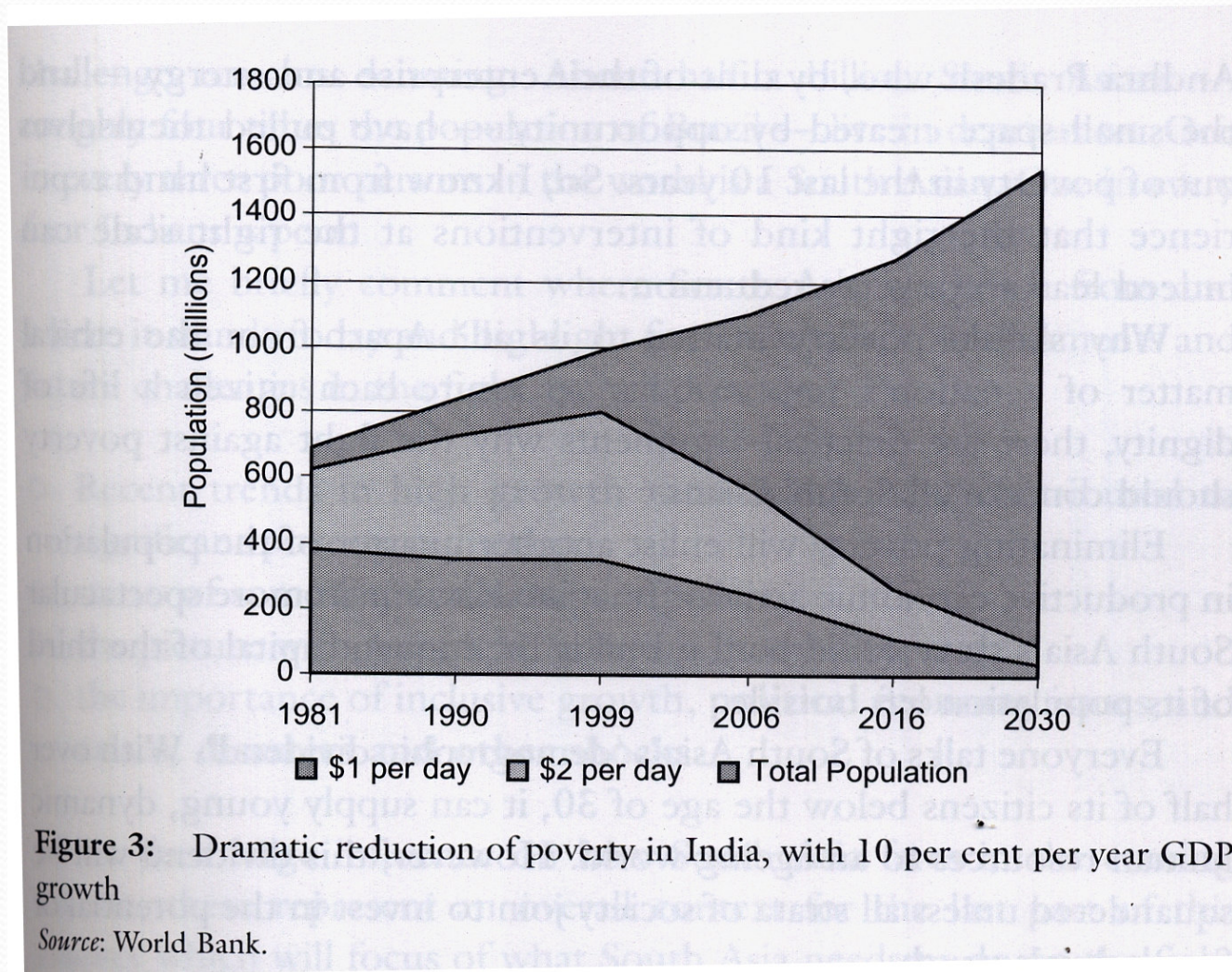
- uneven growth and persistently high levels of absolute and relative poverty
- political turbulence from time to time in the region
- structural, institutional and policy weaknesses
- slow progress in achieving substantive and beneficial regional integration



Meeting the Poverty Challenge

- Most South Asian Countries (SACs) are on track to halve their absolute poverty figures by 2015, as detailed in the MDGs.
- Absolute poverty figures in South Asia have fallen from 43% in 1990 to 30.8% in 2005.
- If SACs sustain their current high levels of growth and channel them towards improving human development in the context of more inclusive economic policy, poverty levels could continue to fall significantly over the next decade.
- At the inaugural World Conference on Recreating South Asia: Democracy, Social Justice and Sustainable Development this year, the UNDP opined that currently, South Asia is uniquely positioned to create a 'growth miracle' and thereby eliminate regional hunger by 2030.

Meeting the Poverty Challenge





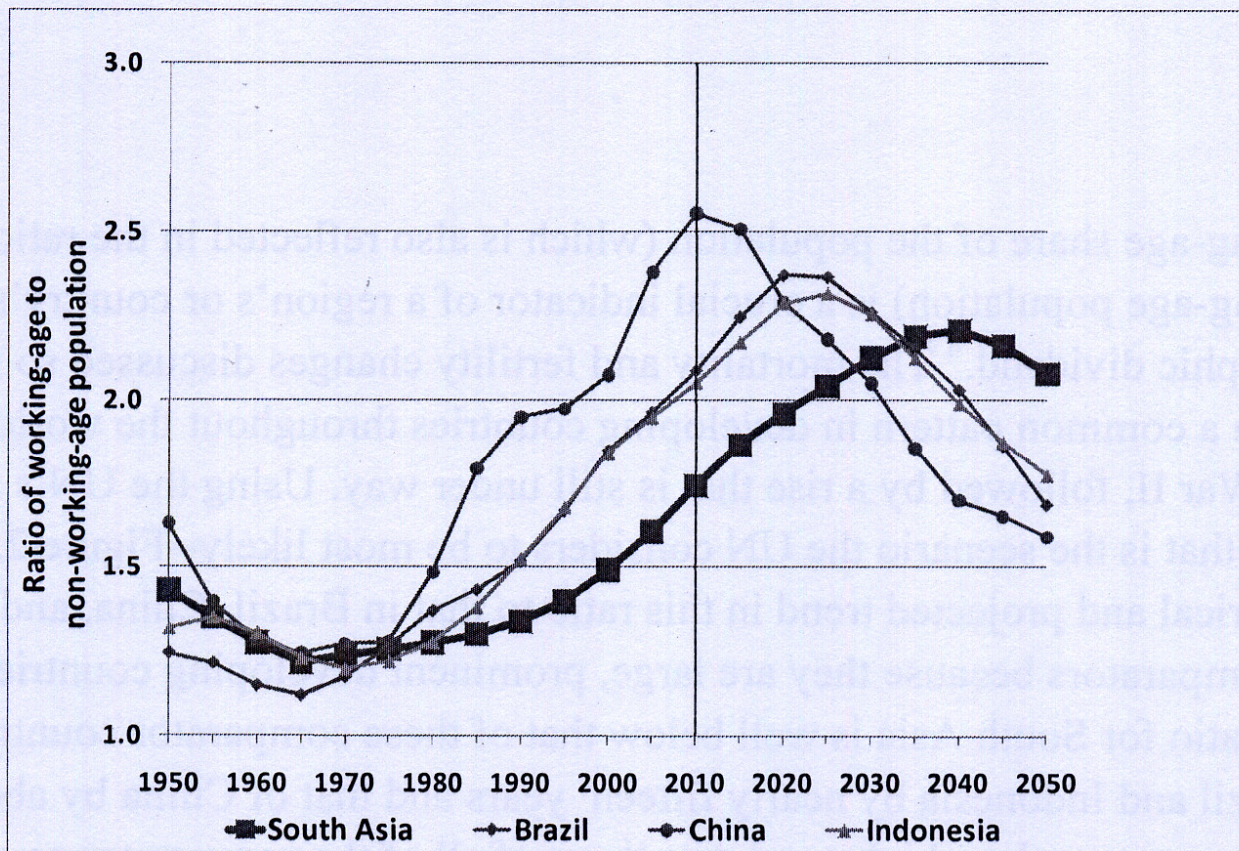
Opportunities

- the demographic dividend
- rise of the middle-class
- increased global integration
- human mobility and high remittances
- service sector development
- India's growth success and associated regional spillover effects:
 - development as a services hub
 - English language proficiency and tradition of high-quality higher education
 - soft power initiatives
 - outward FDI flows

Opportunities: the Demographic Dividend

- Over time, a fall in child mortality rates followed by a fall in fertility rates has created a demographic transition in South Asia: its working-age population is swelling relative to the rest of its population.
- ‘demographic dividend’ = the potential for faster growth generated by this relative labour-force expansion.
- The SACs are at various stages of the transition: Afghanistan is the least, and the Maldives the most, far along in the process. Sri Lanka’s working-age/non-working-age ratio peaked in 2005: it has reaped a moderate dividend.
- In order to reap the benefits of the dividend, policy measures must be taken to:
 - absorb labour into productive employment
 - improve education and training opportunities
 - maintain a stable macroeconomic and trade environment

Demographic Dividend: Graphs

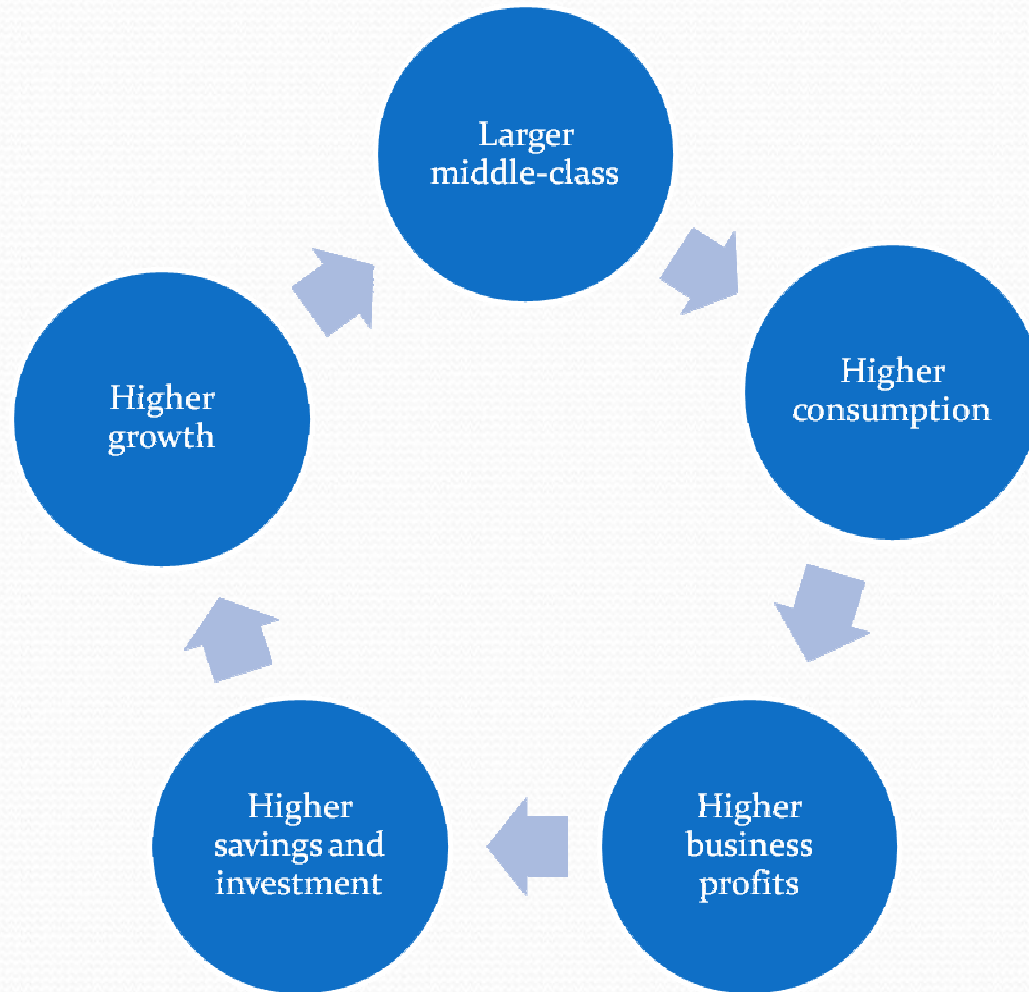


Source: United Nations (2009).

Opportunities: Rise of the Middle-Class

- South Asia's middle-class has grown from approx. 24 million in 2000 to 72 million in 2010 (a 12% annual growth rate). The change is mostly due to middle-class growth in India.
- The middle-class now represents 4.5% of the regional population, but rapid growth and falling absolute poverty figures mean that the share could grow to 55% by 2025.
- As detailed in Banerjee and Duflo (2007), a larger middle-class has positive feedback effects on growth, facilitating improvements in:
 - ◇ democracy
 - ◇ entrepreneurship
 - ◇ human capital and savings
 - ◇ consumption patterns
- A larger middle-class encourages product differentiation, and may consequently generate a virtuous growth cycle upon reaching a threshold level.

A virtuous cycle when the middle-class reaches a critical mass?



Opportunities: Increased Global Integration

- Robust growth in South Asia has been accompanied by increased trade participation and financial openness.
- On average, net exports account for approx. 10% of growth in SACs, with consumption (70%) and investment (20%) making up the remainder.

TRADE:

- Export growth rose to 14.3% in 2002-2006 from only 5.3% in 1997-2001.
- Import growth increased to 24.6% in 2002-2008 from 2.2% in 1997-2001.
- SACs have been expanding their base of trade partners in recent years; developing markets in Asia, Africa and the Middle East are becoming increasingly important.
- Intra-regional trade is also improving.

Opportunities: Increased Global Integration

FINANCIAL FLOWS:

- Capital inflows to South Asia have been on the rise in the last decade, notably in India and Pakistan. The bulk of such flows are directed towards the services sector.
- Deeper regional integration could encourage further FDI inflows, by increasing the attractiveness of smaller SACs as FDI destinations (The ASEAN Investment Area provides important lessons in this respect.)
- South Asia is also emerging as a source of *outward* FDI: outward FDI flows amounted to nearly US\$ 10 billion in 2006-7. This consisted of \$9.67 billion from India, \$0.11 billion from Pakistan and \$0.03 billion from Sri Lanka.
- Remittances constitute a large proportion of capital inflows to SACs. These are usually less volatile than other forms of inflows, a fact that has helped to prevent a collapse of inflows to South Asia in the wake of the global financial crisis.

Opportunities: Human Mobility and High Remittances

- Migration and remittances are an important ingredient in South Asia's growth and poverty alleviation prospects.
- Approx. 1.5% of the regional population (or 24 million) lives outside their country of birth. The table below shows the number of migrants from South Asia (in thousands) in 2000. *Source: Ozden et al. (forthcoming)*

	EU	USA & Canada	Middle East	Other South Asian	Rest of the World	Total
Afghanistan	94	70	2338	44	106	2652
Bangladesh	285	122	666	5534	266	6873
India	793	1400	4049	2045	755	9042
Nepal	19	14	188	911	63	1195
Pakistan	513	313	28	1422	178	2454
Sri Lanka	197	118	967	278	147	1707

Opportunities: Human Mobility and High Remittances

- Remittances are an important source of financial inflows to South Asia. In 2008, these amounted to approx. US\$ 66 billion. The true figure is likely to be even higher, given large unrecorded flows.
- Most OECD countries are experiencing a shrinking labour force and an ageing population. South Asia and Sub-Saharan Africa are the only two regions currently experiencing a swell in their working-age populations. This creates important opportunities for labour movements.
- SACs have large groups of educated workers for this purpose, so they should be the key supplier.
- Caveat: measures (a combination of penalties and incentives) must be taken to ensure *temporariness* of migration in order to prevent the phenomenon of 'brain drain' occurring. e.g. reduce temporary emigration costs, increase incentives for return by providing pension portability and facilitating financial transfers (savings, social security, remittances)

Opportunities: Human Mobility and High Remittances

The Role of the South Asian Diaspora

- Though smaller in size than its African and Chinese counterparts, the South Asian diaspora is the most widely dispersed.
- brain **gain**, not brain drain: the existence of a large South Asian diaspora affords opportunities for skill and technology transfers from developed economies into SACs, as well as for the establishment of ‘transnational networks’.
- The non-resident Indian (NRI) population is a significant contributor in this respect:
 - ◇ Returnee NRIs have been important in establishing Indian subsidiary links with MNCs (particularly with highly innovative Silicon Valley firms such as Google and Yahoo!).
 - ◇ Diasporic entrepreneurs have aided India’s international economic expansion by establishing international firms led by Indians (e.g. Mittal Steel)

Opportunities: Service Sector Development

- South Asia is undergoing a structural transformation of its regional economy, moving from dependence on agriculture to an increased focus on services.
- An empirical study [Ghani (2010)] suggests that service sector development is more highly correlated with poverty reduction than is growth in either of manufacturing or agriculture.
- Enormous potential for growth through services exists for SACs because:
 - ◇ services account for over 70% of global GDP
 - ◇ the cost differential across countries is large
- SACs have a strong base for service sector development, including:
 - ◇ English language proficiency (a legacy of their colonial past)
 - ◇ strong tradition of higher education (esp. in India)
 - ◇ a technology-savvy diaspora
 - ◇ recent embrace of modern telecommunications infrastructure
- In 2008, the service sector accounted for approx. 55% of the region's GDP.
- Services' contribution to growth in 2002-5 was nearly 61% in Sri Lanka, almost 53% in India and approx. 48% in Pakistan and Bangladesh.

Opportunities: Service Sector Development

- Traditional personal services (esp. migration and remittances, tourism and transport) are also growing steadily, though at a lower rate.
- The fastest growing services in SACs are modern impersonal services (esp. business service, communication, banking and insurance), for which India, Bangladesh and Sri Lanka had an average annual growth rate of >10% in 2000-6. Pakistan and Nepal have had slightly lower growth rates.
- The development of the service sector has increased trade in services: South Asian trade in services during 1991-2006 grew at 16.1%, surpassing merchandise trade growth of 12.7%.
- In India and Bangladesh, computer, communications and other services dominate commercial services exports. Nepal, Pakistan and Sri Lanka have high levels of transport and travel services. Maldives' service exports are dominated by travel services.
- Increased regionalism and inter-state cooperation is desirable in order to further the development of these industries, given the benefits of agglomeration afforded by the services sector.

Opportunities: Service Sector Development

Structure of Service Exports by Country

Source: World Bank (2007)

Country	Commercial Services Exports (CSE) (current US\$ mil)		Transport Services (% of CSE)		Travel Services (% of CSE)		Computer, Communications and Other Services (% of CSE)		Insurance and Financial Services (% of CSE)	
	1991	2006	1991	2006	1991	2006	1991	2006	1991	2006
Afghanistan	..	..	..	..	..	..	..	..	..	..
Bangladesh	344.3	603.0	10.4	14.7	6.0	13.3	83.6	66.3	0.1	5.7
Bhutan	..	..	..	..	..	..	..	..	..	..
India	4905.5	75057.0	19.9	10.2	37.5	11.9	40.4	73.7	2.2	4.2
Maldives	107.0	311.0	9.2	7.1	89.0	92.1	1.1	0.6	0.6	0.2
Nepal	201.2	252.0	10.7	14.0	62.8	50.8	26.5	34.6	0.0	0.6
Pakistan	1265.6	2246.0	62.4	49.6	12.5	11.3	24.3	35.4	0.8	3.7
Sri Lanka	523.6	1604.0	38.9	46.8	30.2	25.6	25.2	24.0	5.6	3.6

Opportunities: India's Success Story

The Services Boom

- Indian services exports tripled from US\$ 20 billion in 2002-3 to US\$ 60 billion in 2005-6. Its particular successes include BPO, software, IT, pharmaceutical, biotechnological and medical services.
- This success has largely been attributed to India's low-cost knowledge base and business model, its strong quality consciousness and strong competition generated by the existing of many small firms.
- In 2008, for example, India accounted for 60% of all global software outsourcing.
- As Indian IT (and other service sector) firms continue to move up the value chain, they are beginning to outsource more routine procedures regionally. This creates regional spillover benefits for SACs with lower wages.
- Increased regional integration and cooperation could enable South Asia to draw upon India's success in ICT services and fashion itself as a global ICT outsourcing hub.
- Caveat: SACs must develop their regional ICT infrastructure in order to reap the full benefits of India's success in services.



Opportunities: India's Success Story

The Services Boom

- Indian firms are beginning to move towards knowledge production.
e.g. pharmaceutical companies are beginning to develop new drugs, instead of merely producing generic versions of existing drugs.
If India begins to emerge as a centre of R&D, there would be even larger potential spillover benefits to the region.



Opportunities: India's Success Story

Higher Education

- India's highly-skilled workforce, a key ingredient to its success in services, arises from a tradition of high-quality tertiary education (e.g. Indian IITs).
- There is large scope for regional cooperation in higher education in South Asia, as a means of extending the benefits of such a tradition to the region as a whole.
- The 2010 establishment of the South Asian University in New Delhi (a SAARC initiative) is a first step towards achieving this.



Opportunities: India's Success Story

Soft Power Initiatives

- In addition to its prominent presence in the global services trade arena, India's cultural influence represents another source of South Asia's rising global significance.
- The Indian film and television industry has established itself as an important cultural hallmark and revenue source, both domestically and internationally. More feature films have been produced in India than in any other country for the last few years (1,164 films in 2007).
- Film industry award ceremonies are held overseas, films are shot at international locations, technical work is outsourced overseas, and a small movement of industry workers (actors, directors, etc.) has begun to occur between Bollywood and Hollywood,
- The international fame of such Booker Prize-winning writers as Salman Rushdie and Arundhati Roy, as well as of Ismail Merchant (producer for the film company Merchant-Ivory Productions), has also contributed to India's cultural influence.
- Indian cuisine, music, fashion and sport (e.g. the IPL) are enjoyed by a wide international consumer base.

Opportunities: India's Success Story

FDI Outflows

- India has, in recent years, become a source of outward FDI, particularly for other developing countries.
- India's outward FDI figures have been on the rise: for instance, outward FDI increased from US\$ 5 billion in 2005-6 to \$12.8 billion in 2007-8.
- India's South Asian neighbours are among the recipients of this outward FDI. India is Sri Lanka's 3rd largest FDI source, for example.
- Indian companies are also involved in cross-border FDI
e.g. Tata purchasing Tetly, Tata Motors purchasing Jaguar/Land Rover, Tata Steel purchasing Corus, Hindalco-Novelis.



Conclusions

- Despite the continued challenges posed by poverty, slow regional integration etc., the range of opportunities available to South Asia could, if appropriately harnessed, establish the region as a growing economic power of note.
- Its success in this respect depends largely, however, on India's continued economic success and its ability to benefit from the consequent regional spillovers.
- It seems that – to a certain extent - this is already occurring, though at rather a slow pace.



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