TILL DEBT DO US PART

###### **ECONOMIC UNIONS RAISE THE HACKLES OF NATIONALISTS, BUT THEY’RE THE SUREST WAY TO PROGRESS.**

In 1950, when it was proposed that the economies of Europe be tied so closely together that war becomes impossible, this vision was not taken seriously. But step by step, integration happened. It started with the iron and steel industries, reduction in tariffs, slashing of subsidies, and dismantling of cartels. All of this led to the emergence of the single largest economic union in the world. The road leading to the European Union has been a long and bumpy one, but it has benefited member countries enormously from the free movement of goods, services, and people. Poorer countries and regions gained infrastructure, development, and financing: the economies of Eastern and Central Europe benefitted most as their average GDP per capita jumped by about 50 percent in less than two decades.

The North American Free Trade Agreement was viewed with a great deal of suspicion in all three member countries: the United States of America, Canada, and Mexico. But some 20 years later, it is quite clear that the Mexican economy—the least developed of the three—has gained the most from NAFTA. The living standards of the Mexican people have improved. The illegal movement of poor Mexicans to the U.S. was a source of consternation for America’s protectionist rightwing. The free-trade agreement slowed this flow as more and more American companies relocated their facilities in or near Mexico to reduce production costs.

The success of the EU and NAFTA has proven wrong those skeptical of free-trade economic engagement on one count or another. Clearly, what has worked for North America and Europe can work just as well for Asia. As the relative balance of economic power shifts toward Asia, the ways in which this shift can benefit the majority of Asians need to be examined.

Emerging Asia consists of three distinct regions: East Asia, Central Asia, and South Asia. China and East Asia have clearly done remarkably well; their track-record for the last five decades is impressive. Except for Cambodia and Myanmar, all East Asian countries have graduated from low-income to middle-income status. Korea, Singapore, and Hong Kong have moved to high-income status. Central Asia, rich in natural resources, will be able to fend for itself with better policies and better governance.

South Asia, which has the highest number of the world’s poor and the largest number of young workers in the world, lags far behind East and Central Asia. India has become the largest center for business-process outsourcing and IT services. Yet it is also a country roiled by low human-development indicators, obstacles to doing business, poor infrastructure, and trust deficits. India, accounting as it does for 82 percent of the regional GDP and 75 percent of the population, dominates South Asia. And this domination makes for some unique dynamics.

East Asian countries have not been tied historically, culturally, economically or through common infrastructure, yet they have gained the most from regional integration. Some 96 percent of the South Asian population lived in a contiguous, connected, and unified single country until 1947. The basic ingredients of an economic union between the three separate countries that have emerged since—India, Pakistan, and Bangladesh—remain intact. Of course, retaining political sovereignty and tapping regional economic synergies are neither mutually exclusive nor inconsistent with each other.

South Asia is the least economically integrated region in the world. This was not always the case. Historically, intra-regional trade has been high. In 1948, a fifth of all trade took place within the region. Today, this figure is down to 6 percent. In contrast, intra-regional trade in East Asia and the Pacific region stands at 52 percent. Even Sub-Saharan Africa carries out twice as much intra-regional trade as South Asia.

Despite an overall liberal environment, cross-border investments in South Asia are negligible because of informal restrictions on flows originating from within the region. This is not in keeping with the rest of the world where common history and culture have only facilitated the movement of people, educational exchanges, access to each other’s media and cultural resources, the sharing of scientific and technological knowledge and other forms of cooperation. In South Asia, none of this has happened. Despite being geographically contiguous, Pakistan’s Punjab and India’s Punjab as well as India’s Assam and Bangladesh’s Sylhet have not derived any benefits from their proximity to each other and have, in fact, drifted apart during the past six decades.

Why has this natural flow of goods and services not taken place? The foremost problem is the nature of bilateral relations between India and Pakistan which have been sour, tense, and belligerent for the most part and for the longest time. This adversarial relationship within the region has not only retarded progress on regional trade, but also affected other bilateral relationships within the region.

India’s demographically and economically dominant role in South Asia places a greater responsibility on its shoulders. India can certainly do more to foster a trade-conducive political environment for the region through confidence-building measures, a less condescending attitude and more magnanimity by New Delhi and Indian businesses, media and opinion leaders. Other countries will feel confident and respond positively as such an environment gradually comes about. It has so far failed to materialize because narrow, parochial political considerations have dominated the course of events. There is some hope that a rising, influential civil society in each country that is committed to regional peace can tip the balance in favor of this endeavor and act as a countervailing force.

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If—and that’s a big if—these perpetually adverse bilateral relations are normalized, the prospects offered by regional economic cooperation are highly attractive. South Asia is second only to Europe in terms of the proportion of the population residing in border areas. This has the potential to accelerate growth. High population density and better access to markets can facilitate growth by allowing South Asia to take advantage of agglomeration economies. Empirical studies show that there is a significant trade-creation effect under the South Asia Preferential Trade Agreement with little or no evidence of trade-diversion effects on the rest of the world.

The removal of trade barriers and access to larger regional markets will stimulate competition, which will boost allocative and productive efficiencies by facilitating industrial restructuring. An economically-integrated South Asia would draw global firms to relocate output capacities there in order to meet the demand from South Asia’s burgeoning middle class and to also use South Asia as a platform to supply their global requirements by exploiting economies of scale and lower average costs.

Trade facilitation across borders within the region is beset by issues ranging from the phytosanitary to those concerning health and environmental standards, quality testing and specifications-adherence. These cause considerable delays, lengthen travel times, and entail higher transaction costs. Truck crossings, where allowed, take several days and allegations of harassment by border officials are rampant. Nontariff barriers on India-Pakistan trade have diverted normal trade flows to informal networks and channels, like Dubai and Singapore, raising costs for end-users. The relaxation of these constraints can expand markets for goods and services, facilitate larger capital flows, improve infrastructure, and generate additional opportunities for earnings in lagging areas.

South Asia faces several challenges, but none as pressing as its demographics. Some years down the line, South Asia will be the only region of a sizeable population in the world with more than 50 percent of its population in the productively-employable age bracket. By supplying young workers to countries with aged-population issues, it can ease the unemployment problem. But this will require investment in education—especially in technical and vocational training—expanded access to higher and professional education, and markedly improved instruction in terms of quality and relevance.

If such investments are not forthcoming, South Asia will face the abyss. South Asia is home to two thirds of the world’s illiterate population. At the same time, the number of people ready to join the workforce each year is large, roughly equal to the population of a midsized country. Based on current trends, some 700 million people are projected to move to South Asian urban centers by 2050 in search of a future. This will put extreme pressure on infrastructure, real estate, and services. If economic growth doesn’t keep up with the population boom, the fallout will be lawlessness and disorder.

Why do some countries find themselves in the poverty trap? The answer, largely, is the incapability of poor countries to absorb new knowledge and technology. The capacity of South Asian countries to assimilate, adapt, and widely diffuse emerging technologies is constrained by shortages of skilled technical and vocational manpower, outdated educational systems, and neglect of research and development.

A highly competitive world has raised the demand for skilled workers and professionals, yet the record of many South Asian countries in meeting this is not encouraging, and the deficit in skills remains one of the major obstacles to successful technological diffusion. While the global average for technical and vocational education and training enrollment is 10 percent, in South Asia it is only 1 percent.

The gross tertiary enrollment in South Asia is among the lowest in the world, second only to Sub-Saharan Africa. East Asia has managed to raise this enrollment from 7 percent to 24 percent in four decades. In South Asia, it has gone up from 4.2 percent to 10.5 percent. The choice of disciplines by South Asian students is also a matter of concern: only a fifth of tertiary-level students go for science and technology, compared to 40 percent in East Asia.

*India has a greater role to play than others if an economic union is to transpire.*

The quality and relevance of instruction is also poor. This, of course, results in graduates facing difficulty in finding work. Institutions of higher education with poor academic standards, assessments based on rote learning, and teachers of dubious quality are producing armies of unemployable youth. A study of fresh university graduates in India shows that only 10 percent of them are as good as those produced by any world-class institution; and 50 percent are simply unemployable. The unemployed young have become an attractive pool for recruitment by terrorists, extremists, warlords, criminal syndicates, and mafias.

Information and communications technology tools can help South Asian countries leapfrog the literacy and skills gap by augmenting the delivery of innovatively designed, learner-focused content to equip people with marketable skills within a short period. Even teachers can and should use online resources to brush up on their skills. Such tools are currently being used in South Asia but marginally, through programs run by nongovernmental and civil society organizations. Their coverage and outreach cannot be scaled up meaningfully without the involvement of the state.

R&D activities in South Asia, in the public and private sectors, are negligible. South Asia spends only 0.65 percent of its GDP on R&D—this is less than half of what the East Asia and Pacific region spends—and universities and institutions of higher learning remain mostly cut off from businesses and industries. South Asian scientists and researchers can become a reliable, low-cost resource for the world. But this will require investment in human capital, an embrace of technological shifts, access and cooperation among the science communities of South Asian countries, and pooling resources.

How does a South Asian Economic Union happen? The first step toward effecting economic integration will have to be the creation of a liberalized, free-trade area with low tariffs, the absence of nontariff barriers, and cross-border facilitation and infrastructure. Economic zones at border areas, like Wagah-Atari, can become magnets for investment, common services, and facilities, and make trade even more attractive. The second prong should focus on a South Asia Knowledge Union for cooperation in agriculture, biotechnology, molecular biology, nanotechnology, energy education, health, IT, etc. (A SAARC visa category can be created for knowledge workers to enable them to travel across borders without hassle.)

Like with the EU, a South Asian Economic Union will take decades of convincing and much history to overcome. Trade normalization and the exchange and sharing of knowledge will greatly advance the cause while providing an immediate win-win for the region. India and Pakistan have to take the lead here for the benefit of their own people, the region, and indeed the world. Economic integration makes perfect business sense. It is critical if South Asia is to thrive.

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