Lessons S Asia can learn from E Asia

Among the takeaways are getting the policy basics right for catch-up growth and liberalising markets bottom-up

By RAJEEV SALLY

OUTH Asia is in much better shape than a generation ago. This is most obvious in India, South Asia’s giant. Liberalisation, globalisation and growth have improved the lives of ordinary people, and not only those of the wealthy upper classes. Now, after eight years of “reform pause”, India is seeing a mini-wave of liberalising reforms.

Bangladesh, dismissed as a basket case in the 1990s, has a thriving garment industry. In 2012, Sri Lanka, which is recovering from civil war, is now on the IMF lenders’ radar.

That is because South Asia is a very much part of the “globalising world” and the world economy’s shift to the East. Alongside East Asia, South Asia has seen catch-up growth and narrowed the widening economic gap.

This has accelerated since the global financial crisis. Even accounting for the current global slowdown, the International Monetary Fund (IMF) forecasts China to grow 8 per cent, India 6 per cent and developing Asia 7 per cent this year – compared with 1.4 per cent for growth of advanced economies. Between 2007 and 2012, sub-index economies grew 2 per cent. This is a remarkable story of catching up and broad-based prosperity.

However, for the most part, the region has been a collection of economies, rather than a cohesive entity. East Asia (comprising Japan, South Korea, Greater China and the Asean countries) has a combined population of 2.5 billion, South Asia’s population is 1.5 billion, and Europe’s 800 million. East Asia’s combined gross domestic product (GDP) is US$22 trillion at PPP; South Asia’s GDP is US$5.5 trillion. East Asia’s per capita GDP is almost US$28,000 (PPP); in South Asia, it is US$3,000.

East Asia has a 30 per cent share of world trade and a 16 per cent share of the world’s stock of foreign direct investment (FDI). South Asia manages to attract less than 2 per cent of world trade and just over 2 per cent of global FDI.

China’s GDP, at US$4.4 trillion, is over three times that of India’s economy. China also dominates regional trade, even from trading the number for South Asia. Its IMF stock of over US$100 billion is three times the amount for South Asia. China and India had similar levels of output and rural and urban poverty in 1980. India’s output and living standards are 2.5 times higher than those of China.

East Asia is also a much more integrated economic space. Intra-regional trade is over 36 per cent of total trade and 20 per cent of regional GDP. South Asia is the least integrated region outside the West. Intra-regional trade is 4 per cent of total trade and 2 per cent of regional GDP.

On “human welfare” indicators such as poverty rates, life expectancy, literacy, schooling and nutrition, East Asia countries, with the exception of Cambodia, Laos, Myanmar, North Korea and East Timor, are well ahead of South Asia. East Asia’s trade tariffs are less than half what they are in South Asia. In the World Bank’s Doing Business index, all the top Asian performers (Singapore, Hong Kong, Japan, South Korea, Taiwan, Malaysia and Thailand) are in East Asia.

The best South Asian performer is Sri Lanka (691), while China brings up the rear (1326 place). Last, the World Bank’s governance indicators on “government effectiveness”, “regulatory quality”, “rule of law” and “corruption” show most East Asian countries have performed better.

Two features of the “East Asian miracle” stand out. First, East Asian countries “got the basics right”, prudent monetary and fiscal policies, competitive exchange rates, low domestic distortions (such as price controls and wasteful subsidies), flexible labour markets, openness to international trade, and investments in education and infrastructure. These “hardware”, economy-wide policies provided propitious environments for high levels of savings and investment, and export-oriented industrialisation.

But “software” argues that industrial policies of “developmental states” made a crucial difference. “Vertical” policies of selective intervention promoted targeted industrial sectors, restricted imports and foreign investment, and directed the financial system to channel credit towardsfavoured sectors. According to the revisitation, these policies worked particularly well in Japan, South Korea and Taiwan.

However, there is scant hard evidence — only assertion — that industri al policies worked. They had no discernably positive effect on the productivity of targeted sectors, or on aggregate growth — even in Japan, South Korea and Taiwan. In South-east Asia, and later in China and Vietnam, there were — and are — numerous con grand counterproductive policy failures.

Second, East Asia emerged as the global hub for manufacturing, particularly in information technology (IT) products. Production is fragmented, with different parts of the value chain located in different countries, but it is knitted together vertically by integrated supply chains to serve global markets. ITs and trade in intermediate products drive the process. This has been criticised in East Asia’s overall in dustratisation, growth and global integration.

Now turn to South Asia. India accounts for 70 per cent of South Asia’s population and 80 per cent of its GDP. Over the last 20 years, markets reforms have lifted the growth rate to 6 per cent per annum in the 1990s and 8 per cent to 2004-11. This has delivered significant poverty reduction.

But growth has not benefited the poor nearly as much as in East Asia. That is because India has much bigger

“failed”. At independence, Sri Lanka was the golden boy of South Asia. But, since the 1970s, it has had chronically ethnic strife, progressively weaker institutional and administrative civil society. Politics has become more parochial and localised and power has become extremely centralised and concentrated.

Finally, South Asia, unlike East Asia, has not integrated into global supply chains, apart from Sri Lanka and Bangladesh in garments, and India in a few other niche manufacturing sectors. Even if informal trad e barriers are much higher that they are in East Asia, and cross-border infrastructure much worse.

Shopping list

So what are the takeaways from East Asia for South Asia?

First, get the policy basics right for catch-up growth.

Second, avoid a “picking winners” industrial policy.

Third, liberalise markets bottom-up. There is great scope on international and regional organisation and their grand designs to do the job. Rather market reforms must come in the form from national capital, and sub-national regions and cities. Then they will spread by competitive emulation. That is how East Asia opened up trade and foreign investment, enabling the emergence and expansion of manufacturing supply chains.

Fourth, get the policies right for governance and the rule of law. Easier said than done, of course, but this is one area reforms over time in Pakistan, Nepal, Sri Lanka and other South Asian states.

Fifth, deeper structural and institutional reforms for productivity-led growth in the labour-intensive parts of the region, especially the prime export-oriented cities and states, and Sri Lanka, and also for greater domestic manufacturing, attracting FDI and developing export-capability are critical. This is in addition to big engines of growth and employment for the poor, and the necessity of linking up with East Asian and global supply chains.

Seventh, boost regional economic integration by reducing cross-border tariffs and non-tariff barriers and improving cross-border infrastructure. Unilateral, bottom-up liberalisation will be more important than bilateral and regional free trade agreements, though the latter can be complementarity.

Eighth, boost cross-border sub-regional blocks, for example, between Sri Lanka and the southern Indian states and Sri Lanka.

This is a shopping list for South Asia based on East Asian experience. Political obstacles loom large. Given India’s colossal importance in the region, it is vital for it to take the lead and lead by example.

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