Financial Cooperation in South Asia

Issues, Policies and Way Forward

SAARC Chamber of Commerce and Industry

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SAARC Chamber of Commerce & Industry

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Acknowledgement

The objective of this study is to explore the strong and sustainable economic and financial relations among the countries in South Asia. The report obeserves that how these relations are affected by the political controversies and attempts to explore the possibilities of sustainability in economic relations without political differences. The study thus responces such long standing questions and also uncovers the deep-rooted historical causes of the present political and economic conditions of India and Pakistan, its impact on South Asia and the future prospects in the possible alternative scenarios, supported by extensive use of data to substantiate the facts.

I appreciate the leadership of SAARC Chamber of Commerce & Industry for their initiative to work on such an important issue, reflecting their keen interest to encourage cross border trade and investment in South Asia as one of the key stakeholders of the region.

I am also thankful to Friedrich Naumann Foundation, Regional directorate, New Delhi and EFU (Pakistan) for their support without which bringing out this publication would have been unfeasible.

I am in indebted to the academicians, practitioners and experts from South Asian countries in particular Mr. Muhammad Iqbal Tabish, Secretary General, SAARC CCI for scholarly efforts to add value to the report.

Dr Ayub Mehar
Karachi, October 2013

Foreward

Are you aware, regionalism is gaining momentum in globalization, encouraging the nations across the world to engage in signing regional trade agreements (RTA's). The success of regional economic groupings like EU, NAFTA, ASEAN, COMESA has become role model for other regions, i.e. South Asia which being the largest market (23%) of the world has great potential for socio economic cooperation.

Cooperation in the areas of finance and banking is imperative for promotion of cross border trade and investment and its multiplier impact on cultural and social values, required for deepening of regional integration process in South Asia.

In reading this report, it should be kept in the mind that evidences and data utilised in analysing social and political events and situations can be classified into three categories. First type of data can be collected through census or sampling and extensive background in statistical analysis and inferences may be helpful in collection and analysis of such data. However, there are several problems in this type of statistical analysis, while several "if" and "then" can mislead the readers. So this type of scientific approach was avoided in this project. Personal observations (not views) may be used in scientific analysis. These specific observations may be generalised by applying proper research methodologies. This practice is followed by those persons who have been working on the positions or professions where they can observe those happenings to which everybody does not have access. At places, I have used this approach. However, everybody cannot be compelled to believe in my personal diary. Being a neutral, unbiased and impartial researcher, I should describe my personal observations with their interpretations; some might believe them and some might not; it is purely a matter of trust. However, these observations should not be concealed; they should be shared with others.

The third kind of observations is classified as universal evidences. These are observations where everyone can observe the same thing, like sun rises in the east. No one can deny this observation. However disagreement is possible in interpreting the causes and consequences of such evidences. Majority of my arguments are based on universal evidences.

Here, it is also possible that a limited truth with a false statement might lead to a wrong conclusion. Similarly, external evidences cannot prove internal facts. These principles have been followed in the arguments.

The long-term growth patterns of India and Pakistan indicate that Pakistan has shown a remarkable economic growth in the first thirty years of its history. The annuals growth rate of Pakistan economy was much higher than India's. . However, in the later years Indian economy has made great strides in the economic development and growth. This accelerated advancement of the Indian economy was mainly due to liberalisation and a move away from a centrally planned economy to a market based economy. At the same time,

Pakistan was going through a difficult period because of the Soviet invasion in Afghanistan and then its attendant political and social consequences. This was the period when India and Bangladesh developed their economies in a peaceful environment, while Pakistan has been facing new crises on security and political fronts every day. According to the academic definition of economic freedom, it is not possible in the present context of Pakistan to achieve individual economic liberty, because of the presence of bias and discriminatory tax system, lack of employment opportunities, mis-spending of public funds, and more importantly existence of the various types of mafia. Businessmen cannot show their expenditures in transparently and the cost of paying off several mafias has to be incorporated in the cost of doing business.

In this study, the history of 'Two Nation Theory' has been explained by author with clear intention that this theory and separation of North Western part from British India does not provide justification for the complete isolation of the peoples on both the side of boarder. In fact, formation of Pakistan is a source of sustainable peace and prosperity of the peoples of both the countries. They should live according to their cultures but should not live in isolation. There are hundreds of the nexus between these two nations including thousands kilometres boarder, routes, junctions, shared history, cultural similarities, shared languages, religions, cultural heritages, divided families and many more. To live in isolation and to stop discussion on the issues is not an appropriate option. It is not a matter simply a two neighbouring countries; there relations are more than two neighbours. Such relations (may be complicated) but cannot be restricted. To explain this reality is the primary objective of this study.

Vikramjit Singh Sahney
President SAARC CCI.

Foreword

The primary objective of the globalization is to reduce world poverty. Like other regional blocs, the core objective for creation of South Asian Association for Regional Cooperation was also to uplift of Socio-economics of South Asian Community. SAARC Chamber of Commerce and Industry is playing its due role in identifying challenges, prospects and opportunities critical for socio-economic development of the region. The study on Financial Cooperation in South Asia is an attempt prepared to assess key areas of cooperation among South Asian States to reach financial stability which is an essential factor for the region.

The 21st century begins with Asia's domination with greater number of regional agreements. South Asia with its huge potential in term of natural resources as well as human capital has enormous opportunities for financial cooperation. Liberalization, uniformity and socio-political harmonization can lead to poverty alleviation prevailing in the region.

The Financial Cooperation study analyzes socio-political aspects of economic integration in South Asia. The study also examines nature of challenges, available opportunities and prospects of financial cooperation and how they are affects by political instability in the region. The study also provides comprehensive details of economic progress made by the South Asia with comparison of socio-economic indicators. Factors for business development that will lead for improving competitiveness ranking of the region are also discussed. The study also analyzes state of financial liberalization and cross border investment integration within the region.

The essence of this Financial Cooperation in South Asia is to highlight potential benefits through financial cooperation, thus propelling long term and sustainable economic growth essential for the economic prosperity of the region.

Keeping these various considerations in mind, this study of the Financial Cooperation focuses on the pattern of trade in the new era, feasible economic integration of the region, free trade regime, financial liberalization and financial integration and cross border investment. The study, at the end provides review of the socio-economic indicators in the tabulated form and suggest policy measures for free flow of capital across the region.

Saifuddin Zoomkawala

Chairman SAARC-CCI Committee on Finance,

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Executive Summary

Global economic growth, reducing economic disparities, bridging the gap between nations and achieving the world peace are considered complementariness of free trade and the liberalization polices. One of the common and desirable objectives of globalization and free trade regime is to reduce global disparities in human welfare and spur up development process by interaction of the people in a free world.

It is evident from the historical record that no mentionable achievement in economic relations was observed by implementation of the South Asian Free Trade Agreement (SAFTA). Since formation of South Asian Association of Regional Cooperation (SAARC) in 1985, there is no significant improvement in the magnitude of mutual trade of South Asian countries. Similarly, no evidences of cross border mobilization of entrepreneurship or capital or labor are available. In fact, the political and military rivalries between India and Pakistan over the years are major reasons for making SAARC a comparatively slow moving organization and consequently South Asian nations have not been able to gain the benefits of a unified economy. Formation of South Asian Association for Regional Cooperation (SAARC), Signing Preferential Trade Agreement (SAPTA), formation of the SAARC- Chamber of Commerce, entry into a Free Trade Agreement (SAFTA), and giving the status of most favored nations (MFN) are the steps taken in the past for unified economy. All these steps did not provide a revolutionary development in the economic relations of the South Asian countries in general and Indo-Pakistan, in particular.

Financial cooperation and cross border trade and investment being integral part of integration process require greater degree of liberalization. Without these components idea for achieving economic integration remain elusive. After 1979, it was observed that South Asian countries are moving towards liberalization. This movement has been accelerated after the falloff Soviet Union. In the model of regional integration it must be noted that such models cannot be succeeded in the absence of private sector and new management. The lesser size of government and higher contribution of private sector in state activities ensure the success of such models. Economic freedom and frictionless mobilization of labor and capital will provide a catalyst in the success of regional economic integration. The lesser control by states over the monetary and fiscal policies allows the large markets to work. The hindrances by government monitoring regulating agencies in financial performance of the banks have been exemplified here.

The adverse role of trade barriers in South Asia in past years can be measured by their average tariffs on primary and manufactured products. The simple average tariff rate is 8.7 percent in the world for primary products; it is 15.8 percent in case of South Asia. The weighted average tariff rate for primary products is 2.2 percent in the world; it is 7.0 percent in South Asia. For manufactured products, the simple average rate of tariff is 6.9 percent; it is 13.0 percent in case of South Asia. The weighted average tariff for manufactured products is 3.3 percent in world; it is 7.1 percent in South Asia. This quantification indicates the restriction on international trade by protectionism. No significant enhancement in the mutual trade has been observed even after signing the formation of SAFTA. The growth in non tariff bearers has become the major obstacle in the trade enhancement between India and Pakistan. It was expected that all kinds of trade bearers will be abolished after declaring the status of most favored nation to other country by each side. However, non tariff bearers cannot be identified; they may be changed and identified from time to time. In most of the cases such bearers are invisible. It is obvious that to identify those invisible bearers is not a simple task. It has to be admitted trade relations cannot be isolated from social and political relations, since the "will" for trade enhancement is determined by the political and social relations. Trade enhancement or economic integrations depend upon the nature of relationship between these two nations. The political and social relations will be determined by the interaction among the people. So, as a point of initiation, the policy makers should focus to develop relations among the people by means of sports, cultures, and tourism activities.

Another misleading approach which is being adopted to promote cultural relations is to create harmony between those aspects of culture which are not common in India and Pakistan. In fact, harmony and relations can be initiated by promoting the exchange of activities and relations in those areas which are common on both sides.

In fact, trade enhancement among the nations is jointly associated with the trade liberalization policies and trade competitiveness factors. Legal system, size of government, freedom to trade internationally, sound money and regulations) are the components of economic freedom; and these components are significant determinants of trade competitiveness including goods market efficiency, labor market efficiency, financial market sophistication, governance, technology readiness and innovations. The factors of competitiveness including innovations and governance determine the magnitude of regional and international trade. Without insuring economic freedom trade enhancement cannot be achieved. As already mentioned that extremely high non-tariff barriers have been observed in South Asian countries and it is obvious that existence of such barriers is a significant indicator of the obstacles in economic freedom.

The simultaneous relations show that the commerce departments and their associated institutions are not only responsible for trade promotional activities; regulatory framework and competitiveness are the catalyst for enhancement in trade relations. For trade enhancement and liberalization, the role of interior and foreign ministries is also important. Free Trade Agreements, Bilateral Treaties and Monetary Union cannot achieve the targeted goals unless the interiors and foreign affairs ministries participate in these agreements. The roles of planning authorities, transportation and communication departments are also important in trade promotion among the nations. At the time of agreements of mutual economic relations, the recommendations of planning commission, interior and foreign affairs ministries and the concerned departments of the transportation and communication ministries must be incorporated.

Historically speaking, the trade policies of Pakistan were softer than those of India in past. As a result, dependency on imports has been increasing in Pakistan. Now, it is expected that in case of a free trade policy, Pakistan will import machinery and spare parts from India. On contrary to this, the major part of Pakistani export belongs to the primary and intermediate products including cotton and yarn. As a result, prices of basic goods will increase in Pakistan.

The past experience can predict that foreign exchange will not come into Pakistan by exports to India; because, Pakistani exporters will import Indian products instead by cash earnings to maximize their profits. So, to enhance regional trade, the countries have to develop their competitiveness. The improvement in competitiveness has several factors. One of the important factors facing worse deterioration in Pakistan is the poor and un-maintained infrastructure.

Infrastructure determines the improvement in other factors of competitiveness. Infrastructure development leads the 'Freedom & Trade internationally' which accelerates competitiveness through enhancement in Technology Readiness. Various studies and statistical analysis have been showing the significant impact of the components of infrastructure on GDP.

The inducement of cultural relations and interaction among the people of partner countries is the most important aspect of trade in services. The interaction between the people promotes trade in merchandizing goods. Reduction among disparities between the nations, accelerated development of the institutions and growth of economic activities are the ultimate output of trade in services. The quantum of trade in merchandizing goods does not reflect the relations between the people of partner countries. However, connectivity of people through availability of appropriate means of transport and communications, tourism, and linkage in services industries including education, finance and heath leads the interaction among the people of partner countries. It may lead the peace and reduction in political tensions and disparities. Strong and sustainable financial linkages are thus required to promote flow of cross boarder investments in South Asian countries. However, before recommending a financial integration model, a review and comparison of present status of the South Asian capital markets is required.

The sustainability of free trade regime is closely associated with the cross boarder mobilization of capital, labor, entrepreneurship and utilization of land. So, free mobilization of the factors of production cannot be restricted in implementation of free trade policies. Free trade policy requires business competiveness, while free mobility of the factors of production is a pre-requisite to achieve sustainable competitiveness in global environment. Trade facilitation, currency convertibility, and uniformity in the accounting standards and regulatory frameworks are the peripheral steps of a sustainable free trade policy.

In consequence of a generalized acceptance of free trade regime, the national economies have initiated to change their policies to synchronize with the globalization. There are several examples of amendments in the rules and regulations to deal with the flow of foreign capital and investment in the new scenario. Australia removed the 25 percent limit on individual foreign investors in Qantas and a 35 percent cap for total foreign airlines holdings. Brazil raised the limit of foreign participation in the capital of Banco do Brasil -a state-owned bank- from 12.5 percent to 20 percent. Malaysia increased the foreign shareholding threshold from 49 percent to 70 percent for insurance companies and investment banks, allowed full foreign ownership in the wholesale segment of fund management, and deregulated the purchase of real estate by foreigners. Qatar liberalized foreign investment in a number of sectors, including consultancy services, information technology, services related to sports, culture and entertainment, and distribution services. The Syrian Arab Republic now allows foreign majority ownership in the banking sector of up to 60 percent, subject to certain conditions. Indonesia abolished the monopoly of the state electricity company on the supply and distribution of electricity – paving the way for private domestic and foreign investment. India introduced a "Consolidated FDI Policy" circular, which combines in one document all the prior policies and regulations on FDI in an effort to make FDI policies more transparent, predictable, simpler and clearer. The Libyan Arab Jamahiriya adopted an investment promotion law which encourages national and foreign investment projects in accordance with national development strategies. The Russian Federation amended its Law on Special Economic Zones to reduce the minimum investment threshold, widen the list of permitted business activities, and simplify land acquisition and administration procedures. Rwanda improved its laws on company formation, organization, registration and operations, and simplified its business startup procedures.

Despite a remarkable global trend towards further investment liberalization, instances of trade protectionism are frequently being observed in the present scenario. Such protectionists' policies can negatively effect flows of foreign investment indirectly. The free mobilization of goods and services and across the boarders flows of investment argue that a large part of the responsibility of economic development has now been shifted to corporate sector from the public sector institutions, while the entire structure and growth of the corporate sector depends on the transparent and prudent financial system. In this contemporary scenario, an incorrect judgment regarding the financial patterns in corporate sector may be a cause of heavy distortion in the society by means of volatilities in the stock markets, drop out in employment opportunities, unusual distribution of income, and demand-supply gap in the commodities' markets. In the present economic structure, overall economic growth depends on the performance of corporate sector, while the financial resources of corporate sector are determined by the level of performance, gravity and strength of the financial markets in a country. It is interesting and extremely important that permissibility of the mobilization of capital among some economies is closely associated with the political strategies, particularly among the countries where apprehensions are reflected in the historical relations.

In the context of South Asia, Indo-Pakistan economic relation is one of the most appropriate examples. This situation may lead further deterioration in the economically weak region, if business friendly relationship is not established.

The seven countries in South Asia represent 23 percent population of the world, which is a visible indicator of the importance of this region. However, the share of South Asia in 'World Domestic Product' is less than 3 percent; it is less than 5 percent in global trade. The share of South Asia in World GDP does not match with its population. It is a source of the low per capita income in the region, which is about 1/10th of the world per capita income. It is notable that GDP is not a stock concept; it is a flow of resources during a year. A shortfall or gap in the resources implies the reduction in overall national wealth in future. It indicates also deficiency of funds for investment.

South Asia's share in world's stock market capitalization is less than 2 percent. With 5 percent share in world trade, less than 2 percent share in equity markets, and about 2 percent share in gross world product, South Asia can play a little role in the world economic development.

To improve the financial linkages among the countries in South Asia, this study suggest the following measures:

(1) Establishing SAARC Development Bank

In fairly a large number of studies and assessment it has been pointed out that the lack of interlinking infrastructure is a major obstacle in the enhancement of economic relations among the SAARC nations. Railways, road transportations, storage facilities at borders, lack of certification bodies, infrastructure of the joint institutions and efficient communication facilities etc are included in these hurdles. The development of these infrastructure and institutions requires joint financing from the SAARC nations. More than one nation may involve in such projects. However, many times such projects cannot be accomplished because of the lack of financing from one partner. It is suggested that the proposed institution should provide, advisory and financing facilities to those projects which can promote the economic linkages among the South Asian countries.

(2) Exchange and Transfer of Investment and Technology

During the last two decades, the South Asian nations have shifted their relations from 'negations to negotiations' stage. One of the important changes in this respect is the softening in the rule for foreign investment. The restrictions in the maximum limit of foreign investment in one company or sector have significantly relaxed in almost all the countries. However, the amendments and adjustments in investment policies in the recent past are not sufficient to achieve the desired goals of greater achievement to form a monetary or economic union in South Asia. Here, it is also recommendable that South Asian countries may develop their investment relations on the same patterns which have been suggested by the UNDP under the SSGATE program for South-South cooperation. Such programs may lead to joint ventures and transfer of technology and skills and mobility of labor and dependency in some cases, which will lead the enhancing in social relations among the people.

(3) Harmonization in Financial Regulations and Environment

The efficient utilization of financial resources can be achieved by flow of investment from one to other country in the region, and it is obvious that this type of efficiency is directly linked with the comparative advantage based specialization and economies of scale. Improvement in the socio-economics relations and technological advancements are the ultimate benefits of such efficiencies. This model is directly linked with the free mobilization of capital among the countries in South Asia, while mobilization of investment for its efficient utilization requires the harmonization in.

(4) Financial Integration

Though, formation of a monetary union is an ideal condition to achieve the target of efficiency in use of resources, and the historical experiences of integrated financial markets show that investment mobilization have been successfully achieved in those regions where common currency units are in practice. However, in the present political conditions it is not possible and recommendable to form a monetary without successful achievements in the precondition of the formation of an economic union. It is interesting and extremely important that permissibility of the mobilization of the factors of production among some economies financial environment and regulations. At present, there is a huge difference in the investment and financial regulations and environment. Structure of the corporate boards, stock exchanges mechanism, listing requirements, dividend payment procedures, brokerage house operations and transfer of money have different requirements and procedures in the countries in South Asia. For efficient utilization of capital, this mechanism should be harmonized. Capital accounts convertibility, uniformity in accounting standards, permission for cross border investment and synchronization in the monetary and fiscal policies are the prerequisite of financial integration. The regulating agencies including Securities and Exchange Commissions (Corporate Law Authorities), Central Banks, Competition Commission (Monopoly Control Authorities) and the other relevant agencies of the member countries will have to involve in making the regulations on uniform basis.

(5) Synchronization in Monetary and Fiscal Policies

The most crucial step belongs to the synchronization in monetary and fiscal polices of the countries in South Asia. The sustainable growth in stock prices and long-term changes in the funds allocation are largely determined by the economic fundamentals and corporate performance and policies.

(6) Improving Informational Efficiency

It is obvious that financial integration in South Asian economies can improve the efficiency and investment activities in the region. However, like other economic strategies, this policy is also closely related with the informational efficiency. Information efficiency in financial market is a prerequisite of efficient resource allocation. Fortunately, achieving the information efficiency has become possible; because in the present state of information technology, networking allows the

function of a common stock exchange, on-line transfer of money, registering and listing requirements, and profit, expectation about future returns, dividend announcements, changes in corporate governance and expected change in the market share of the firm's products are the factors which can affect the market capitalization of a company. At macro level, the magnitude of investment in equities and market liquidity are more important economic variables for the growth of stock market, and again it is obvious that synchronization in monetary and fiscal policies is required between the countries in the region to harmonize these variables.

Chapter 01

Political Economy
of
Regional Integration:

Regionalization & Globalization

A: From the Theories of Regionalization

Theory of globalization believes that the World will adopt a common culture and economic system ultimately. The trade and commerce has become much easier due to the advancement in information technology and has improved means of communication. The countries having more knowledge and information sources will be developed nation. English will be the sole common language and the role of professionals will increase substantially. The Bankers, Economists, Programmers, Business Executives and the Military personnel are included in those professionals. There will be no geographical boundary for those professionals. The countries with more number of professionals, will be advancing more, because such peoples will play an important role in the economic management, technological advancement, trade facilitation, socio-economic & political security.

Contemplation of Huntington's Theory of Regionalization

Contrary to the theory of Globalization, Huntington (1994) has shown his views that now world would be divided on the basis of cultures - not on the basis of economic ideology. Huntington (1994), divided the world in the following eight blocs:

Table 1.1: Huntington's Theory of Regionalization

No	Bloc	Countries
1	Western Bloc	USA, Western Europe, Canada, Australia and New Zealand
2	Islamic Bloc	All the Muslim Countries
3	Latin America	South and West American Countries
4	Orthodox Bloc	Eastern Europe and Russian Federation
5	African Bloc	Sub Sahara and Central African Countries
6	Japanese Bloc	Japan
7	Confucius Bloc	China and Hong Kong
8	Hindu Bloc	India, Nepal, Bhutan and Sri Lanka

Huntington (1995) has used the term of "Hindu Bloc" for India, Nepal, Sri Lanka, and Bhutan. It will be the smallest one among at eight expected blocs. Huntington's theory has not provided the answer about the severe cultural differences within a nation. Almost in every country, at least two cultures live simultaneously: its urban educated class has closer similarities with Western culture in terms of their accent to speak English, clothing, and dinning. Those cultural similarities cannot negate the deep-rooted socio-religious ideologies. For instance, if a resident of a Muslim Country wears a coat, uses a tie, drinks coffee and is graduated from an American University and read American literature, he/she may not belong to the Huntington's Western Bloc, in spite of similarities and adoptability of American culture.

According to the cultural-based regional bloc theory, religion and social values play an important role in the economic development. This thought recognises the role of culture and social values in the pattern of economic development. The role of a theocratic society in economic development will not be similar to a liberal society. The Roman Catholics and the Protestants cannot play a uniform role in the economic growth of a region. The religious and social attitudes have been playing significant roles in the economic growth of Germany, Switzerland, Taiwan, Korea, Japan, and Latin America. Fukuyama (1995) has also concluded that complicated financial system and open business Institutions cannot be created in those societies, where lack of trust in other persons or where social relations are limited up to the nearest relatives and family members. For example, the people of China, Italy and France are not much interested in the formation of big multinational corporations. On contrary, Japanese, American and German businessmen are the founders of numerous Multinational Corporations. The number of China-based Multinational Corporations are much lower in relation with the economic development of China. While, the numbers of Korean based Multinational corporations are much greater in relation with the economic development of Korea.

Discrepancies in social attitudes may affect the transaction and interpretation of the business agreements. They may create hurdles in the process of globalization. This is the major cause behind the formation of economic blocs on the basis of cultures rather than geographical locations and economic ideologies. The countries of similar culture may form their blocs. Those blocs will be more powerful than the present economic and political agreements.

South Asian Economic Zone of eight countries - including Afghanistan - will raise two basic questions: Will it negate the Huntingtons "Clash of Civilization" theory? The second interesting and worthy question is concerned with the Muslim domination in South Asia.

It is hypothesized that four Muslim countries and more than 50 percent Muslim population in South Asian Economic Zone may classify it as a 'Sub-continent' of Muslim World. Almost same conditions will be faced by the European Union after inclusion of Turkey, Cyprus, Albania, Kosovo and Bosnia in the European Union. The major and historically recognized part of the Muslim World - North Africa and Middle East - after exclusion of Pakistan, Malaysia, Indonesia and Turkey - will be the least developed zone in terms of science and technology.

B: Formation of Economic Zones: Preconditions and Outcomes

The formation of an economic zone, a free trade agreement or economic cooperation accords among the nations do not necessarily imply the closer links of the nations. Thousands of examples from the world history indicate the failure of economic accords and trade agreements because of the lack of will among the nations. There were several agreements between USSR and USA, Israel have several economic accords with Egypt, Jordan and Turkey. Economic treaties are exist between China and India and India and Pakistan. These agreements do not necessarily imply the friendships among the nations. In fact, closer relations among the peoples and successful of trade relations depend on the relations among the common peoples of the countries. Relations among the statesmen, politicians, and businessmen are not sufficient to achieve the targeted goals of trade and investment enhancements. The European Union and North American Free Trade Area are the examples of successful achievements in the targeted goals. These successes have been achieved because of relations among the peoples of t he countries in agreement. These relations require changes in the political, social and cultural environment and systems. A liberal visa policy, softness in cross boarder mobility of goods and services, freedom of individuals, friendly, attractive and liberal laws for flow of investment and commodities etc. are the usual aspects of such liberalization. Certainly, the role of national governments may be reduced in the presence of such relations. However, it will not be considered as the death of the nations. Despite such practices in Europe and North America, their national identities have not been damaged. For instance, in Europe, seventy percent of the peoples believe that first they are French or German or Spanish then they are European. The blocs cannot replace the countries. Although, the public expenditures will certainly decrease due to the free trade, common defense, joint investment, and lower risk in the fluctuation of the currencies. The role of the central government will be changed. The most important change, which is being felt, is that the role of the provincial governments will be abolished and their responsibilities will be shifted either to the federal or the local governments.

An economic or trade agreement will be considered as a successful policy if its growth rate or Human Development Index (HDI) is improved by joining the agreement. Such a goal can be achieved only in case of the fulfillment of the following two conditions:

1) There must be similarities and uniformities in the economic cultures. These uniformities can be created by changing in the fiscal and monetary policies and structure of economic governance.
2) The counties have strong and significant mutual trade relations and their requirements must depend on each other.

C: Economic Integration: Leading Politics by Economics

Theory of regionalization is implemented through the formation of blocs among the nations. These blocs may cover broader areas of cooperation including politics, culture, defense and security, and economy. However, after the growing role of economic issues in world politics now blocs are formed on the basis of economic cooperation among the nations. A much specialized and close linkage of the economies of different nations is defined as 'Economic integration', which refers to trade unification between different states by the partial or full abolishing of customs tariffs on trade taking place within the borders of each state. It implies the lower prices of goods or services for distributors and consumers because of duty free imports from the countries in the integrated region. This economic integration is treated as the second best option, because in economic theory, the best option is free trade. Free trade is considered as an idealistic option. The degree of economic integration can be categorized into six stages, which have bee explained in the following table:

Table 1.2: Types of Economic Integrations

No.	Degree of Economic Integration	Integrated Areas
1	Preferential trading area (PTA)	A partial abolishment of custom tariffs on the inner borders of the member states.
2	Free trade area (FTA)	A full abolishment of custom tariffs on the inner borders of the member states.
3	Customs union	A unified (common external) tariffs on the exterior borders of the union.
4	Common Market	Including the movement of services, capital and labor to an FTA.
5	Economic Union	A combination of the customs union with a common market
6	Fiscal union	Introducing a shared fiscal and budgetary policy
7	Monetary union	Introducing a shared currency
8	Complete economic integration	Unification of economic policies (tax, social welfare benefits, etc.), reductions in the rest of the trade barriers, introduction of supranational bodies, and gradual moves towards the final stage, a "political union".

These differ in the degree of unification of economic policies, with the highest one being the political union of the states. One of the initial steps towards economic integration is known as the Status of "Most Favoured Nation" (MFN). It means the country which is the recipient of this status must, nominally, receive equal trade advantages as the "Most Favoured Nation" by the country granting such treatment. All tariff and non tariff advantages are included in this term. In effect, a country that has been accorded (MFN) status may not be treated less advantageously than any other country with (MFN) status by the promising country. There is a debate in legal circles whether (MFN) clauses in BIT's include only substantive rules or also procedural protections.

It is interesting that the members of the World Trade Organization (WTO) agree to accord (MFN) status to each other. It is a cornerstone of (WTO) laws. So, there is nothing more than implementation of the (WTO)conditionality. However, exceptions are allowed by (WTO) for preferential treatment of developing countries, regional free trade areas and custom unions.

It is a common mistake in Pakistan to interpret the 'Most Favored Nation (MFN) as "Most Favourite Nation" (MFN). This misleading translation has been greatly publicized in Pakistan, and even translated in Urdu as "Sab say ziayda pasand deeda qaum". This misleading interpretation invited an unhealthy and unnecessary debate on the 'Likeness' of Indian nation by Pakistan, when Pakistan has officially declared the (MFN) status for India. The forces who are against the globalization and establishment of the relation with India, invited the criticism of the circles who strongly believe in Muslim nationalism to make their arguments of this situation. The attention has been drawn to the point that declaring India as most favourite (liked) nation is negation of Two Nations Theory: If we cannot live jointly with a nation then how this nation may be the favourite nation. In fact, all such arguments are baseless because they are based on misleading (and off course, a wrong) translation and interpretation. A 'most favoured' does not necessarily mean 'most favourite'. To favour someone is different from a favorite personality. Sometimes, a favour may be given to enemies, but enemy cannot be friend or favorite. It is one of the example that how academic circles and media can exploit the sentiments.

D: The Politics of Regionalization and Economic Blocs

The literature on international relations has summarized the three objectives of the agreements and contracts among the nations: (1) To get economic and political benefits of such agreements; (2) to force a small nation by a large nation to join this agreement because of the pride of the large nation and think itself the master of world or regional affairs, (3) any kind of apprehension in the absence of such agreement (Geo TV: 2009). Though, international organization including United Nations Organization (UNO), World Economic Forum, World Trade Organization (WTO), International Monetary Fund (IMF), and World Bank cover all these three objectives, the alliances or made by the countries on the basis of regionalization or other common grounds. Organization of Islamic Countries (OIC), Islamic Development Bank, Asian Development Bank, G8, and D8 etc are included in those alliances. The globalization movement and the growing membership of (WTO) have reduced the need of regional alliances, however a fast growth in the number and coverage of regional alliances can be observed over the last two decades.

Together, the G8 countries represent about 65 percent of the Gross World Product, the majority of global military power (seven are in the top 8 nations for military expenditure), and almost all of the world's active nuclear weapons. The eight countries making up the G8 represent about 14 percent of the world population, but they account for 65 percent of the world's economic output measured by Gross Domestic Product (GDP), all 8 within the top 10 countries according to (GDP) (nominal). Their combined military spending is almost 72 percent of the world's total military expenditures. Four of the G8 members United Kingdom, United States of America, France and Russia together account for 97 percent of the world's nuclear weapons.

Table 1.3: Mutual Trade and Regional Blocs

Regional Bloc	Mutual Trade as Percentage of Total Trade
Asia Pacific Economic Cooperation	73.1
European Union	61.5
North American Free Trade Association	47.5
Andean Group	10.4
Central American Common Market	15.7
Caribbean Community	12.9
Latin American Integration Association	16.5
Southern Common Market	22.8
Organization of Eastern Caribbean States	11.6
Economic and Monetary Community of Central Africa	1.9
Economic Community of Great Lake Countries	0.5
Common Market of Eastern and Southern Africa	9.3
Economic Community of Central and African States	1.9
Community of West African States	8.7
Menu River Union	0.0
Southern African Development Community	10.4
West African Economic and Monetary Union	9.3
Association of South East Asian Nations	23.2
Bangkok Agreement	2.3
Economic Cooperation Organization	6.7
Gulf Cooperation Council	4.6
South Asian Association for Regional Cooperation	4.3
Arab Maghreb Union	3.4

The Developing 8 (D-8) is a group of developing countries that has formed an economic development alliance. It consists of Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan, and Turkey. The group was established after an announcement in Istanbul, Turkey in 1997. Membership is open to countries other than the current member-states, though no expansion is currently planned. The objectives of (D-8) are to improve developing countries' positions in the world economy, diversify and create new opportunities in trade relations, enhance participation in decision-making at the international level, and provide better standards of living. The Developing 8 does not have a large impact on the affairs of more influential international organizations such as the "United Nations" (NATO), or (ASEAN).

Table 1.4: Regional Blocs' Memberships

Name of Bloc	Countries included:
Asia Pacific Economic Cooperation (APEC)	Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong (China), Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, the Russian Federation, Singapore, Taiwan (China), Thailand, the United States, and Vietnam
Central European Free Trade Area (CEFTA)	Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, and Slovenia
Commonwealth of Independent States (CIS)	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Tajikistan, Ukraine, and Uzbekistan
Euro-Mediterranean Free Trade Area (EMFTA)	European Union, Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syrian Arab Republic, Tunisia, Turkey, and West Bank and Gaza
European Union (EU; formerly European Economic Community and European Community)	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom;
Free Trade Areas of the Americas (FTAA)	Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Republica Bolivariana de Venezuela, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, the United States, and Uruguay
North American Free Trade Agreement (NAFTA)	Canada, Mexico, and the United States
Economic and Monetary Community of Central Africa (CEMAC)	Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, Gabon, and São Tomé and Principe
Economic Community of the Countries of the Great Lakes (CEPGL)	Burundi, the Democratic Republic of Congo, and Rwanda
Common Market for Eastern and Southern Africa (COMESA)	Angola, Burundi, Comoros, the Democratic Republic of Congo, Djibouti, the Arab Republic of Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Tanzania, Zambia, and Zimbabwe
Cross Border Initiative	Burundi, Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe
East African Community (EAC)	Kenya, Tanzania, and Uganda
Economic Community of Central African States (ECCAS)	Angola, Burundi, Cameroon, the Central African Republic, Chad, the Democratic Republic of Congo, the Republic of Congo, Equatorial Guinea, Gabon, Rwanda, and São Tomé and Principe
Economic Community of West African States (ECOWAS)	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, the Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, and Togo
Indian Ocean Commission	Comoros, Madagascar, Mauritius, Réunion, and Seychelles
Mano River Union (MRU)	Guinea, Liberia, and Sierra Leone

Southern African Development Community (SADC; formerly Southern African Development Coordination Conference)	Angola, Botswana, the Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe
Central African Customs and Economic Union (UDEAC)	Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon
West African Economic and Monetary Union (UEMOA)	Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo
Association of Caribbean States (ACS)	Antigua and Barbuda, the Bahamas, Barbados, Belize, Colombia, Costa Rica, Cuba, Dominica, the Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Suriname
Andean Group	Bolivia, Colombia, Ecuador, Peru, and República Bolivariana de Venezuela
Central American Common Market (CACM)	Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua
Caribbean Community and Common Market (CARICOM)	Antigua and Barbuda, the Bahamas (part of the Caribbean Community but not of the Common Market), Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago
Central American Group of Four	El Salvador, Guatemala, Honduras, and Nicaragua
Group of Three	Colombia, Mexico, and República Bolivariana de Venezuela
Latin American Integration Association (LAIA; formerly Latin American Free Trade Area)	Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and República Bolivariana de Venezuela
Common Market of the South (MERCOSUR)	Argentina, Brazil, Paraguay, and Uruguay
Organization of Eastern Caribbean States (OECS)	Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines
Arab Common Market	the Arab Republic of Egypt, Iraq, Jordan, Libya, Mauritania, the Syrian Arab Republic, and the Republic of Yemen
Association of South-East Asian Nations (ASEAN)	Brunei, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam
Bangkok Agreement	Bangladesh, India, the Republic of Korea, the Lao People's Democratic Republic, the Philippines, Sri Lanka, and Thailand
East Asia Economic Caucus (EAEC; formerly East Asia Economic Group)	Brunei, China, Hong Kong (China), Indonesia, Japan, the Republic of Korea, Malaysia, the Philippines, Singapore, Taiwan (China), and Thailand
Economic Cooperation Organization (ECO)	Afghanistan, Azerbaijan, the Islamic Republic of Iran, Kazakhstan, the Kyrgyz Republic, Pakistan, Tajikistan, Turkey, Turkmenistan, and Uzbekistan

Gulf Cooperation Council (GCC)	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates
South Asian Association for Regional Cooperation (SAARC)	Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka
Arab Maghreb Union (UMA)	Algeria, Libya, Mauritania, Morocco, and Tunisia.
Greater Arab Free Trade Area (GAFTA)	Members, Bahrain, Egypt, Iraq, Jordon, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, United Arab Emirates, Yeman; Possible future members:http://en.wikipedia.org/wiki/Image:Flag_of_the_Comoros.svg Comoros, Djibouti, Mauritania, Somalia

The Greater Arab Free Trade Area (GAFTA) is a pact made by the Arab League to achieve a complete Arab economic bloc that can compete internationally. (GAFTA) is relatively similar to (ASEAN). (GAFTA) has a high income, population, and area and has significant resources available.

It is notable that 5 out of 37 leading regional trade blocs are purely affiliated with Muslim countries. Obviously, the larger number of Muslim countries and their diversified problems and locations is one of the reasons for these large alliances.

The darkest side of this picture is the failure of this bloc in achieving the targets. To believe that mere formation of a bloc on the basis of some common interests and regions is sufficient to accelerate the development is a misleading approach. In fact, the formation of a bloc can at as catalyst for development process, but it itself can not cause economic development. It is envisaged by the historical record of growth in the trade between the regions that mere regional blocs did not accelerate the mutual trade growth, the factors of growth require economic justifications. Existence of the trade barriers, interaction among the people and the mechanism of the demand and supply forces are the determinants of trade growth.

E: Liberalization and New Management: Prerequisites for Integration

It is notable that two types of integration models are currently in practice in the world and the choice of model is depends entirely on the objectives and vested interests of the decision making authorities. The choice of integration models is also closely related with the political ideologies, which is being followed by a particular country (See Appendix: VIII). In first type of integration, political centralization and unification is required with complete economic independence of the regions. The best example of such model is the economy of Hong Kong in China where Hong Kong is a free economy administered by China which is a socialist republic. (UAE) is an other example of such economic independency of the states within the same country. Existence of free ports in some centralized economies also reflects such type of integrations where a specific region of the country works as engine of growth for entire country. This model suggests the existence of multiple economies in the same country, while European Union is an example of the second type of integration where different political entities share a common economy. This second model indicates the common economies of multiple countries.

One can ask the question that now after 70 years of colonialism regime and at the time support, facilitation and encouragement of the free trade and globalization policies, why economic history could not be revive in South Asia? Why South Asia could not be included in the world top 3 economies? There are three major obstacles in the revival of South Asian economic history: (1) the global trade and development patterns at present do not depend on natural resources. The economic development and ranking in today's world depend on the contribution of knowledge based products in the economy, which is closely related with the technological advancement, research & development and the quality of higher education. These factors cannot be achieved over the night. Sustainable policy measures for development of human resources are required. A stereo-type economic and political management cannot achieve the desired results for a u-turn in economic development. Knowledge based growth requires development in science and technology. It takes time from 10 to 30 years depending which model has been adopted to develop the economy. (2) The trend of popular decision making to improve the vote banks of ruling political parties is another major cause of slow growth and under development in South Asian economies. Majority of the politicians in South Asia think about the next elections. They take all those steps which are required to win the elections. Paying stipends, subsidies, grants, generating employment opportunities in public sector and unsustainable projects are the common tools of those policy measures. Emotions, sentiments in the names of patriotism, religion and welfare sometimes create unrest in the society and can create hurdles in the way of peace, development and good relations with the neighbouring countries. They may derail the patterns of public finance. The underdevelopment is an ultimate consequence of such popular decision making. (3) Resources of South Asian countries have been spent on the unproductive investment because of the fear of war. The fear of wars in South Asia is no doubt a major cause of underdevelopment. However, this fear cannot be removed without unwilling and superficial agreements among the partners. It requires the removal of the causes of fear. The relations among the people and removal of the restrictions in the movement of people, goods, services and capital can remove such fears.

All kinds of economic integration including permission of the cross border investment and financial integration require the greater degree of liberalization. Without liberalizing economies and economic freedom, economic integration cannot be achieved. After 1979, it was observed that South Asian countries are moving towards liberalization. This movement has been accelerated after the disintegration of Soviet Union.

Table 1.5: A calendar of economic liberalization Country Year: Third Round of Liberalization in South Asia.

Country	Year
Pakistan	1988
Sri Lanka1	1989
Bangladesh	1989
India	1991
Nepal	1991

In the model of regional integration it must be noted that such models cannot be successful in the absence of private sector and new management. The lesser size of government and higher contribution of private sector in state activities ensure the success of such models. Economic freedom and restriction free mobilization of labor and capital will provide a catalyst in the success of regional economic integration.

Table 1.6: Regression Results Dependent Variable: Non-performing Loans

Variable	Coefficients	T-statistics
Intercept	19.93142	3.421722
Bank Capital to Assets	-0.28343	-0.84561
Easy Access to Loan	-1.92157	-1.38954
Credit by Banking Sector	-0.0135	-1.01708
Public Credit Coverage Bureau	0.103917	1.758853
Private Credit Coverage Bureau	-0.07465	-3.02768
Adjusted R Square	0.318563	
No. of observations	36	
Source: Mehar (2011)		

The lesser control by the state over the monetary and fiscal policies allows the large markets to work. The hindrances by government monitoring regulating agencies in financial performance of the banks have been exemplified here. A study (Mehar: 2011) indicates that the size of private credit coverage bureau improves the performance, reduces the default and non performing loans in the economy, while the size of public credit coverage bureau increase the defaults in the economy. Obviously, it indicates the undue pressure on the sensitive record of state owned enterprises and its misuses. The World Economic Forum Report (2012) and World Development Indicators (World Bank: 2012) also indicate the positive correlation among the higher magnitude of business regulations and economic development.

Chapter 02

Socio-Political Aspects of Economic Integration in South Asia

A: Outcome of the Indo-Pakistan Economic Relations

The diversification and pluralism in political thoughts, ideologies and religions do not affect the socio-cultural and linguistic attributes of the people who live in the same region for centuries. Surprisingly, this hypothesis has not been accepted in the case of India and Pakistan – two major countries in South Asia. Muslims - either in India or Pakistan - have different lingo-cultural attributes.

South Asia is considered a burning point and most dangerous zone at the geopolitical stage of world; not only because of the present tension between India and Pakistan and rift on Kashmir, but also due to tendency of deep rooted and complicated issues, and growing militancy reflect a dark picture of future scenarios. It is an illusion that all complications in Indo-Pak relations are based on geo political issues of Kashmir, distribution of river water and determination of disputed borders. Great diversity in political ideologies, tragedy events in the 1000 years of Muslims' history in India, Hindu-Muslim riots before and after 1947, separation of East Pakistan, and control over Muslim dominated internally independent states by India, Mumbai attack and many other disputes determine the complications in politico-economic relations between India and Pakistan. The acquisition of nuclear power by India and Pakistan has added more severity in this strange thematic issue.

It is interesting to note that the Dhaka Summit in 2005 accorded observer status to People's Republic of China, Japan, South Korea and United States of America. In the 14th summit of association, Afghanistan became its 8th member.

It is evident from the historical record that no mentionable achievement in economic relations has been observed by implementation of the South Asian Free Trade Agreement (SAFTA), formation of South Asian Association of Regional Cooperation (SAARC) for over a decade of discussions and debates between the stakeholders of South Asian nations. There is no significant improvement in the magnitude of mutual trade of South Asian countries. Similarly, no evidences of cross border mobilization of entrepreneurship or capital or labor are available. In fact, the political and military rivalries between India and Pakistan over the years are major reasons for ineffective role of SAARC and consequently South Asian nations have not been able to gain the benefits of a unified economy.

Formation of South Asian Association for Regional Cooperation (SAARC), Signing Preferential Trade Agreement (SAPTA), formation of the SAARC- Chamber of Commerce, entry into a Free Trade Agreement (SAFTA), and giving the status of most favoured nations (MFN) are the steps taken in the past for unified economy. All these steps did not provide a revolutionary development in the economic relations of the South Asian countries in general and Indo-Pakistan, in particular. There are two obvious reasons behind this ineffectiveness. First, the countries in South Asia do not depend on each other; their industries are not vertically integrated; and their products and services do not complement each other. Second reason of this undesired outcome is the attitude of the governments of both countries. Despite relaxation in tariffs, several non tariff barriers are still active and but also on rise.

Table 2.1: Tariff Barriers

COUNTRY	Most recent year	All Products %						Primary Products (%)		Manufactured products (%)	
		Binding coverage	Simple mean bound rate	Simple mean tariff	Weighted mean tariff	Share of lines with international peaks	Share of lines with Specific rates	Simple mean tariff	weighted mean tariff	Simple mean tariff	weighted mean tariff
Pakistan	2005	44.8	52.2	14.6	12.4	42.6	-	13.8	8.6	14.6	14.5
Bangladesh	2005	14.9	162.1	16.8	55.8	36.0	-	21.8	19.4	16.0	76.7
India	2005	73.8	49.6	17.0	14.5	15.5	3.5	24.4	16.5	15.9	12.8
Srilanka	2005	36.8	29.6	11.3	7.7	23.4	0.4	18.2	9.5	10.3	6.8
Nepal	2005	-	-	14.7	14.3	21.6	-	13.9	9.3	14.7	16.4
South Asia		61.1	42.6	15.2	16.1	31.4	1.6	18.4	15.1	14.6	16.8
Middle East & N. Africa		93.4	34.8	10.6	8.9	23.7	-	15.8	8.9	9.8	8.8
World		77.4	30.8	7.7	3.3	13.8	0.5	9.9	3.3	7.4	3.2

Source: UNCTAD

Majority of South Asian scholars have attempted to compare SAARC efforts to increase economic cooperation with those of other regional trading bodies such as the European Union and Association of South East Asian Nations (ASEAN). Unlike the (EU) or (ASEAN), however, trade between the eight (SAARC) states has remained limited despite the fact that all are located within a close proximity of one another and all are part of the World Trade Organization (WTO). To expect that free trade with India or formation of an economic union can revolutionize the economy of Pakistan or other countries in the region is absolutely an irrational understanding. The mutual trade of South Asian countries is only 4 percent of their global trade.

It was estimated that after taking all the measures and necessary steps to liberalize across the border movements of goods and services, the mutual trade can be grown up to Rs. 5 billion only, which is less than 3 percent of total exports from Pakistan (Mehar: 1999). The countries in South Asia do their 96 percent trade with the countries outside the South Asia. They have more discouraging position in the mobilization of labor and capital. From macroeconomic indicators' point of view, South Asia is in the weakest position as compared to European Union (EU) and Japan. The countries in South Asia are facing similar economic problems like inflation, unemployment, poverty, low investment, and deficit financing.

Table 2.2: Comparison of Economic Status

Zone	Population (Million)	GDP (Equivalent Purchasing Power (Billion $)	Per Capita Income ($)	Growth Rate (%)	Un-employment (%)	Inflation (%)
Euro-11	290	5942	20490	2.6	11.6	1.8
USA	268	8080	30149	3.8	4.9	2.4
Japan	126	3002	30825	0.9	3.4	1.7
South Asia	1266	1924	1520	4.6	18.0	7.2

Source: World Development Indicators

Table 2.3: Share in the International Trade and Finance

Zone	Share in Global Exports (%)	Share in Global Imports (%)	Market Capitali-zation (Billion $)	Number of Listed Companies	Head Quarters of Top 500 MNCs
Euro 11	20	23	3841	5242	100
USA	16	15	8484	8479	151
Japan	10	8	3089	53	104
South Asia	1	1	140	10102	5
World	100	100	20177	42404	500

Source: IMF data base

The idea of regional cooperation in South Asia and formation of South Asian Association for Regional Cooperation (SAARC) was first mooted in 1980 and was established in 1985; and the SAARC Chamber of Commerce and Industry (SCCI) was set up under the umbrella of SAARC in 1992 as a SAARC recognized apex body for bringing together the National Chambers of Commerce and Industry of member states. After that the agreement on SAARC Preferential Trading Agreement (SAPTA) was signed in 1993. The proposal was initially met with enthusiasm as India agreed to reduce tariffs in 106 of 226 fields recommended by the SAARC; and Pakistan agreed to grant concessions in 35 fields. Due to several deep rooted historical/ political conflicts, the desire for South Asian states to trade with one another has been limited. It is important to point out that SAARC does face some serious obstacles to success. The organization is facing a serious resource crunch and the SAARC countries have shown little willingness to increase their contributions to the Association. Moreover, SAARC has been criticized by the public for only reaching agreements on the lowest level of cooperation among states instead of pushing for cooperation that would actually benefit South Asia. It is notable that when SAPTA was being implemented, only 3 percent of all South Asian trade was conducted in the region. Six years later, the improvements seen in regional trade were marginal. India's trade within South Asia accounts for only 4 percent of its total global trade and Pakistan's trade in the region accounts for merely 3 percent of its overall trade. Compared to other countries with similar proximities and income levels, intra regional trade among SAARC states is relatively small. Much of the trade that is conducted in South Asia is also considered symbolic and generally does not involve goods vital to the economies of the South Asian states. Moreover, some states still have high tariff and non-tariff barriers to trade, indicating that the spirit of free trade does not seem alive in (SAARC).

It was hoped that the establishment of a South Asian Free Trade Area (SAFTA) in 2006 would stimulate trade in the region; even it did not provide desirable results. After several years, now Pakistan has decided to give most favoured nation (MFN) status to India, while India has already given this status to Pakistan.

Total population of (SAARC) region as on 2007 was recorded to be about 1.5 billion, the largest of any regional organization that constitutes more than 23 percent – or one fourth- of the total population of the world. The (SAARC) countries statistically 50 percent of the worlds poor popele are concentrated in the (SAARC) countries. With the world's largest population, total (GDP) volume of (SAARC) region was determined to be approximately (US$) 3000 billion in 2008. (SAARC) share in total world trade is less than 1.5 percent. Total volume of exports of the whole region was registered only about (US $)123 billion in 2007. India and Pakistan are two major economies in the region that constitute 73 percent and 13 percent respectively in the total exports of the region. The volume of total imports of (SAARC) region was (US $) 186 billion in 2007. Share of India in the total import of the region is 71 percent, Pakistan 14 percent, Bangladesh 7 percent, Sri Lanka 5 percent and of Afghanistan about 2 percent. Total exports of the (SAARC) region rose by 92 percent in five years from (US$) 65 billion in 2002 to (US $) 123 billion in 2007. However, total imports rose more impressively of about 137 percent in the same period of 5 years. These statistics show a great variation in the economic conditions of the region. India and Pakistan are obviously the two most dominant nations in the region. Trade between India and Pakistan's within (SAARC) region shows the stagnant share of about 50 percent during the last 6 years, however, increased notably to 66 percent in the year 2006-07. It constitutes India the biggest trading partner of Pakistan within the region.

Table 2.4: Pakistan's Trade Share

Region / Group	Share in Exports (%)	Share in Imports (%)
Industrialized Countries	59.4	47.6
Eastern Europe and Russian Federation	0.7	0.9
Developing Countries	39.9	51.5
Total:	100	100
Share of South Asia	2.9	2.2

Source: Federal Bureau of Statistics, Pakistan

In fact, the basic and important justification behind the formation of South Asia Free Economic Zone is not directly concerned with the economic benefits. The benefits, which are being mentioned, are not the solution of regional economic problems, because of their lower magnitude. However, they have much importance from the global political point of view. United States is interested in the good relations between India and Pakistan. Several objectives including a sustainable peace in the world can be achieved with good relations between India and Pakistan.

There are several fundamental questions and apprehension in the minds of people to analyze the need and benefits of free trade among the nations. Frequent and frictionless travelling of people among the partner nations, and cultural transformation are the joint determinants of free trade. How these transformations and movements are allowed by the government and what are their effects and side effects on the political and social environments, this should be determined before any agreement. Without this consideration, free trade agreements cannot be sustainable and effective. Free trade can lead to dependency, it can damage local economy, it leads to undue political influences, it cannot enhance the share of inter-regional trade, it cannot enlarge the size of pie, it cannot provide any benefits to low income groups, and it does not have any effect on the living standards of the people; these are those questions and objections which require careful analysis.

The adverse role of trade barriers in South Asia in past years can be measured by their average tariffs on primary and manufactured products. The simple average tariff rate is 8.7 percent in the world for primary products; it is 15.8 percent in the case of South Asia. The weighted average tariff rate for primary products is 2.2 percent in the world; it is 7.0 percent in South Asia. For manufactured products, the simple average rate of tariff is 6.9 percent; it is 13.0 percent in case of South Asia. The weighted average tariff for manufactured products is 3.3 percent in world; it is 7.1 percent in South Asia. This quantification indicates the restriction on international trade by protectionism. No significant enhancement in the mutual trade has been observed even after signing the formation of (SAFTA). The growth in non tariff barriors has become the major obstacle in the trade enhancement between India and Pakistan. It was expected that all kinds of trade barriors will be abolished after declaring the status of most favoured nation to other country by each side. However, non tariff barriors cannot be identified; they may be changed and identified from time to time. In most of the cases such barriors are invisible. It is obvious that to identify those invisible barriors is not a simple task.

It has to be admitted trade relations cannot be isolated from social and political relations, since the "will" for trade enhancement is determined by the political and social relations. Trade enhancement or economic integrations depend upon the nature of relationship between these two nations . The political and social relations will be determined by the interaction among the people. So, as a point of initiation, the policy makers should focus to develop relations among the people by means of sports, cultures, and tourism activities. Another misleading approach which is being adopted to promote cultural relations is to create harmony between those aspects of culture which are not common in India and Pakistan. In fact, harmony and relations can be initiated by promoting the exchange of activities and relations in those areas which are common on both sides.

The interaction among the people of South Asian countries and the cross border investments indicate a dark picture, which is another cause of lower trade volume between these countries.

Though, apprehensions reflected by the complex and complicated historical relations between the two big South Asian nations require testing of several hypotheses before any recommendations, e.g.

1. Kashmir issue is the only hindrance in strengthening of the economic relations;
2. Kashmir is not a cause, it is a consequence of historical complications in the relation of two nations;
3. Future relations can ignore the history;
4. Participation of Afghanistan and Pakistan in South Asian Economic Zone and the formation of a Muslim Bloc are two mutually exclusive ideologies;
5. Apprehensions are consequences of two nations theory, and
6. The Indo Muslim relations in present context at large are the determinant of Indo-Pak relations.

These testable hypotheses can be helpful in formulation of an ultimate policy to determine the role and scope of mutual relations among South Asian countries.

In the philosophy of international trade, the most notable point is the requirement of goods and services by the importing country. An importer (or buyer of the products) makes its decision on the basis of availability of his required goods and services at the competitive price and quality, which depends on the competitiveness strength of the exporting (producing) country. The role of government of the exportable products is important in providing a competitive environment to its producers. However, the more important factor is the "requirement" of those goods by importing country. The importer (or buyer) must demand the goods. If required goods for Pakistani buyers are being produced in India or other countries, these must be bought and imported in Pakistan. Even in the presence of regulatory controls, the goods will be imported via 3rd country or illegal channels or longer routes. The regulatory restrictions can increase the landed cost of products, and end user will have to take this inflationary burden, Moreover, in the free trade regime such restrictions are not possible; even in case of some justifiable restrictions on imports, the discrimination has no longer a valid option. Restrictions because of political reasons cannot be imposed in the present regime. So, the question of impact of free trade agreements or MFN status is not important in the long-term. Enhancement of trade with a particular country depends entirely on the availability of required goods at competitive price and quality.

In fact, trade enhancement among the nations is jointly associated with the trade liberalization policies and trade competitiveness factors. (Legal system, size of government, freedom to trade internationally, sound money and regulations) are the components of economic freedom; and these components are significant determinants of trade competitiveness including goods market efficiency, labor market efficiency, financial market sophistication, governance, technology readiness and innovations. The factors of competitiveness including innovations and governance determine the magnitude of regional and international trade. Without insuring economic freedom trade enhancement cannot be achieved. As already mentioned that extremely high non-tariff barriers have been observed in South Asian countries and it is obvious that existence of such barriers is a significant indicator of the obstacles in economic freedom.

The simultaneous relations show the commerce departments and their associated institutions are not only responsible for trade promotional activities; regulatory framework and competitiveness are the catalyst for enhancement in trade relations. For trade enhancement and liberalization, the role of interior and foreign ministries is also important. Free Trade Agreements, Bilateral Treaties and Monetary Union cannot achieve the targeted goals unless the interior and foreign affairs ministries participate in these agreements. The roles of planning authorities, transportation and communication departments are also important in trade promotion among the nations. At the time of agreements of mutual economic relations, the recommendations of planning commission, interior and foreign affairs ministries and the concerned departments of the transportation and communication ministries must be incorporated.

Historically speaking, the trade policies of Pakistan were softer than Indian trade policies in past. As a result, dependency on imports has been increasing in Pakistan. Now, it is expected that in case of a free trade policy, Pakistan will import machinery and spare parts from India. On contrary to this, the major part of Pakistani export belongs to the primary and intermediate products including cotton and yarn. As a result, prices of basic goods will increase in Pakistan. The past experience can predict that foreign exchange will not come into Pakistan by exports to India; because, Pakistani exporters will import Indian products instead by cash earnings to maximize their profits.

So, to enhance regional trade, the countries have to develop their competitiveness. The improvement in competitiveness has several factors. One of the important factors facing worse deterioration in Pakistan is the poor and un-maintained infrastructure. Infrastructure determines the improvement in other factors of competitiveness. Infrastructure development leads the "Freedom & Trade internationally" which accelerates competitiveness through enhancement in Technology Readiness. Various studies and statistical analysis have been showing the significant impact of the components of infrastructure on (GDP).

The inducement of cultural relations and interaction among the people of partner countries is the most important aspect of trade in services. The interaction between the people promotes trade in merchandizing goods. Reduction among disparities between the nations, accelerated development of the institutions and growth of economic activities are the ultimate output of trade in services. The quantum of trade in merchandizing goods does not reflect the relations between the people of partner countries. However, connectivity of people through availability of appropriate means of transport and communications, tourism, and linkage in services industries including education, finance and heath leads the interaction among the people of partner countries. It may lead the peace and reduction in political tensions and disparities. Reduction among the disparities between nations, accelerated development of the institutions and growth of economic activities are the ultimate output of the connectivity and international trade. The causal relation in the famous slogan of "World Peace" through World Trade was not accepted through historical evidences. Historical evidences show the inverse direction in causality: Peace leads the trade.

B: Economic Integration in South Asia: Considering Prosperity without Politics

The benefits at large and prosperity in consequence of free trade regime has largely been recognized in post soviet regime by the economic policy makers and leading global think tanks. However, the success and sustainability of free trade regime is closely associated with the dynamism and patterns of competitiveness of domestic industries. This dynamism and competitiveness depends largely on the free mobilization of the factors of production from one to another region. Without allowing mobilization of the factors of production, the sustainability of free trade in goods and services will remain doubtful. The mobilization of the factors of production is always associated with the mobility of labour and migration and across the borders flow of foreign investment. These are two problematic areas which have not been fully addressed in the policy debates and implementation of global policies. This study is mainly concerned with the economic integration by flow of investment among the South Asian countries.

Despite several theoretical disagreements on the merits of economic integration, it can not be avoided in the present inclination of new liberalism and free trade regime. Regional economic integration is a subset of free trade policies, which has an ultimate goal to enter into globalization regime. Here, it is notable that economic integration is not properly understood in South Asia where the policy makers consider economic linkages as economic integration. Economic integration is defined and determined by the complex relations and interaction of various systems. It requires interactions among the public and private sector participants from countries in the region. From public sector, ministries of finance, commerce, communications, transportations, foreign affairs, homeland security and interior affairs, planning commission and monetary authorities are the integral parts of this strategy, while trade bodies, financial markets representatives and financial institutions are the natural participants from private sector.

Economic integration covers the transfer and retransfer of the economic resources including capital, labor, entrepreneurs and money from one to other sector or region. It requires a chain of participation and transfer of goods and services. It is something more than economic linkages. Such integrations in past have been achieved and depended on the willingness and systematic gradual planning by the member countries of a bloc or economic union, however, now it has become the part and parcel of the globalization. The countries in a region will have to adopt this policy willingly or unwillingly because economic isolation from the neighboring countries is no longer possible in the new global scenario.

Contrary to full economic freedom or free trade, economic integration has been considered as the second best option for global trade where barriers on free trade cannot be removed because of several politico economic and social reasons. Formation of preferential trading areas, free trade areas, customs unions, and economic and monetary unions are the earlier stages of a complete economic integration.

Several important aspects of economic integration have been discussed in the policy documents and research papers. Limitation and importance of the South Asian Association for Regional Cooperation (SAARC), scope of the South Asian Preferential Trade Agreement (SAPTA), magnitudes and potentials of economic integration, facilitations and policies, harmonization in trade relations among South Asian countries, South Asian perspectives of the 'Railways Mega Project' from Malaysia to Turkey, role of the regulatory and policy making organizations - interior, foreign and commerce ministries and the communication, transportations, tourism development departments and the planning commissions - in economic integration of South Asian countries, collaborative dimensions of the investment and financing activities including the role of financial institutions, capital markets and monetary authorities, role of the think tanks, and media in exchange of views and dialoges, and collaboration in the research, higher education and technological advancements are the areas which have been classified for developing a sustainable economic integration in South Asia.

It is widely considered that economic relations and mutual dependency on economic resources may diffuse the political tensions and divert the cold war or a war like situation. Economic integration is a natural mechanism for sustainable development of economic relations among the nations. To assess the success and possibility of economic integration among the nations which have severe political disputes and disagreements requires several dynamic models and many complex and complicated variables, which are beyond the scope of this study. Regardless of the impacts of ideologies, political thoughts, history and variations in cultural and linguistic diversities and sociology, this study assess the possibilities and consequences of economic integration of South Asian countries.

The most important issue in the economic integration in South Asian countries belongs to geo-political relations between India and Pakistan - two largest countries of the region. Though economic methodology allows us to explore the possibility of economic integration among South Asian countries in isolation of the political strategic issues; and in this study we analyzed the possibility and consequences of economic integration and cross border investment among the South Asian countries without considering the politico-strategic questions. However, as a reference, it is notable that history of the region denies the impossibilities of economic integration between India and Pakistan even in the presence of geo-political tensions. It will be interesting to mention here that since 1947 to mid 1960s, the mobility of capital and labor was not restricted between India and Pakistan. Several business entities and funds have been transferred across the borders. This free movement of capital did not create any problem and provided facilitation in flourishing business empires across the borders. The process of migration between the countries was not completed in months, it continued till 1953. It is more interesting to note that in early days after the independence, Baloch Regiment (Pakistan Army) had been deployed in the major cities of India to provide safe exit to those Muslims who wanted to migrate to Pakistan. Pakistani flag on the residences of Muslims in Indian provinces and deployment of Pakistan Army in major Indian cities had never created law and order problems in India. It was a portrait like a cricket match, which never created any serious problem. The unfortunate severe clashes, killing and brutalities were observed in the divided provinces of Punjab and Bengal – not in the provinces (UP, CP, Gujarat, Sindh and Mumbai), which made decision of the partition of India at earlier stage. This instance is sufficient to realize the possibility of economic integration among the two nations despite historical controversies. The countries can maintain economic integration after partition like United States of America and Canada.

The target of peace cannot be achieved through defence or trade accords and agreements. The restoration of trust and mutual relations among the people (not only among the governments) is required for sustainable peace and creates an environment of mutual relations like USA and Canada. All defense accords including minimum capability and first attack doctrines provide mere adjustments to minimize apprehensions. They do not lead to sustainable peace. Peace may be ensured only by free movement of goods and services and relations among the people. However, these free movements and across the border relations may create some issues in the political and civil governance, and the governments of the countries are avoiding from handling these governance related issues.

C: Foreign Investment in South Asia: Need, Opportunities and Environment

It has been mentioned earlier that in the globalization regime, cross border mobilization of capital is a required and desirable activity to synchronize the global economic environment and creating business competitiveness. The stock of foreign capital and flow of investment in the South Asian countries show a dismal picture of the inclined achievement in the globalization. Magnitude and consistency of the flow of foreign direct investment, foreign portfolio investment, investment treaties and agreements and the Mergers and Acquisition activities indicate that South Asian countries except India require substantial changes in their policies and regulatory structures.

The unfavorable balance of trade of South Asian countries emphasis to explore non-trade sources for earning foreign exchange. Workers' remittances and net flow of foreign direct investment are the non-trade sources of foreign exchange earnings. The requirement of foreign investment by South Asian countries can be assessed by the flow of foreign exchange through these non-trade sources. It was noted that works remittances are the largest non-trade source of foreign exchange earnings by South Asian countries. It is 11 percent of (GDP) in case of Bangladesh where inflow from (FDI) is only one percent of GDP. Foreign exchange earnings as percentage of (GDP) is about 4.3 percent in case of India and the same is for Pakistan; while inflow of foreign exchange by (FDI) is 3.6 percent of (GDP) for India and 3.3 percent for Pakistan. India also spent its foreign exchange on investment which was about 1.6 percent of its (GDP).

Share of South Asia in global foreign direct investment has reached at 2 percent in 2008; it was less than one percent in 1995. In case of foreign portfolio investment a net outflow of resources was observed in 2008; though it was favorable in 1995. This phenomenon is consistent for all South Asian economies. It is notable that flow of portfolio investment can not be predicted on the basis of long term planning; it is directly associated with the current social, political and economic scenario of the country. So far as foreign direct investment inflows are concerned they are largely determined by the size of market, availability of work force and public policies. These factors are examined by a feasibility report before making the recommendations for investment. The size of foreign investment in South Asian bonds (debt) markets is negligible.

A comparison of the FDI in South Asian economies indicates that about 50 percent of the inflow of foreign investment is transferred to the outflow. The lower inflow of investment than its outflow is a reflector of the resource gaps. It indicates that South Asian countries require more foreign investment.

The share of total foreign direct investment is 8.5 percent in South Asia, while the world average is 12.5 percent. This share is 9.6 percent for India, 17 percent for Afghanistan and 18 percent for Pakistan. Over the period this share is increasing and shows a requirement of foreign investment in South Asian economies.

The magnitude of foreign direct investment in South Asia is $218 billion, which is less than 2 percent of world Foreign Direct Investment (FDI) stocks. It is an indictor that South Asia is not well-integrated with the global economy. Global FDI-to-GDP ratio is 22 percent; this ratio is 12 percent in case of South Asia, 21 percent for Pakistan and 10 percent for India.

South Asia invested only $82 billion at abroad; out of these $77 billion belong to India. Despite low magnitude of FDI at abroad (outward), it is interesting to note that India invested $48 billion for purchasing (Acquisition) of 466 foreign companies over the last three years; while foreign investors acquired 407 Indian companies for $18 billion in the same period. In case of Pakistan, where privatization of public owned business entities is in process, 24 companies were sold to foreign investors for $3 billion, and in the same time one foreign company was acquired for $2 billion.

Though, South Asian record shows a rosy picture in the number of International Investment Agreements (IIAs). More than 400 IIAs have been signed by South Asian Nations -161 by India and 104 by Pakistan. More than 90 percent of those IIAs are bilateral.

As, it was indicated that foreign direct investment largely depends on the size of market and public policies, where investment decisions are made in the feasibility reports, it was observed that opportunities are available in telecommunication, energy, transport and water and sanitation sectors. The recent history shows large private investment in these sectors.

Several observations from the monetary and fiscal environment indicate the disparities between South Asia and the other part of the world. Lower private sector investment in South Asia invites the need of foreign investment because of lower propensity to save. However, the conversion of South Asian currencies in term of purchasing power parity (PPP) indicates the soundness and power of the currencies, despite the economic weaknesses and inflationary pressures.

Structure of tax collection indicates zero collection on account of social contribution. As a result, all burdens are transferred to the direct and indirect taxes, which is a cause of higher tax rates in the region.

Table 2.5: Doing Business Indicators
(See Appendix II for Details)

Indicators	B' desh	India	Nepal	Pakistan	Sri Lanka	Low Income Economies	Middle Income Economies	High Income Economies	South Asia	World
Time Required to get Permission for Construction (Days)	231	195	424	223	214	291	209	169	241	216
Employment Rigidity Index	28	30	46	43	20	33	27	24	27	27
No. of Procedures to Enforce a Contract	11	46	39	47	40	39	39	35	44	38
Time Required to Enforce a Contract	1442	1420	735	976	1318	605	649	526	1053	607
Investors Protection (Disclosure Index)	6	7	6	6	4	5	5	6	4	5
Time required to Resolve Insolvency/ Closing (years)	4	7	5	2.8	1.7	3.8	3.1	2.1	4.5	3

Source: World Bank

Doing business indicators play the role of a catalyst in creating favorable environment for both domestic and foreign trading. An overview of these indicators shows there is no great variation among the South Asian nations. Pakistan is much better in the time required to enforce a contract, while India has advantage to protect investors and resolving insolvency issues (Appendix II for details).

In analyzing the major constraints in investment, it is interesting that despite negative reputation of Pakistan in corruption, the country has much better position in informal payments to public officials as compared to India and Bangladesh, where such payments are much higher. Pakistan has also a better position in spending of time to deal with taxation authorities, where information technology has minimized the role of tax officials. However, the losses due to theft, robbery, vandalism & arson and electric outage are much higher as compared to India. India has great advantages in the field of financing from banks for businesses, formal training for the workers and acquisition of internationally recognized certifications. No other South Asian country can compare Indian investors in these fields.

Table 2.6:Major Constraint in Investment

Indicators	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Time to deal with tax authorities as % of management time	3.2	6.7	6.5	2.2	3.5
Average No. of times to met with tax authorities	1.3	2.6	1.3	1..6	4.9
Time required to obtain operating license (Days)	6.0	-	14.5	16.4	49.5
Informal payments to public officials (% of firms)	85.1	47.5	15.2	27.2	16.3
Losses due to theft, robbery, vandalism & arson (% of sales)	0.1	0.1	0.9	0.5	0.5
Firms with female participation in ownership (% of firms)	16.1	9.1	27.4	6.7	-
Firms using banks to finance investment (% of firms)	24.7	46.7	17.5	9.7	26.2
Value lost due to electric outages (% of sales)	10.6	6.6	27.0	9.9	-
Internationally recognized quality certification (% of firms)	7.8	22.5	3.1	9.6	-
Average time to clear direct exports through customs (days)	8.4	15.1	5.6	4.8	7.6
Firms offering formal training (% of firms)	16.2	15.9	8.8	6.7	32.6

Source: Survey of enterprises

Chapter 03

Financial Cooperation & Free Trade Regime

A: Level Assessment of Development Stages in South Asia

It is notable that India, Pakistan and Bangladesh are three countries that are still at the first stage of development (Factors Driven) in comparison of economic development, while Sri Lanka is the only country from South Asia which has arrived at the 'Pre Efficiency Driven Transition Stage'. China has reached the 'Pre Innovation Driven Transition Stage', while the United States of America and many countries in Western Europe have attained the highest stage of Development- Innovation Driven.

Interpreting these development stages, it should be remembered that categorization of countries in these stages has been defined by the European Commission Joint Research Centre and World Economic Forum (2009). These rankings and classifications are based on several economic factors and development indicators. One should not, however, confuse these rankings with the famous 'five stage model' in Development Economics introduced by W. W. Rostow (Rostowian take-off model), which postulates that economic growth occurs in five basic stages of varying length:

1. Traditional society
2. Preconditions for take-off
3. Take-off
4. Drive to maturity
5. Age of high mass consumption

This model is one of the more structuralism models of economic growth, particularly, in comparison with the 'backwardness" model developed by Alexander Gerschenkron. Rostow argued that economic take-off must initially be led by a few individual sectors. This belief echoes David Ricardo's comparative advantage thesis and criticizes Marxist revolutionaries push for economic self-reliance in that it pushes for the 'initial' development of only one or two sectors over the development of all sectors equally. Though, this model has become one of the important concepts in the theory of modernization in the social evolutionism. However, in the modern age of globalization, now the countries are moving towards the higher stages of development in a much faster way. The stages defined by the World Economic Forum and European Commission Joint Research Center fulfill requirements to categorize the countries in development stages. In fact, the factors of development have been categorized in three classes:

1. The foremost factor of economic development belongs to primary resources including agricultural products, raw materials and human resources. These resources may be helpful in achieving the higher growth but up to limited level;
2. The second stage requires the efficiency in production by establishing good institutions, markets and physical infrastructure;
3. The last and third highest stage belongs to the knowledge based economy where research and technological advancements are the much required activities and main contributors to the economic development.

Table 3.1: Stages of Economic Development

	1		2		3
	Factors Driven	Transition	Efficiency Driven	Transition	Innovation Driven
Bangladesh	X				
India	X				
Pakistan	X				
Sri Lanka		X			
China			X		
USA					X

On the basis of this classification Pakistan, India and Bangladesh are at the first stage which is based on the availability of resource. However on the basis of Rostow's growth model India and Pakistan have passed through the second stage – preconditions of take off in 1951 and now they are ready to take off.

Table 3.2: Macro Economic Status of South Asian Nations

Variables	Bangladesh	India	Nepal	Pakistan	Sri Lanka	South Asia	World
Gross Domestic Product (B $)	79.6	1159	12.6	164.5	40.6	1470	60521
Gross National Income (B $)	83.4	1186.7	11.5	157.3	35.8	1487	57960
Gross National Income (Per capita $)	520	1040	400	950	1780	963	8654
Gross National Income at PPP (B$)	232.4	33933	32.1	429.9	89.9	4163	69749
Population below poverty line (%)	40	28.6	30.9	32.6	22.7	--	--
Income Inequality (Gini coefficient)	31	36.8	47.3	31.2	41.1	--	--
Current Account balance as % of GDP	2.8	-2.7	--	-5.1	-1.4	--	--
Foreign Exchange Reserves (M $)	10225	266166	--	11434	5578	--	--
Annualized GDP Growth (1990-2000)	4.8	5.9	4.9	3.8	5.3	5.5	2.9
Annualized GDP Growth (2000-08)	5.8	7.9	3.5	5.4	5.5	7.3	3.2
Annual change CPI 2000-09	6.7	4.8	5.6	7.1	11	--	--

Source: National Economic Surveys

The comparison of South Asian economies by macroeconomic indicators clearly indicates that South Asia is far below than world averages and it caters a frictional part of world economic growth. South Asian contribution to the world trade is less than 10 percent while its share in World GDP is less than 5 percent (this contribution is much lower in global investment, market capitalization and equities, which is less than 3 percent though the rate of growth in South Asia GDP is higher than world's average. The sources of output indicate that share of agriculture in South Asia is higher (about 20 percent) as compared to world average (2 percent). This contribution is consistent in almost all South Asian economies including India and Pakistan. It indicates the reason for placing India, Pakistan and Bangladesh at the earlier stage of development; these economies are largely based on the natural resources.

Table 3.3: Structure of Output

	Agriculture	Industry	Manufacturing	Services
	% of GDP			
Bangladesh	20	28	17	52
India	18	28	16	55
Pakistan	19	27	19	53
Sri Lanka	16	27	14	56
South Asia	18	28	17	54
Low Income Group	20	28	16	52
High Income Group	2	26	17	72
World	3	28	18	69

Source: National Economic surveys

Though, India's economy has grown more rapidly than Pakistan's in the last ten years. However, both nations have accepted and implemented significant economic reforms that have opened up their economies and made rapid growth, more than doubling the size of each economy.

Table 3.4: Growth of Output

	Agriculture	Industry	Manufacturing	Services
Bangladesh	2.8	7.7	7.3	5.8
India	2.7	8.0	7.7	8.9
Pakistan	2.5	7.9	10	6.1
Sri Lanka	1.2	4.4	3.5	6.3
South Asia	2.7	7.9	7.8	8.2
Low Income Group	3.1	7.6	7.7	7.6
High Income Group	0.5	1.4	1.8	2.4
World	2.5	2.6	2.9	2.8

Source: National Economic Surveys

The level of globalization (in term of share of foreign trade in GDP) of the two nations though remains well below than China's; both India and Pakistan have made significant strides in this direction. In Pakistan, exports account for less than 15 percent of GDP, compared with about 25 percent in India and 40 percent in China; both countries continue to run large budget deficits. The banking sectors in both nations have seen major improvements in the delivery of new services/products. India and Pakistan have ranked 31 and 34 respectively, among 52 countries in the World Economic Forum's first Financial Development Report. Both nations are ranked ahead of the Russian Federation (35), Indonesia (38), Turkey (39), Poland (41), Brazil (40), Philippines (48) and Kazakhstan (45). But, Pakistan's HDI ranking dropped by 3 places from 138 last year to 141 this year, whereas India slipped six places from 128 in 2008 to 134 this year.

According to World Food Program, Pakistan fares significantly better than India on the hunger front. One out of very two hungry persons in the world is an Indian. According to UNDO, 42 percent of Indian population earns $1.25 per day, while 23 percent Pakistanis are included in this category. The reason for higher levels of poverty in India (in spite of its rapid economic growth) is the growing rich-poor disparity. Gini Index measuring rich-poor gap for India is at 36, higher than Pakistan's 30. It is notable that 'Gini index' is defined as a ratio with values between 0 and 100: a high Gini index indicates more unequal distribution. It has been shown in a report that about 200,000 farmers committed suicides during last 10 years in India mainly because of two reasons:

(1) Excess commercialization of agriculture production, and/or
(2) Unbearable burden of debts

Even in the years 2008 - which was a popular year for exemption of debt repayments for farmers – 16,196 farmers committed suicides (according to an Indian newspaper, "Hindu"); while 16,632 farmers committed suicides in 2007 (according to the National Crimes Record Bureau of India). The report also indicates that suicides in non agricultural sector are 10 times more as compared to agriculture sector. Indian growers have to spend huge funds on seeds, equipments and fertilizes etc. This is a clear indicator of dual economy in India.

There is no such type of situation in rural Pakistan, because their system is not based on much debt financing, and in most of the cases political shelter provides economic protection to the landlords. This protection transfers all burden of taxes to the urban economy. Consequently, today's Pakistan is a country where corporate tax rates are highest in the world. The rate of income tax for higher income bands is also one of the highest rates in the world, while tax-to-(GDP) ratio is only 9 percent, which is one of the lowest in the world. This indicates that number of tax payers are lower but tax rates are higher. This analysis reflects difference in the prioritization of economic strategies between India and Pakistan. Urban economy in India is considered as an engine of the growth so all emphasizes are given to the urban development and it is assumed that development of big urban centers will also lead to the rural development by allocation of resources and commercialization in rural economy.

On the contrary, policy makers in Pakistan have been focusing to facilitate rural areas by adopting a balanced growth model. Consequently, the rate of growth in the size of middle class population in Pakistan is higher than India. Last year, the Asian Development Bank (ADB) released a report on the Asia's rising middle class that indicates Pakistan middle class has grown to 40 percent of the population, significantly larger than the Indian middle class of about 25 percent of its population, and it has been growing faster than India's middle class. Foreign visitors to Pakistan see on the ground, of course where the reality is different and first-time visitors to Pakistan are almost always surprised by the country's visible prosperity. Middle-class Pakistani houses are often bigger and better appointed than their equivalents in India. Moreover, the Pakistani economy is undergoing a construction and consumer boom. Effects can be seen everywhere: in new shopping centers and restaurant complexes, in the hoardings for the latest laptops and iPods, in the cranes and building sites, in the endless stores selling mobile phones.

India is ranked at 66th on the 2008 Global Hunger Index of 88 countries while Pakistan is slightly better at 61st and Bangladesh slightly worse at 70th. According to the first India State Hunger Index (ISHI) report (2008), Madhya Pradesh is facing the worst level of hunger in India as compared to Chad and Ethiopia; while Punjab, Kerala, Haryana and Assam are also included in the 'serious' category. Though the affluent state of Gujarat is ranked at 13th on the Indian list, it is below than Haiti, ranked 69th in the world. The authors of ISHI have mentioned India's poor performance was primarily due to its relatively high levels of child malnutrition and under-nourishment resulting from calorie deficient diets. Though the nutritional status has improved in both nations – India and Pakistan, there are still very high levels of malnutrition, particularly among children. In spite of the fact, Pakistan suffers from nearly 22 percent in child malnutrition being much higher at 40 percent (versus India's 46 percent); the average per capita calorie intake of about 2500 calories is within normal range. But the nutritional balance necessary for good health appears to be lacking in Pakistanis' dietary habits.

Another basic indicator of healthcare is access to physicians. There are 80 doctors per 100,000 people in Pakistan versus 60 in India, according to the World Health Organization (WTO). For comparison with the developed world, the US and Europe have over 250 physicians per 100,000 people. Similarly, life expectancy at birth in Pakistan is 66 years versus 63 years in India, according to the report released by the United Nations Development Program (UNDP).

Although India has about 270 million illiterate adults, its overall literacy ratio is higher than Pakistan's. The estimated number of illiterate adults in Pakistan is 47 million, fourth largest in the world after India's 270 million, China's 71 million, and Bangladesh's 49 million. But India is better than Pakistan in higher education. In this category, six Indian universities have made the list of top 400 universities while only one Pakistani university was considered worthy of such honor - National University of Science and Technology (NUST) ranked at 350. In response to growing concerns about the nation lagging in higher education achievement, Pakistan launched Higher Education Reforms led by Dr. Ata ur Rahman. This reform resulted in over fivefold increase in public funding for universities, with a special emphasis on science, technology and engineering. The reform supported initiatives such as a free national digital library and high-speed Internet access for universities as well as new scholarships enabling more than 2,000 students to study abroad for PhD — with incentives to return to Pakistan afterward. The years of reform have coincided with increases in the number of Pakistani authors publishing in research journals, especially in mathematics and engineering, as well as boosting the impact of their research outside Pakistan.

It is one of the most important points of the study that deterioration in macroeconomic indicators and infrastructure in Pakistan including present energy crisis shows only one side of the picture about the shortage of energy and available resources. This one side picture does not show the reality of crisis. As we have concluded (see the part II of this study) crisis does not reflect the shortage of energy or material resources which are available in the country and economy is working at less than 50 percent of available and installed capacity. Hence, it is the issue of governance, not the shortage of resources.

Per capita energy consumption is a yardstick commonly used to measure the economic progress of a nation. Per capita energy consumption in Pakistan is estimated at 14.2 million (BTU), which is much higher than Bangladesh's 5 million (BTUs), but slightly less than India's 15.9 million (BTUs). However, South Asia's per capita energy consumption is only a fraction of other industrialized economies in Asia, which is 56.2 million (BTUs) in China, 58 million (BTUs) in Thailand, and 104 million (BTUs) in Malaysia. Americans consume 352 million (BTUs) per capita. For interpretation, it is notable that these statistics are based on report released by the US Department of Energy in the mid of last decade. With 40 percent of Pakistani households that have yet to receive electricity, and only 18 percent of the households that have access to pipeline gas, the energy sector is expected to play a critical role in economic and social development. With this growth comes higher energy consumption and stronger pressures on the country's energy resources. At present, natural gas and oil supply the bulk (80 percent) of Pakistan's energy needs. However, the consumption of those energy sources vastly exceeds the supply. For instance, Pakistan currently produces only 18.3 percent of the oil it consumes, fostering a dependency on imports that places considerable strain on the country's financial position. On the other hand, hydro and coal are underutilized resources, as Pakistan has ample potential supplies of both.

Table 3.5: Comparison of Business Competitiveness in South Asia

	Overall Index		Basic Requirements		Efficiency Enhancers		Innovation Factors	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Bangladesh	107	3.64	114	3.71	97	3.62	109	3.01
India	51	4.33	81	4.30	38	4.42	42	3.96
Pakistan	123	3.48	132	3.39	95	3.66	76	3.38
Sri Lanka	62	4.25	73	4.42	69	4.01	40	3.97

Source: Global Competitiveness Report

These development indicators provide sufficient justifications to understand the root causes of placing South Asian countries at the initial stage of development. Policy makers and political leaders in Pakistan have been focusing on the ideological advancements, cultural development and geopolitical strategies, while economic development has been a most concerned area in India. However, the development indicators of Indian economy do not reflect the transfer of macroeconomic development to the social development. A much deeper strategic depth for economic development is available in Pakistan, which may lead the sustainable growth in future. But, it is subject to the change in governance to allow economic freedom in Pakistan.

B: Comparison of Financial Policies

Over the last two decades, it was observed that all the economies in South Asia are opening their borders for investment mobilization. Since 1991, Indian government has focused on investment-led economic growth, when a debt crisis forced it to undertake market oriented economic reforms. India has gradually moved from a closed economy, with heavy central planning, to a more privatized economy with lower tariff. This reform resulted in 7 percent growth rate for the economy, which was less than 3 percent before reforms. Consequently, foreign investment in India also increased significantly in this period. India's chief political rival, Pakistan, is openly seeking new investment opportunities from countries in Middle East, China, the European Union (EU) and Japan. Nepal and Sri Lanka, both reliant on the Indian economy as a supplier and market for goods, would like to increase intra regional trade and foreign investment in their developing industries. Similarly, Bangladesh is also looking for new investment opportunities. SAARC Chamber of Commerce and Industry and other think tanks representing new economic liberalism have strongly recommended the promotion of cross border investment among South Asian countries.

Table 3.6: Economic and Financial Strength

Economy	Share in world GDP	Rank in GDP at PPP	Stage of Development	Financial Strength (Ranks)
Bangladesh	0	45	1	NA
India	6	3	1	30
Iran	1	17	1-2	NA
Nepal	0	88	1	NA
Pakistan	1	27	1	51
Sri Lanka	0	63	1-2	NA
China	14	2	2	39
UK	3	8	3	17
USA	19	1	3	5
Hong Kong	0	36	3	1

No doubt, strong and sustainable financial linkages are required to promote flow of cross border investments in South Asian countries. However, before recommending a financial integration model, a review and comparison of present status of the South Asian capital markets is required. Though, distribution of financial assets, stock market indicators and valuation of assets in the stock market are sufficient to compare the capital markets in South Asian countries, the study of factors of financial sector development is also important to analyze causal relations between capital markets and financial environment and policies.

Table 3.7: Distribution of Financial Assets

Type of Financial Assets	Bangladesh	India	Pakistan	China	UK	USA	Hong Konh
Public Debt Securities (Billion $)	33.6	82.14	89.7	972.6	1801.3	9123.7	95.5
Private Debt Securities	0.0	151.3	0.0	1478.6	3349.7	21162.9	119.3
Banking Deposits	50.6	1128.8	56.7	10340.8	4046.0	11175.3	715.4
Equity Securities	15.7	1615.9	38.2	4762.8	3107.0	17139.0	1079.6
Total Financial Assets	100.0	3717.3	184.5	17554.8	12304.0	58600.9	2009.9

First of all, it is important that there is a great variation between India and Pakistan – two major economies in the South Asia – in the distribution of financial assets. Fairly large part of financial assets in India belongs to the equity market; in Pakistan, public debt is the largest part of financial assets; while the major part of financial assets in Bangladesh is in the form of bank deposits. The higher magnitude of public debt securities accompanied with the higher rate of corporate taxes in Pakistan reflects the public borrowing by the government of Pakistan to finance its budget deficit. It is interesting that share of equities securities in total financial assets is about one-third in Pakistan and USA; while it is about 50 percent in case of India and China, which is against the common intuitive that people in these countries do not prefer to invest in risk free instruments like bonds and bank deposits.

Table 3.8 Economic and Financial Liberalization

Country	Bangladesh	India	Iran	Nepal	Pakistan	Sri Lanka	China	UK	USA	Hong Kong
Commitment to WTO Agreement on	55	55	NA	NA	55	NA	26	1	1	30
Cap Acc Liberalization	60	55	NA	NA	54	NA	49	1	1	1
Domestic financial sec liberalization	NA	50	NA	NA	49	NA	42	1	1	1
Financing Credit Eases (Rank)	98	38	141	91	65	88	50	48	20	7
Financing Equity (Rank)	42	19	65	44	54	2	46	8	18	1
rules governing foreign direct investment (FDI) encourage (Rank)	26	62	127	111	95	35	41	13	64	4
Prevalence of foreign ownership (Rank)	117	84	144	140	119	48	99	4	51	5

Source: National Economic Surveys

The magnitude of South Asian stock markets is less than 0.5 percent of global stock markets in term of market capitalization, which indicates its extremely lower contribution to global corporate financing activities. Obviously, this share has no consistency with the share of South Asia in global population and geo-economic resources. In South Asia, only India covers about 95 percent of South Asian equity markets, while Pakistan and Bangladesh are other partners and Sri Lanka has grown over the last decade. The other

South Asian countries have negligible size. South Asia has lower than world average market capitalization to (GDP) ratio, value of shares traded as percentage of (GDP) and value of shares traded as percentage of market capitalization.

Though Indian equity market is bigger in terms of the number of stock exchanges, but trading activities are highly concentrated in Mumbai Stock exchange. Trading activities are concentrated in Karachi Stock Exchange in case of Pakistan, where demutualization and merger of the stock exchanges are in process. South Asia has more than 6000 listed companies but over the last decade a delisting trend was also observed in India and Pakistan.

Table 3.9: FDI Flows, by Region and Economy, 2006-2011

	(Millions US $)											
	2006	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010	2011
World	1463351	1975537	1790706	1197824	1309001	1524422	1415094	2198025	1969336	1175108	1451365	1694396
South Asia	27919	34695	52869	42370	31746	38942	14812	20070	19756	16403	13605	15234
Afghanistan	238	189	94	76	211	83	-	-	-	-	-	-
Bangladesh	792	666	1 086	700	913	1 136	4	21	9	29	15	9
Bhutan	72	3	7	18	16	14a	-	-	-	-	-	-
India	20328	25506	43406	35596	24159	31554	14285	19594	19257	15927	13151	14752
Iran Islamic Republic of	1647	2005	1909	3048	3648	4150	386	302	380	356	346a	360a
Maldives	95	126	174	152	212	282	-	-	-	-	-	-
Nepal	- 7	6	1	39	87	95	-	-	-	-	-	-
Pakistan	4273	5590	5438	2338	2022	1327	109	98	49	71	47	62
Sri Lanka	480	603	752	404	478	300a	29	55	62	20	46	50a

Source: World Investment Report-2012

The most important observation from recent past is Pakistani stock market that has lower 'P/E multiplier' and price-to-book value ratios as compared to India and other Asian markets. It indicates that securities listed at Pakistani stock market are undervalued, and room is available to invest in this market where appreciations in securities' prices are expected. Though, Pakistani market has witnessed the higher volatility market capitalization and value of shares traded over the last decade; the stock valuation in terms of 'P/E multiplier' and 'price to break up value ratio' show that Pakistani equities are being sold at lowest value in the region, while Indian equities have higher valuation ratios. If we relate this phenomenon with the value of shares traded as percentage of market capitalization, it can be corroborated that selling pressure in Pakistani market affects the stocks' value more drastically.

The ranking of countries on the basis of their financial development stages indicates that India is leading in South Asian markets in all the components of financial development except financial stability where Bangladesh has a better position. The overall financial development has been assessed on the basis of overall 'Financial Development Indexes' constructed by the World Economic Forum (WEF). 'Financial Development Index' is a composition of seven pillars including: institutional environment, business environment, financial stability, banking financial services, none banking financial services, financial markets and financial access.

Table 3.10: FDI Stock, by Region and Economy, 1990, 2000, 2011

	(Millions US $)					
	FDI inward stock			FDI outward stock		
	1990	2000	2011	1990	2000	2011
World	2081147	7450022	20438199	2092927	7952878	21168489
South Asia	6795	29834	270890	422	2949	116141
Afghanistan	12a	17a	1 475a	-	-	-
Bangladesh	477a	2 162	6 166	45a	69	107
Bhutan	2a	4a	177a	-	-	-
India	1657	16339	201724	124	1733	111257
Iran	2039a	2597a	32443	0a	572a	2915a
Maldives	25a	128a	1372a	-	-	-
Nepal	12a	72a	348a	-	-	-
Pakistan	1892a	6919	21876	245a	489	1432
Sri Lanka	679a	1 596	5 308a	8a	86	430a

Source: World Investment Report- 2012

Institutional environment, business environment and financial stability represent the factors, policies and institutions directly concerned with the policy makers. Banking financial system, non-banking financial system and financial markets reflect the financial intermediations that represent the role of financial institutions, while financial access is concerned with the end users of capital, which is mainly the corporate sector of the economy.

C: Means of the Regional and Global Integration

Global economic growth, reducing economic disparities, bridging the gap between nations and achieving the world peace are considered complementariness of free trade and the liberalization polices. One of the common and desirable objectives of globalization and free trade regime reduction of global disparities in human welfare and development by interaction of the people in a free world.

Table 3.11: South Asian Economies in Global Context at Present: Selected indicators of FDI and international production, 1990–2011

(Billions US $)					
Item	1990	2005–2007 Average	2009	2010	2011
FDI inflows					
	207	1 473	1 198	1 309	1 524
FDI outflows	241	1 501	1 175	1 451	1 694
FDI inward stock	2 081	14 588	18 041	19 907	20 438
FDI outward stock	2 093	15 812	19 326	20 865	21 168
Income on inward FDI	75	1 020	960	1 178	1 359
Rate of return on inward FDI	4.2	7.3	5.6	6.3	7.1

Income on outward FDI	122	1 100	1 049	1 278	1 470
Rate of return on outward FDI	6.1	7.2	5.6	6.4	7.3
Cross-border M&As	99	703	250	344	526
Sales of foreign affiliates	5 102	20 656	23 866	25 622	27 877
Value added (product) of foreign affiliates	1 018	4 949	6 392	6 560	7 183
Total assets of foreign affiliates	4 599	43 623	74 910	75 609	82 131
Exports of foreign affiliates	1 498	5 003	5 060	6 267	7 358
Employment by foreign affiliates (thousands)	21 458	51 593	59 877	63 903	69 065
Memorandum					
GDP	22 206	50 411	57 920	63 075	69 660
Gross fixed capital formation	5 109	11 208	12 735	13 940	15 770
Royalties and license fee receipts	29	156	200	218	242
Exports of goods and non-factor services	4 382	15 008	15 196	18 821	22 095

Source: UNCTAD

Though, acceleration in the movement of capital was observed in last decade, the targeted goal of the movement of labor does not show a brilliant picture. Several economies are developing their policies to ensure mobilization of capital; and these policies have been reflected in the growth of inflow and outflow of investments over the last decade. Multi National Corporations, international donors, funding agencies, and fund managers are representatives of the mobility of entrepreneurships. The mobility of land though is not possible; corporate farming, involvement of transnational corporations in the exploration and marketing of mineral resources, international builders, developers and construction companies are serving to achieve utilization of the land resources on equal footing. The most problematic area belongs to the mobilization of labor. The growing issues of law and order situations, cultural clashes, human trafficking, and terrorism are the obstacles in the way of free mobility of labor, which are being mentioned by the policy makers. These issues led to the restrictions on migration and visit visas.

Table 3.12: FDI Contribution Index, by host region, 2009
(Percentage shares in each variable's total for the region)

Region/economy	Value added	Employment	Exports	Tax revenue	Wages and salaries	R&D expenditures	Capital expenditures
All Developed countries	12.7	7.5	19.3	13.9	14.6	24.2	10.5
All Developing economies	12.2	7.9	17.3	14.6	15.4	24.1	11.6
Africa	21.7	7.3	..	..	21.7	37.2	18.4
East and South-East Asia	10.5	9.9	30.9	7.7	8.9	22.5	6.2
South Asia	10.3	6.1	..	..	16.0	..	3.8
West Asia	16.8	5.5	1.9	..	15.0	..	3.8
Latin America and the Caribbean	15.9	6.0	17.9	18.9	16.0	35.0	14.8
Transition economies	21.7	3.0	..	..	11.2	15.4	25.7

Source: UNCTAD

It was observed over the last decade that the rates of growth in (GDP), merchandizing trade, trade in services and mobilization of capital have no consistency with the growth in international migration stock. 14 percent growth in foreign direct investment (FDI), about 6 percent growth in (GDP) and 9 percent growth in trade do not reflect the impact of free trade and globalization regime on the mobility of labor. The more astonishing fact is annualized growth in the workers' remittances and compensation received in labor exporting countries that are much higher than annualized growth in the workers' remittances and compensation paid by the host countries. It is an indicator that immigrant workers are now in the process of returning to their countries of origin because they are transferring their savings to their homelands.

Table 3.13: FDI flows, by region, 2009–2011

(Billions US $ and %)						
	FDI inflows			FDI outflows		
	2009	2010	2011	2009	2010	2011
World	1 197.8	1 309.0	1 524.4	1 175.1	1 451.4	1 694.4
Developed economies	606.2	618.6	747.9	857.8	989.6	1 237.5
Developing economies	519.2	616.7	684.4	268.5	400.1	383.8
Africa	52.6	43.1	42.7	3.2	7.0	3.5
East and South-East Asia	206.6	294.1	335.5	176.6	243.0	239.9
South Asia	42.4	31.7	38.9	16.4	13.6	15.2
West Asia	66.3	58.2	48.7	17.9	16.4	25.4
Latin America and the Caribbean	149.4	187.4	217.0	54.3	119.9	99.7
Transition economies	72.4	73.8	92.2	48.8	61.6	73.1
Structurally weak and small economies a	45.2	42.2	46.7	5.0	11.5	9.2
LDCs	18.3	16.9	15.0	1.1	3.1	3.3
LLDCs	28.0	28.2	34.8	4.0	9.3	6.5
SIDS	4.4	4.2	4.1	0.3	0.3	0.6
Memorandum: percentage share in world FDI flows						
Developed economies	50.6	47.3	49.1	73.0	68.2	73.0
Developing economies	43.3	47.1	44.9	22.8	27.6	22.6
Africa	4.4	3.3	2.8	0.3	0.5	0.2
East and South-East Asia	17.2	22.5	22.0	15.0	16.7	14.2
South Asia	3.5	2.4	2.6	1.4	0.9	0.9
West Asia	5.5	4.4	3.2	1.5	1.1	1.5
Latin America and the Caribbean	12.5	14.3	14.2	4.6	8.3	5.9
Transition economies	6.0	5.6	6.0	4.2	4.2	4.3
Structurally weak and small economies a	3.8	3.2	3.1	0.4	0.8	0.5
LDCs	1.5	1.3	1.0	0.1	0.2	0.2
LLDCs	2.3	2.2	2.3	0.3	0.6	0.4
SIDS	0.4	0.3	0.3	0.0	0.0	0.0

Source: UNCTAD

It is another notable observation from the world economy that though the number of tourists has increased by 52 percent from 1995 to 2008; per capita tourist expenditures have declined steeply. More important observation is expenditure on tourism as percentage of spending on imports has significantly declined over the last decade. It reflects change in the patterns of household expenditures. Though, it was expected globalization will lead higher spending on the international travel and tourism activities, but growth in the household spending on such activities is lesser than growth in other economic activities, which is against common perception.

It is a common intuitive that spending on the international travelling may lead the higher earnings and households' economic development. The reduction in the share of this expenditure may deteriorate growth in the households' incomes. At the same time, it was also noted the share of developed countries in income from tourism has declined over this period. The share of high income economies in international receipts from tourism was 81 percent in 1995 that dropped at 72 percent in 2008.

Table 3.14: Barriers in Integration

Economy	Prevalence Trade Barriers (Rank)	Weighted average tariff rate	Inflation Rate (CPI)	Total Tax Rate (%)	No of Procedures Required to start business	Time Required to start business (Days)	Redundancy costs in weeks of salary
Bangladesh	81	13.1	10.7	35	7	19	31
India	78	12.6	8.6	61.8	12	29	16
Iran	125	25.6	21.3	44.1	6	8	23
Nepal	120	16.4	9.6	31.5	7	29	27
Pakistan	114	16.5	13.7	35.3	10	21	27
Sri Lanka	101	11.7	6.7	105.2	4	35	59
China	79	11.5	5.4	63.5	14	38	27
UK	13	0.9	4.5	37.3	6	13	8
USA	50	1.4	3.1	46.7	6	6	0
Hong Kong	4	0	5.3	23	3	3	6

What are the causes of reduction in the share of high income economies in receipts from tourism, lower per capita spending on tourism and travelling activities, and declining ratio of outbound tourism expenditures as percentage of imports? It is obvious that sustainable causes of migration are economic, but determinants of migrants are not the only factors of migration; determinants of migration policies adopted by the host countries are also important. The host countries' visa policies are one of the major determinants of migration, and the hosts' policies depend on their own requirements. These requirements can be classified into four broad categories:

1. Inflow of investment with the immigrants
2. Inflow of required (skilled or unskilled) labor with immigrants
3. Creating gender equality
4. Maintaining required ratio of youth in the population

Now, it has been realized in the economic literature that higher population is not always a source of deterioration in economy. The higher population by maintaining a required capital-labor ratio in economy can accelerate the economic growth. The major issue in developed countries is not higher growth of population; it is the skewed distribution and growth unequal gender ratio or decreasing ratio of young people in the population. There were 6 percent old aged persons in the world population in 1980, while at present the ratio of old age persons is 8 percent in developing countries and 18 percent in developed countries. It is estimated that in 2025 this rate will reach at 18 percent.

Table 3.15: Global Linkages among the People

Indicators	Bangladesh	India	Nepal	Pakistan	Sri Lanka	SA	World
Net Migration (000)	-700	-1540	-100	-1239	-442	-3181	--
International Migration Stock as % of total Population	0.7	0.5	3	2.3	1.9	0.8	3
Immigrants with Territorial education in OECD % of Age 25 +	4.4	4.3	4	12.7	28.2	5.3	5.4
International Voice Traffic (Minutes per Person)	6	--	--	--	34	--	--
Internet Bandwidth Bits Seconds per Person	4	32	5	43	190	31	3546

No doubt, the priorities of immigrants by host countries on the basis of their capital adequacy and skills will enhance the rich-poor gap in global economy, but this is not the darkest side of the picture. The darkest side of the picture is the prioritization of labor on the basis of their origin. Given the past and current situations, the expected deterioration in law and order situation, clashes among cultures and the 'vote bank politics' play an important role in determining the host countries' policies for migration. Such policies create severe biasness in the visa and migration policies.

The great variations in the freedom of travelling among the people of various countries can be analyzed on the bases of visa restrictions by other countries. No doubt, visa restrictions play an important role in controlling the movement of foreign nationals across the borders; there is no need to mention that people of under developed nations are losers of visa restriction policies. It creates an unequal playing field for the mobility of labour.

It is a common justification in favour of restrictive visa and tight work permits policies that higher number of immigrant stocks may lead to cultural clashes and unrest in the societies of host countries. Empirical observations clearly reject this hypothesis. It was noted that countries which have higher ratio of immigrant stocks in their population do not have internal clashes (like Qatar, Kuwait, UAE, Singapore and Hong Kong etc); while the ratio of immigrant stock is negligible or much lower in the countries which are facing worse law and order situations; social unrest and ethnic, sectarian or cultural clashes (like Afghanistan, Iraq, Nigeria, Sudan, Sri Lanka and Pakistan).

It is quite obvious that benefits of globalization cannot be achieved without free mobilization of people and migration of labor. The protection of domestic labor in the host countries has also become an important issue after WTO Ministerial Conference in Seattle. The labor protection policies may create unnecessary tightening in the work permit policies, which may lead towards the higher costs of labor in the developed countries. The outflow of capital from the developed countries and investment in the developing world are natural consequences of restrictive visa and work permit policies. This may also lead to improvement in the trade balance of developing world. However, it will not be a sustainable policy; ultimately free mobilization of labor will have to be allowed.

Another notable aspect of the migration stock is its effects on the trade between labor exporting and host countries. Recent economic studies suggest that migration and trade integration affecting development are closely linked to one another. Migrants promote the host countries' products in their native countries. Though, migration improves trade relation also at the export front; the empirical results show that role of migration stock is more significant in promoting the exports from host country to the country of origin of migrants. The inducement of cultural relations and interaction among the people of partner countries is the most important aspect of trade enhancement. The interaction between the people promotes the trade, while reduction in disparities between the nations, accelerated development of the institutions and the growth of economic activities are ultimate outputs of trade enhancement.

It is an astonishing side of the migration policies that they lead more concentration of wealth because of several factors. On determinants of migrants' side, the initial cost and risks involved in migration discourages low income groups to migrate. On the host countries' side, the requirement of investable funds and assessing economic status of intended migrants discourages the lower income classes. Consequently, the benefits of migration will be gone to the privileged and affluent people of a country that may lead to further disparities in wealth distribution.

To reduce rapidly growing disparities and to achieve the benefits of globalization, restrictions on visas should not be used to stop mobility of people. However, it should be for record keeping purposes only. The monitoring of mobility and tracking should be allowed for security purposes but movement of people should not be restricted.

D: Towards the New Public Management and Lean Government

The study concludes that without development of present infrastructure the economic policies will not work. The indicators of trade, monetary and fiscal policies show that deteriorated public infrastructure is one of the major causes of policy failure in Pakistan.

The present structure of public financing in Pakistan cannot provide the resources for development funding; restructuring is required in all public sector institutions even if they are privatized. Pakistan Railways, Steel Mills, PIA, and energy producing services including big projects require huge finance. These projects neither can be financed nor governed by the government. Managing these institutions by the civil servants can mislead the objectives of the civil services institutions; and unnecessary involvement of those civil servants who do not have their background in managing the commercial services can result in a drastic failure.

During recent years, the responsibility of economic development has largely been shifted on corporate sector from the governmental agencies. The responsibilities of every type of development are being shifted from bureaucrats to technocrats. The political roles and pressures of the armed forces, business leaders, international consultants, technocrats, and community leaders are being re-shaped. In the present transitory condition, the role and responsibilities of civil servants are also being changed. The financial markets experiences in the Far Eastern and South American countries in recent past have shown that the problems of corporate sector are not only the problems of investors, speculators and stockbrokers, but they are also the problems of a common man. The financial problems in corporate sector cannot be segregated from the problems of unemployment, income distribution, poverty and development.

Several studies in the context of Pakistan concluded and there are several surveys which indicate that business competitiveness cannot be achieved within the present system. It is highly recommended that management of public sector enterprises should be changed by adopting new management policies and lean government where not only investment activities but governance of the public goods and facilities should also be changed. The tabulation of data and survey responses presented in the appendixes show that economic and governance experts are in favor of change in the present structure of governance of public sector institutions.

Table 3.16: Competitiveness Scores in Public Policy Related Fields

Country	Overall Business Competitiveness Index	Institutional Governance	Infrastructure	Macroeconomic Stability	Health &Primary Education	Higher Education
Pakistan	3.77	3.66	3.22	4.37	4.09	2.72
India	4.33	4.32	3.45	4.21	4.92	4.13
Bangladesh	3.55	2.87	2.19	4.62	4.71	2.47
Sri Lanka	3.99	3.85	3.21	3.71	5.65	3.77
France	5.18	5.09	6.46	4.93	6.31	5.38
Italy	4.36	3.77	3.91	4.46	6.08	4.55
Germany	5.51	5.83	6.65	4.93	5.88	5.33
Nepal	3.38	3.1	1.96	4.64	4.46	2.65
United Kingdom	5.41	5.31	5.71	5.18	6.16	5.42
United States	5.67	4.76	6.1	4.78	6.00	5.68

The sustainability of free trade regime is closely associated with the cross border mobilization of capital, labor, entrepreneurship and utilization of land. So, free mobilization of the factors of production cannot be restricted in implementation of free trade policies. Free trade policy requires business competiveness, while free mobility of the factors of production is a necessary condition to achieve sustainable competitiveness in global environment. Trade facilitation, currency convertibility, and uniformity in the accounting standards and regulatory frameworks are the peripheral steps of a sustainable free trade policy.

In consequence of a generalized acceptance of free trade regime, the national economies have initiated to change their policies to synchronize with the globalization. There are several examples of amendments in the rules and regulations to deal with the flow of foreign capital and investment in the new scenario. Australia removed the 25 percent limit on individual foreign investors in Qantas and a 35 percent cap for total foreign airlines holdings. Brazil raised the limit of foreign participation in the capital of Banco do Brasil -a state-owned bank- from 12.5 percent to 20 percent. Malaysia increased the foreign shareholding threshold from 49 percent to 70 percent for insurance companies and investment banks, allowed full foreign ownership in the wholesale segment of fund management, and deregulated the purchase of real estate by foreigners. Qatar liberalized foreign investment in a number of sectors, including consultancy services, information technology, services related to sports, culture and entertainment, and distribution services. The Syrian Arab Republic now allows foreign majority ownership in the banking sector of up to 60 percent, subject to certain conditions. Indonesia abolished the monopoly of the state electricity company on the supply and distribution of electricity – paving the way for private domestic and foreign investment. India introduced a "Consolidated (FDI) Policy" circular, which combines in one document all the prior policies and regulations on (FDI) in an effort to make (FDI) policies more transparent, predictable, simpler and clearer. The Libyan Arab Jamahiriya adopted an investment promotion law which encourages national and foreign investment projects in accordance with national development strategies. The Russian Federation amended its Law on Special Economic Zones to reduce the minimum investment threshold, widen the list of permitted business activities, and simplify land acquisition and administration procedures. Rwanda improved its laws on company formation, organization, registration and operations, and simplified its business start-up procedures. Despite a remarkable global trend towards further investment liberalization, instances of trade protectionism are frequently being observed in the present scenario. Such protectionist policies can affect flows of foreign investment indirectly.

The free mobilization of goods and services and across the borders flows of investment argue that a large part of the responsibility of economic development has now been shifted to corporate sector from the public sector institutions, while the entire structure and growth of the corporate sector depends on the transparent and prudent financial system. In this contemporary scenario, an incorrect judgment regarding the financial patterns in corporate sector may be a cause of heavy distortion in the society by means of volatilities in the stock markets, drop out in employment opportunities, unusual distribution of income, and demand-supply gap in the commodities' markets. In the present economic structure, overall economic growth depends on the performance of corporate sector, while the financial resources of corporate sector are determined by the performance, gravity and strength of the financial markets in a country.

It is interesting and extremely important that permissibility of the mobilization of capital among some economies is closely associated with the political strategies, particularly among the countries where apprehensions are reflected in the historical relations. In the context of South Asia, Indo-Pakistan economic relation is one of the most appropriate examples. This situation may lead to further deterioration in the economically weak region.

The seven countries in South Asia represent 23 percent population of the world, which is a visible indicator of the importance of this region. However, the share of South Asia in 'World Domestic Product' is less than 3 percent; it is less than 5 percent in global trade. The share of South Asia in World GDP does not match with its population. It is a source of the low per capita income in the region, which is about 1/10th of the world per capita income. It is notable that GDP is not a stock concept; it is a flow of resources during a year. A shortfall or gap in the resources implies the reduction in overall national wealth in future. It also indicates deficiency of funds for investment.

South Asia's share in world's stock market capitalization is less than 2 percent. With 5 percent share in world trade, less than 2 percent share in equity markets, and about 2 percent share in gross world product, South Asia can play a little role in the world economic development.

At present there are about 6000 listed companies in South Asian countries, which is 12 percent of the companies listed in world stock exchanges, but the number of companies in South Asia does not reflect the capitalization in the region. Unfortunately it is an indicator of the isolation and segregation of the businesses. It shows a trend of the creation of small businesses on family ownership basis. Such type of corporate entities will not be helpful for the economies from the globalization point of view. Economic power cannot be achieved without investment in knowledge-based technologies, sophisticated research and development activities, which require large capital basis. The formation of large size corporations (MNCs) with endogenous capital are required to compete in the globalize environment and to improve the share and participation of South Asia in global economy. To compete in a globalized world and to form the large size corporate entities, South Asian corporate sector has to induce the capital from local, regional and global markets. Regional financial integration is one of the required strategies to achieve this goal. Here it is notable that consideration of financial integration in South Asia as a part of globalization and free trade regime is directly associated with the WTO's General Agreement on Trade in Services. This agreement includes financial services in the four modes of supply, which entail regulation of cross-border services.

Regional financial integration is a joint outcome of synchronization in monetary and fiscal policies of the participating countries and harmonization in the corporate laws and uniformity in financial market procedures. These policy-related aspects of financial integration argue the political harmonization between the countries.

In an efficient capital market, investors can determine their required rate of return on the basis of risk free rate of return, risk associated with the company, and the price of risk taking in term of the difference between the returns on risk free and risky assets. Corporate earnings, dividend policies and the monetary and fiscal policies including prime rate of interest, taxes on dividend and capital gains, and the taxes on corporate income and its revenue from business activities play an important role in the determination of the equilibrium in stock markets. The investors' required rate of return determines the magnitude and patterns of the sector wise distribution of investable funds in the economy. It also affects the business competitiveness by determining the cost of capital. The interaction of development and efficiency of capital markets and the monetary and fiscal polices determine the business competitiveness, patterns and magnitudes of investment and the flow of capital in the economy.

The cross border mobilization of capital and reallocation of investment among the various sectors of the participating countries are the natural consequences of financial integration; however, to attract the foreign portfolio investment it may lead to the frequent and major changes in the monetary and fiscal policies of the participating countries in response of the macroeconomic policies of the other participating countries.

The variations among the South Asian financial markets indicate the need of synchronization in the monetary and fiscal policies of the participating countries. Monetary and fiscal policies are classified as the significant determinants of the market capitalization. The variations in prime interest rates, exchange rates, taxes on corporate earnings, dividend incomes and capital gain may lead the change in the direction of investment inflows and outflows.

The harmonization and uniformity in the monetary and fiscal policies require some basic regulatory works including interest rate determination mechanism, investment protection regulations, stock market procedures, taxation policies, financing and investment regulation, prudential regulations, regulations for transfer of dividend income, and corporate governance parameters. Harmonization between the rules and regulations are also required to determine the strategies regarding the reinvestment of corporate profits (retained earnings) for modernization and expansion, dividend payments, treatment of the sick units and placement of the companies at default counters of the stock exchanges.

The prime changes in monetary and fiscal policies and harmonization in the regulatory framework are closely associated with the political consideration. In short there is no possibility of improvement in the economic prosperity of the nations in South Asia without considering their political relations.

Chapter 04

Economic & Financial Liberalization in South Asia

A- Financial Enironment in South Asia

Financial sector liberalization, corporate governance, legal and regulatory issues and contract enforcement are included in the institutional environment. Business environment covers the human capital development indicators, taxes, infrastructure and cost of doing business. Financial stability covers the stability of national currency, banking system and risk of sovereign debt crisis. Banking financial services include the size index, efficiency index and financial information disclosure. Initial public offering (IPOs), merger and acquisition (M&A), insurance and assets securitization are included in the non-banking financial services. Foreign exchange market, derivatives market, equity market and bond market's development are the components of financial market, while financial access covers the commercial access and retail access.

Financial sector liberalization covers capital account liberalization, commitment to (WTO) agreement for trade in services and domestic financial sector liberalization. Corporate governance covers the extent of incentive-based compensation, efficacy of corporate boards, reliance on professional management, willingness to delegate the power, strength of auditing and reporting standards, ethical behavior of firms, protection of minority shareholders' interests, official supervisory power, and private monitoring of the banking industry, while regulation of securities exchanges is a part of overall legal and regulatory environment.

World Economic Forum (WEF) Financial Development Indexes indicate that India and Pakistan have same positions in equity market development, while capital account liberalization is a weak area in all the three South Asian economies. Their position in capital account liberalization is not different from China, which has been experiencing as a socialist country.

India is leading in the corporate governance related factors, while it is one of the weakest areas in Pakistan's financial sector. Weak informational efficiency, lack of institutional investment, and weak corporate governance are causing the weak financial market in Pakistan.

In discussion on the factors of overall financial development in South Asia and leading position of India, it is extremely important to note the parameters of the financial access and stability. To get financing either through credit or equity market is easier in India as compared to Pakistan. Even position of India is much better than China and USA. Its impacts on overall financial and corporate sector development are obvious. The ratio of non-performing loans is much lesser in India than its neighboring countries, which is an indicator that financing activities are efficiently being transformed into economic growth. This achievement is correlated with the strength of investors' protection and the size of private credit bureau coverage. It is extremely important that all these achievements of Indian economy in the field of financial market indicators are based on its liberalization policy adopted after 1990. This financial liberalization and development is a cause of ultimate economic growth.

Several observations from the monetary and fiscal environment indicate disparities among the South Asian countries. The tightening in monetary policy in Pakistan is reflected in the supply of money, domestic credit by the banking system and banks' capital to assets ratio. An expansionary monetary policy is clearly reflected by these parameters in Indian economy, though credit expansion is much lower in South Asian economies as compared to China, USA and world average. However, lower capital-to-assets ratio also reflects the high risk in the banking industry of India and Bangladesh.

Table 4.1: Financial Access and Stability

Factor\ Country	Bangladesh	India	Pakistan	USA	China
Ease access to credit (Index: 7 is best)	3.70	4.04	3.51	2.75	3.97
Financing through equity market (Index: 7 is best)	4.47	5.04	4.22	4.38	3.89
Strength of investors' protection (10 is best)	6.00	6.70	6.30	8.30	5.00
NPL as % of total loans	13.00	2.30	8.40	2.30	2.50
Private credit bureau coverage as % of total adults	00.00	10.50	1.50	100.00	00.00
Public credit registry coverage as % of total adults	0.90	00.00	4.90	00.00	59.00

Interest rate spread is almost equal in South Asian economies, which is slightly higher than the world average; however it is much higher than China. The reason is obvious; China's central planning experience allows it to set the interest rate spread, corporate profits and wages at minimum level, which is not possible in liberal economies. Despite uniformity in the interest rate spread, a significant great variation was observed in the central banks' policy discount rates. The rate of interest in Pakistan is almost three times higher as compared to India and Bangladesh. In fact, policy interest rate in Pakistan is being applied by the State Bank of Pakistan as a tool of contrationary monetary policy. Consequently, Pakistan is one of the few countries in the world where policy interest rates are 15 percent or more. Interest rates in United States, China, Japan and European Union are much lower than South Asian economies, which provide the opportunities of financial expansion to the investors of those countries. The variation of policy interest rates between India and Pakistan are consistent with the market based interest rates for short term financing and long term public borrowing. The exchange rates in term of US dollar make Pakistan's financial position weaker.

to other countries except China. More than 75 percent of business profits in China are transferred to the national exchequer, which shows the strong element of government ownership in the central planned economy.

B: Economic Prosperity and Cross Border Investment

In the contemporary global scenario, a large part of the responsibility of economic development has been shifted to corporate sector from the governmental agencies. The entire structure and growth of the corporate sector depends on the transparent and prudent financial system. An incorrect judgment regarding the financial patterns in corporate sector may be a cause of heavy distortion in the society by means of volatilities in the stock markets, employment opportunities, distribution of income, and demand-supply gap in the commodities' markets. In the present economic structure, overall economic growth depends on the performance of corporate sector, while the financial resources of corporate sector are determined by the performance, gravity and strength of the financial markets in a country.

Table 4.2: Sources of Central Government Revenues (%)

Countries	Taxes on income, profits, and capital gains	Taxes on goods and services	Taxes on International Trade	Other taxes	Social contributions	Grants and other revenue
Bangladesh	12	29	33	4	-	22
India	39	30	15	0	0	16
Pakistan	20	33	13	1	-	33
Sri Lanka	16	51	15	3	1	14
South Asia	16	33	15	2	0	32
Euro area	24	26	0	3	35	7
U.K.	39	31	-	6	21	4
United States	57	3	1	1	36	3
World	21	34	6	2	-	14

Highest marginal tax rates for corporate sector are lower than average tax on profits from business incomes in India, China, Bangladesh and United States of America. On fiscal policy front, Pakistan's corporate sector is in disadvantageous position where highest marginal tax rate on corporate sector is higher than average tax on business profits. Pakistan is the only example of such a taxation policy. This dichotomy leads the discouragement of corporate sector and stock markets in Pakistan. However, average tax rate on profits from business is lower in Pakistan as compared

In discussion on globalization and integration in South Asia, the South Asia Human Development Report (2001) pointed out that globalization process in South Asia has focused on integrating markets for capital goods and services without enhancing the quality of people's lives. Globalization has not been accompanied by the reduction of poverty, while income inequalities have widened in South Asia. The report mentioned that South Asia's integration with trade and capital markets has expanded considerably but the region still remains amongst the least integrated regions in the world. Trade among South Asian countries is very low (less than 5 percent of region's total exports) compared to (NAFTA) (55 percent) and (ASEAN) (22 percent).

The seven countries in South Asia represent 23 percent population of the world, which is a visible indicator of the importance of this region. However, the share of South Asia in "World Domestic Product" is less than 3 percent; it is 5 percent less in global trade. The share of South Asia in World (GDP) does not match with its population. It is a source of the low per capita income in the region, which is about 1/10th of the world per capita income. It is notable that (GDP) is not a stock concept; it is a flow of resources during a year. A shortfall or gap in the resources implies the reduction in overall national wealth in future. It also indicates deficiency of funds for investment. South Asia's share in world's stock market capitalization is less than 2 percent. With 5 percent share in world trade, less than 2 percent share in equity markets, and about 2 percent share in gross world product, South Asia can play a little role in the world economic development.

based technologies, sophisticated research and development activities, which require large capital basis. The formation of large size corporations (MNCs) with endogenous capital is required to compete in the globalize environment and to improve the share and participation of South Asia in global economy.

Lower private sector investment in South Asia invites the need of foreign investment because of lower propensity to save. However, the conversion of South Asian currencies in terms of purchasing power parity (PPP) indicates the soundness and power of the currencies, despite the economic weaknesses and inflationary pressures. Strong and effective physical infrastructure to revive social and economic relations among the South Asian countries is also required to promote financial linkages between the countries. To achieve this goal, South Asian economic planners have to create harmonization between the rules and regulations of financial sector. They need synchronization in policies for allocation of funds for investment on their comparative advantage basis. The regulatory bodies and planning authorities need to take

Table 4.3: Comparison of Economic Status

Countries	Population (Millions)	Gross Domestic Product (Million $)	Per Capita Income ($)
Bangladesh	156	61897	450
India	1110	911813	820
Nepal	28	8938	320
Pakistan	159	126836	800
Sri Lanka	20	26964	1310
South Asia	1,499	1146716	768
Euro area	317	10636418	34307
U.K.	61	2376984	40560
United States	299	13163870	44710
World	6,538	48461854	7448

At present there are about 6000 listed companies in South Asian countries, which is 12 percent of the companies listed on world stock exchanges, but the number of companies in South Asia does not reflect the capitalization in the region. Unfortunately, it is an indicator of the isolation and segregation of the businesses. It shows a trend of the creation of small businesses on family ownership basis. Such types of corporate entities will not be helpful for economies from the globalization point of view. Economic power cannot be achieved without investment in knowledge-

initiatives to make a peaceful and uniform investment and financial environment.

The gravity and magnitude of economic relations among the South Asian countries show a disappointing picture of the outcomes of several strategies and efforts to promote their mutual economic relations. It was corroborated in various studies that trade relations cannot be promoted without strong politico-cultural relations among the nations; that can be strengthened by the exchange of services including health, education,

Table 4.4: Travel and Tourism

	International Tourists		Inbound tourism expenditure		outbound tourism expenditure	
	Thousands					
	Inbound	Outbound				
Bangladesh	200	1819	80	0.6	444	2.6
India	4447	8340	9227	4.6	9296	4
Pakistan	898	-	919	4.5	2029	5.8
Sri Lanka	560	757	733	8.6	666	5.7
South Asia	7296	12998	11608	4.8	12923	4.2
Low Income Group	27246	-	22549	5.7	24213	4.4
High Income Group	510271	533390	633422	5.9	632672	6
World	850778	1030976	887743	6	803866	5.6

energy, communications, transportations and financial assets and intermediation. The quantum of trade in merchandizing goods does not reflect the relations between the people of partner countries. However, higher trade in services (health, education, tourism, transportation and financial assets etc.) lead to frequent interactions among the people of partner countries. It may lead to the enhancement in trade of merchandizing goods. The exchange of financial services provides cross border investment opportunities, which may lead towards the ultimate development of trade among the nations.

For sustainable economic and financial infrastructure development, South Asian countries have to mobilize and utilize their resources endogenously. It will improve the efficient utilization of financial resources. It is possible through cross border investment among the South Asian countries. However, to make it practicable the policy makers and planners have to make their financial system transparent, frictionless and efficient.

It is interesting to mention here that a Trans-Asian Railway (TAR) project was initiated by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) to create an integrated freight railway network across Europe and Asia. The project was initiated in the 1960s, with the objective of providing a continuous 14,000 kilometer rail link between Singapore and Istanbul, Turkey, with possible further connections to Europe and Africa. The Northern Corridor already operational in 1960s, only for Soviet Union-China trade. The project promised to significantly reduce shipping times and costs between Europe and Asia. The (TAR) was also seen as a way to accessibility of landlocked countries like Laos, Afghanistan, Mongolia, and the Central Asian republics. By 2001, the four corridors had been studied as part of the plan: Northern Corridor covers Germany, Poland, Belarus, Russia, Kazakhstan, Mongolia, China, and the Koreas; Southern Corridor includes Turkey, Iran, Pakistan, India, Bangladesh, Myanmar, and Thailand, with links to China's Yunnan Province and, via Malaysia, to Singapore; A Southeast Asian network

Table 4.5: Merchandizing Exports within Regional Trade Blocs ($ Billions)

	Year of Creation	1990	1995	1999	2000	2001	2002	2003	2004	2005
European Union	1957	1,011	1,386	1,579	1,608	1,613	1,721	2,087	2,482	2,643
NAFTA	1994	226	394	581	676	639	626	651	738	825
ECO	1985	1	5	4	5	4	5	7	10	14
SAARC	1985	1	2	2	3	3	3	5	5	7

Table 4.6: Merchandizing Trade within Regional Trade Blocs (% of total bloc exports)

Bloc	Year of Creation	1990	1995	1999	2000	2001	2002	2003	2004	2005
European Union	1957	67	66	68	67	66	66	67	67	66
NAFTA	1994	41	46	55	56	56	57	56	56	56
ECO	1985	3	8	6	6	6	6	7	7	8
SAARC	1985	3	4	4	4	4	5	6	6	6

to link the South East Asian countries, and the North-South Corridor covers Northern Europe to the Persian Gulf. The Trans-Asian Railway Network Agreement was signed on November 10, 2006, by 17 Asian nations as part of a United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) effort to build a transcontinental railway network between Europe and Pacific ports in China. Transportation and railway ministers from 41 nations participated in the week-long conference held in Busan, South Korea, where the agreement was formulated. It is unfortunate that this important project which can change the lives of

Table 4.7: Merchandizing Exports within Regional Trade Blocs (% of world exports)

Bloc	Year of Creation	1990	1995	1999	2000	2001	2002	2003	2004	2005
European Union	1957	45	41	41	38	40	40	42	41	39
NAFTA	1994	16	17	19	19	19	17	16	15	14
ECO	1985	1	1	1	1	1	1	2	2	2
SAARC	1985	1	1	1	1	1	1	1	1	1

the people of Asian countries has not been successful, mainly because of political reasons. Progress in developing the (TAR) was hindered by political and economic obstacles throughout the 1960s, 1970s and early 1980s. By the 1990s, the end of the cold war and normalization of relations between some countries

Table 4.8: Competitiveness Scores in Public Policy Related Fields

Country	Overall Business CompetitivenessIndex	Institutional Governance	Infrastructure	Macroeconomic Stability	Health & Primary Education	Higher Education
Pakistan	3.77	3.66	3.22	4.37	4.09	2.72
India	4.33	4.32	3.45	4.21	4.92	4.13
Bangladesh	3.55	2.87	2.19	4.62	4.71	2.47
Sri Lanka	3.99	3.85	3.21	3.71	5.65	3.77
France	5.18	5.09	6.46	4.93	6.31	5.38
Italy	4.36	3.77	3.91	4.46	6.08	4.55
Germany	5.51	5.83	6.65	4.93	5.88	5.33
Nepal	3.38	3.1	1.96	4.64	4.46	2.65
United						
Kingdom	5.41	5.31	5.71	5.18	6.16	5.42
United						
States	5.67	4.76	6.1	4.78	6.00	5.68

improved the prospects for creating a rail network across the Asian continent. Here, it is notable that much of the railway network already exists, although some significant gaps remain.

The failure of Trans Asian Railway project is one of the extreme adverse impacts of the political tensions and unrest in South Asia including India, Pakistan and Afghanistan. The success of this project not only may reduce the shipment cost and promote the trade among the nations, but it may bring closer the three continents, Asia, Europe and Africa via rail road. It can revolutionize the tourism industry and the process of globalization. It is again another strong justification in favour of a greater South Asian bloc including China and (ECO) countries. South Asia can meet Europe by its extension to Turkey via central Asian states.

Table 4.9: Competitiveness Score in Private Sector Related Fields

Country	Goods Market Efficiency	Labor Market Efficiency	Financial Market Sophistication	Technology Readiness	Market Size	Business Sophistication	Innovation
Pakistan	3.95	3.86	4.32	2.77	4.56	3.85	3.15
India	4.66	4.07	4.93	3.17	6.16	4.81	3.90
Bangladesh	3.84	4.21	4.09	2.25	4.41	3.41	2.56
Sri Lanka	4.35	3.71	4.39	2.84	3.74	4.26	3.58
France	5.03	4.06	5.2	4.88	5.66	5.47	4.69
Italy	4.32	3.5	3.96	4.37	5.61	4.91	3.45
Germany	5.29	4.45	5.64	5.05	5.9	5.93	5.46
Nepal	3.73	3.62	3.64	2.41	3.06	3.29	2.49
United Kingdom	5.3	5.29	6.17	5.27	5.74	5.41	4.79
United States	5.32	5.71	5.68	5.43	6.83	5.6	5.77

All these discussion and justifications provide the causations for global planning and policy advocacy institutions to focus a greater economic alliance in Asia to achieve the economic prosperity and growth for ultimate welfare of the mankind.

Table 4.10: Tax Policies

COUNTRY					Highest marginal tax rate			
					Individual			
	% of GDP		Number of payments	time to prepare, file, and pay taxes hours	Total tax rate % of profit	%	On income over $	Corporate %
	2005	2011						
Pakistan	9.9	12.4	47.0	560.0	43.4	35.0	11,763.0	37.0
Bangladesh	8.8	12.0	17.0	400.0	40.3	-	-	-
India	10.8	11.8	59.0	264.0	81.1	30.0	5,669.0	34.0
Srilanka	13.3	14.3	61.0	256.0	74.9	35.0	4,975.0	35.0
Nepal	10.4	14.9	35.0	408.0	32.8	-	-	-
South Asia	10.1	11.9	30.0	305.0				
45.1	-	30.2	-					
Middle East & N. Africa	18.1	35.0	33.0	276.0	43.8	-	-	-
Europe EMU	16.1	23.9	19.0	250.0	56.0	-	-	-
World	15.8	16.1	35.0	334.0	54.0	-	-	-

Chapter 05

Steps towards Financial Integration and Cross Border Investment

A: Importance and Requirement of Cross Border Investment

Achieving the competitiveness is a basic requirement for survival of a business in the free trade regime, while free mobility of the factors of production is a necessary condition to achieve sustainable competitiveness in global environment. By this way, the sustainability of free trade regime is attached with the cross border free mobilization of the factors of production including capital, labor, entrepreneurship and the utilization of land. It concludes that flow of capital and intra-regional long-term investment are integral parts of the free trade policy.

It is obvious that a greater flow of financial capital and intra-regional long-term investment may ensure the sustainability in the trade relations also. The availability of large number of avenues for utilization of surplus funds and saving by means of cross border investment opportunities will also provide the benefits of comparative advantages to the investors. Return on investment in different sectors varies from country to country because of the variations in relative cost advantages in different regions. This variation will be helpful in efficient allocation of financial resources. This efficient allocation of resources can be transferred to the consumers' higher quality and lower prices of commodities and services. So, it will enhance consumer welfare ultimately. The efficient utilization of financial resources by flow of capital across the countries may improve the socio-economic and technological advancement in South Asia.

Moreover, the economic indicators, financial market observations and global data indicate that all South Asian economies require inflow of foreign investment, while their mutual integration may fill the resource gap in some sectors of their economies.

Because of these above-mentioned reasons, the greater flow of financial capital and intra-regional long-term investment has been suggested by the Heads of states in 17th SAARC Summit held in Maldives.

Table 5.1: Key Economic Indicators of South Asian Countries

Economic Indicators	Bangladesh	Bhutan	India	Maldives	Nepal	Sri Lanka	Pakistan
GDP (US$ bn)	65	967	850	934	8	26	143
GDP per capita (US$)	420	1235	769	2,706	335	1308	1085
Real GDP growth (%)	6	13.2	7.3	8	3	5.6	5.8
Inflation (%)	6.1	6	4.8	7	5.3	8	12
Unemployment (%)	2.5	2.5	7.8	---	---	7.6	7.7
Total Exports (US$ bn)	12.0	0.4	120.2	0.2	0.8	6.9	19.2
Total Imports (US$ bn)	16.1	0.3	174.4	0.9	2.1	10.2	40.0

B: Policy Measures

It was suggested in the 17th SAARC Summit that SAARC Finance Ministers will chart the proposals that would allow for greater flow of financial capital and intra-regional long-term investment, while the SAARC Chamber of Commerce and Industries has been requested to suggest Mechanism for flow of Investment and Financial Cooperation in the Region.

It is noteworthy that several institutions have been exploring the avenues of mutual cooperation among the financial sectors of South Asian countries. Several efforts in the past have also been made to achieve the same purpose; however, following steps can be considered the origination in this direction:

1 The need to strengthen international financial systems of SAARC countries by connecting their institutional capacity and surveillance mechanism as well as through closer consultations and coordination of macroeconomic policies was also recognized by the 10th summit of SAARC in 1998.

2 A regional agreement on the promotion and protection of investments in the SAARC region, a SAARC Arbitration Council, and a regional agreement on the avoidance of double taxation was also adopted to facilitate trade between South Asian countries.

3 In order to enhance SAARC collective capacity in policy analysis on international, financial,

monetary, trade and investment issues, meetings of officials from finance ministers and governors of the central banks has also been organized.

4 The Securities and Exchange Commission of Pakistan has signed a Memorandum of Understanding with the Securities and Exchange Commission of Sri Lanka, which sets forth a statement of intent to establish a framework for mutual assistance and to facilitate the exchange of information between them in order to ensure compliance with their respective securities and futures laws and regulatory requirements.

5 The South Asian Federation of Exchanges (SAFE) was formed in January 2000. Its members comprise 13 stock exchanges from Bangladesh, Bhutan, India, Nepal, Pakistan and Sri Lanka. The convener bourse, the Chittagong Stock Exchange, acts as the SAFE secretariat.

6 The most important step in this direction is establishing of the network of (SAARC) Finance'. This network was established in 1998 as a regional Network of the (SAARC) Central Bank Governors and Finance Secretaries. The primary function of the Network is to conduct a dialogue on macro-economic policies of the region and share experiences and ideas of the member countries. The Terms of Reference of the (SAARC) Finance were approved at the 11th (SAARC) Summit held in Kathmandu in January 2002. (SAARC) Finance Network' is a permanent body at the level of the Governors of Central Banks and Secretaries of Finance of (SAARC) Member States, and it submits its report to the (SAARC) Council of Ministers through (SAARC) Finance Ministers. The terms of reference describe the following objectives of the '(SAARC) Finance':

1. To consider and propose harmonization of banking legislations and practices within the region.
2. To work towards a more efficient payment mechanism within the (SAARC) Region and strive for higher monetary and exchange cooperation.
3. To study global financial developments and their impact on the region including discussions relating to emerging issues in the financial architecture, (IMF) World Bank and other international lending agencies.
4. To monitor reforms of the international financial and monetary system and to evolve a consensus among (SAARC) countries in respect of the reforms.
5. To monitor international currency and capital flows and to work towards a common (SAARC) position.
6. To evolve feasible joint strategies, plan and common approaches in international forums for mutual benefit particularly in the context of liberalization of financial services.
7. To undertake training of staff of the Ministries of Finance, Central Banks and other financial institutions of the (SAARC) member countries in subjects relating to economics and finance.
8. To explore networking of the training institutions within the (SAARC) Region specializing in various aspects of monetary policy, exchange rate reforms, bank supervision and capital market issues.
9. To promote research on economic and financial issues for the mutual benefit of (SAARC) member countries.
10. To consider any other matter on the direction/ request of the (SAARC) Finance Ministers, Council of Ministers or other (SAARC) bodies.

C: Asian Clearing Union (ACU)

Another important requirement to efficiently integrate the South Asian countries is to establish a Clearing Union. For this purpose, the (ACU) was established at the initiative of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP). The decision to establish the (ACU) was taken at the Fourth Ministerial Conference on Asian Economic Cooperation held in December 1970 at Kabul. The Draft Agreement Establishing the (ACU), was finalized at a meeting of senior officials of the governments and central banks held at (ESCAP), Bangkok, in December 1974 after five central banks (India, Iran, Nepal, Pakistan, and Sri Lanka) signed the Agreement. Bangladesh and Myanmar were the sixth and seventh signatories to this Agreement. Bhutan and Maldives signed the Agreement in 1999 and 2009 respectively and the number of the (ACU) participants reached nine. Asian Clearing Union (ACU) is the simplest form of payment arrangements whereby the participants settle payments for intra-regional transactions among the participating central banks on a multilateral basis. The main objectives of a clearing union are to facilitate payments among member countries for eligible transactions, thereby economizing on the use of foreign exchange reserves and transfer costs, as well as promoting trade among the participating countries. The (ACU) is a clearing house/payment arrangements operating in various regions of the world. The magnitudes in the following tables show the performance and requirement of the clearing union.

Table 5.2: Transactions Channeled through the ACU Mechanism during 1975-2011 (Millions of USDs)

	Amount	Growth (percent)	Amount	Share in yearly transactions (percent)	Amount	Share in yearly Transactions (percent)
1975	0.44	-	0.09	20.00	0.35	80.00
1976	25.72	5745.45	4.12	16.00	21.60	83.98
1977	79.36	208.55	16.67	21.01	62.69	78.99
1978	137.60	73.39	39.90	29.00	97.70	71.00
1979	161.31	17.23	83.88	52.00	77.43	48.00
1980	182.94	13.41	98.79	53.99	84.15	46.01
1981	269.39	47.26	166.92	61.96	102.47	38.05
1982	300.41	11.51	196.63	65.45	103.78	34.55
1983	498.66	65.99	192.32	38.57	306.34	61.44
1984	662.84	32.92	322.24	48.62	340.60	51.39
1985	605.20	-8.70	373.50	61.72	231.70	38.28
1986	690.62	14.11	581.12	84.14	109.50	15.86
1987	625.34	-9.45	396.97	63.48	228.37	36.50
1988	940.84	50.45	698.52	74.24	242.32	25.76
1989	1041.78	10.73	832.39	79.90	209.39	20.10
1990	1366.54	31.17	947.79	69.36	418.75	30.64
1991	1851.44	35.48	1424.35	76.93	427.09	23.07
1992	1928.32	4.15	1172.46	60.80	755.86	39.20
1993	1448.88	-24.86	1018.00	70.26	430.88	29.74
1994	1965.38	35.65	1110.71	56.51	854.67	43.49
1995	2702.90	37.53	1353.42	50.07	1349.48	49.93
1996	3161.10	16.95	1448.30	45.82	1712.80	54.18
1997	2654.95	-16.01	1251.60	47.14	1403.35	52.86
1998	2842.77	7.07	1130.61	39.77	1712.16	60.23
1999	2630.74	-7.46	1057.39	40.19	1573.35	59.81
2000	3383.54	28.62	1634.66	48.31	1748.88	51.69
2001	3553.67	5.03	1643.56	46.25	1910.11	53.75
2002	3448.40	-2.96	1446.40	41.94	2002.00	58.06
2003	4546.30	31.84	1877.95	41.31	2668.35	58.69
2004	6679.79	46.93	3163.25	47.36	3516.54	52.64
2005	8199.62	22.75	4512.16	55.03	3687.46	44.97
2006	12049.84	46.96	5864.27	48.67	6185.57	51.33
2007	15830.57	31.38	6977.33	44.08	8853.24	55.93
2008	20966.74	32.44	8031.32	38.31	12935.42	61.69
2009	14072.42	-32.88	5780.46	41.08	8291.96	58.92
2010	20634.21	46.63	8900.70	43.14	11733.51	56.86
2011	14542.67	-29.52	4974.80	34.21	9567.87	65.79
Total	156683.24	-	70725.55	45.14	85957.69	54.86

Source: Asian Clearing Union

- Figures indicate one-way transactions and accrued interest.
- Amount relevant to years 1975 to 1995 converted from SDRs to US Dollars.
- Figures for years 2009 to 2011 include ACU dollar and ACU euro transactions

Table 5.3: Total Transactions1 Routed through the ACU during 2010-2011
(Millions of USDs)

	2010		2011			
	Amount	Share in Total Transactions (percent)	Amount	Share in Total Transactions (percent)		
Bangladesh	4554.79	11.04	5731.59	19.71	1176.80	25.84
Bhutan	21.10	0.05	21.11	0.07	0.01	0.05
India	18283.67	44.30	11792.08	40.54	-6491.59	-35.50
Iran	13191.29	31.97	4934.39	16.96	-8256.90	-62.59
Maldives	13.81	0.03	10.56	0.04	-3.25	-23.53
Myanmar	6.75	0.02	4.37	0.02	-2.38	-35.26
Nepal	72.00	0.17	69.88	0.24	-2.12	-2.94
Pakistan	2374.45	5.75	2109.36	7.25	-265.09	-11.16
Sri Lanka	2750.56	6.67	4412.00	15.17	1661.44	60.40
Total	41268.42	100.00	29085.34	100.00	-12183.08	-29.52

Source: Asian Clearing Union

- Figure includes exports, imports, and accrued interest.
- Figures include ACU dollar and ACU euro transactions

D: Suggested Measures to Improve Financial Flows

(1) Establishing SAARC Development Bank

Though, establishing a development bank is almost a common strategy of all regional cooperation associations. These banks help the member nations to provide project financing facilities either through equity participation or through lending facility. The boards of the development banks approve the projects of the member countries on the basis of merit and established criterion. However, in establishment of (SAARC) Development Bank, a novel idea is under consideration. In fairly a large number of studies and assessment it was pointed out that the lack of interlinking infrastructure is a major obstacle in the enhancement of economic relations among the (SAARC) nations. Railways, road transportations, storage facilities at borders, lack of certification bodies, infrastructure of the joint institutions and efficient communication facilities etc are included in these hurdles. The development of these infrastructure and institutions requires joint financing from the (SAARC) nations. More than one nation may involve in such projects. However, many times such projects cannot be accomplished because of the lack of financing from one partner. It is suggested that the proposed institution should provide, advisory and financing facilities to those projects which can promote the economic linkages among the South Asian countries.

(2) Exchange and Transfer of Investment and Technology

During the last two decades, the South Asian nations have shifted their relations from 'negations to negotiations' stage. One of the important changes in this respect is the softening in the rule for foreign investment. The restrictions in the maximum limit of foreign investment in one company or sector have significantly relaxed in almost all the countries. However, the amendments and adjustments in investment policies in the recent past are not sufficient to achieve the desired goals of greater achievement to form a monetary or economic union in South Asia. Here, it is also recommendable that South Asian countries may develop their investment relations on the same patterns which have been suggested by the (UNDP) under the (SSGATE) program for South-South cooperation. Such programs may lead to joint ventures and transfer of technology and skills and mobility of labor and dependency in some cases, which will lead the enhancement in social relations among the people. This program provides the feasible mechanism for transfer of technology, skills, entrepreneurship and investment from the people of one country to the other; this is the only way to strengthen economic relations without political considerations. Such programs can promote the small and medium enterprises in the member countries and boost the relations among the people.

(3) Harmonization in Financial Regulations and Environment

The efficient utilization of financial resources can be achieved by flow of investment from one to other country in the region, and it is obvious that this type of efficiency is directly linked with the comparative advantage based specialization and economies of scale. Improvement in the socio-economics relations and technological advancements are the ultimate benefits of such efficiencies. This model is directly linked with the free mobilization of capital among the countries in South Asia, while mobilization of investment for its efficient utilization requires the harmonization in financial environment and regulations. At present, there is a huge difference in the investment and financial regulations and environment. Structure of the corporate boards, stock exchanges mechanism, listing requirements, dividend payment procedures, brokerage house operations and transfer of money have different requirements and procedures in the countries in South Asia. For efficient utilization of capital, this mechanism should be harmonized. Capital accounts convertibility, uniformity in accounting standards, permission for cross border investment and synchronization in the monetary and fiscal policies are the prerequisite of financial integration. The regulating agencies including Securities and Exchange Commissions (Corporate Law Authorities), Central Banks, Competition Commission (Monopoly Control Authorities) and the other relevant agencies of the member countries will have to involve in making the regulations on uniform basis.

Table 5.4: Major Constraint in Investment: Survey of Enterprises

Indicators	Bangladesh	India	Nepal	Pakistan	SriLanka
Time to deal with tax authorities as % of management time	3.2	6.7	6.5	2.2	3.5
Average No. of times to met with tax authorities	1.3	2.6	1.3	1..6	4.9
Time required to obtain operating license (Days)	6.0	-	14.5	16.4	49.5
Informal payments to public officials (% of firms)	85.1	47.5	15.2	27.2	16.3
Losses due to theft, robbery, vandalism & arson (% of sales)	0.1	0.1	0.9	0.5	0.5
Firms with female participation in ownership (% of firms)	16.1	9.1	27.4	6.7	-
Firms using banks to finance investment (% of firms)	24.7	46.7	17.5	9.7	26.2
Value lost due to electric outages (% of sales)	10.6	6.6	27.0	9.9	-
Internationally recognized quality certification (% of firms)	7.8	22.5	3.1	9.6	-
Average time to clear direct exports through customs (days)	8.4	15.1	5.6	4.8	7.6
Firms offering formal training (% of firms)	16.2	15.9	8.8	6.7	32.6

Source: World Bank

(4) Financial Integration

Though, formation of a monetary union is an ideal condition to achieve the target of efficiency in use of resources, and the historical experiences of integrated financial markets show that investment mobilization have been successfully achieved in those regions where common currency units are in practice. However, in the present political conditions it is not possible and recommendable to form a monetary without successful achievements in the precondition of the formation of an economic union. It is interesting and extremely important that permissibility of the mobilization of the factors of production among some economies is closely associated with the political strategies, particularly among the countries where apprehensions are reflected in the historical relations. In South Asian context, Indo-Pakistan economic relation is one of the most appropriate examples. In this situation, a financial integration without monetary union is a softer and workable option.

Permission for establishing across the borders bank branches, offices of corporate entities for cross boarder business operation and ensuring the mobility of the people without undue limitations or restrictions are also included in the success factors of financial integration. Financial integration provides opportunities not only to the investors; it facilitates the inflow of capital at comparable cost. The permission of the networks of bank branches across the borders, common stock exchanges, cross the border brokerage houses and joint ventures are the common ingredients of the financial integration. It is obvious that these financial institutions in South Asia can improve the efficiency and investment activities in the region. However, this step is an advanced stage of the cross border investment and listing which can create arbitrage opportunities if markets are fundamentally different in their macroeconomic policies and informational efficiency.

(5) Synchronization in Monetary and Fiscal Policies

The most crucial step belongs to the synchronization in monetary and fiscal polices of the countries in South Asia. The sustainable growth in stock prices and long-term changes in the funds allocation are largely determined by the economic fundamentals and corporate performance and policies. The net profit, expectation about future returns, dividend announcements, changes in corporate governance and expected change in the market share of the firm's products are the factors which can affect the market capitalization of a company.

At macro level, the magnitude of investment in equities and market liquidity are more important economic variables for the growth of stock market, and again it is obvious that synchronization in monetary and fiscal policies is required between the countries in the region to harmonize these variables.

There are several observations from the monetary and fiscal environment, which indicate the great disparities among the South Asian countries. The variations in prime interest rates, exchange rates, taxes on corporate earnings, dividend incomes and capital gains may leads the change in the direction of investment inflows and outflows. Without synchronization in these macroeconomic variables, polarization in financial markets will be created which will lead the ultimate failure of the objectives of SAARC.

Table 5.5: Monetary and Fiscal Policy Indicators

Indicators	Bangladesh	India	Pakistan	SouthAsia	USA	China	World
Domestic Credit to Private Sector as % of GDP	39.2	51.4	29.5	49.5	187.1	108.3	129.7
Banks Capital to Assets Ratio	6.5	6.4	10.6	6.9	9.3	6.1	9.0
Policy (Prime) interest rate	5.0	5.50	13.0	--	0.5	3.0	--
Interest Rate Spread	6.7	6.3	6.0	6.6	--	3.1	6.0
Tax rate on profit (Average)	35.0	64.7	31.6	40.0	46.3	78.5	48.3
Highest Tax rate on corporate	28.0	34.0	35.0	--	40.0	25.0	--

Source: World Economic Forum 2010

(6) Improving Informational Efficiency

It is obvious that financial integration in South Asian economies can improve the efficiency and investment activities in the region. However, like other economic strategies, this policy is also closely related with the informational efficiency. Information efficiency in financial market is a prerequisite of efficient resource allocation. Fortunately, achieving the information efficiency has become possible; because in the present state of information technology, networking allows the function of a common stock exchange, on-line transfer of money, registering and listing requirements, and transfer of funds. This does not require merger of the institutions and passing through the complicated legal requirements. The issuers, investors and financial intermediaries are the natural participants, while facilitation from the central banks; stock exchanges and regulatory bodies are required. These entire requirements can be fulfilled by the proper use of information technology. The print and electronic media, academic institutions, advisory and consulting firms and financial brokerage houses can make the financial market more efficient by supplying the frictionless information and proper interpretation and analysis of the event and financial transactions.

Table 5.6: Science and Technology

	Researchers in R&D	Technicians in R&D		Expenditures for R&D	High-technology exports		Royalty and license fees		Patent applications filed		Trademark applicationsfiled	
	per million people			% of GDP	$ millions	% of manufactured exports	Receipts $ millions	Payments $ millions	Residents	Non-residents	Residents	Non-residents
Bangla-desh	-	-	193	-	21	0	0	5	-	-	-	-
India	-	-	14608	0.61	3511	5	112	949	6795	10671	-	-
Nepal	59	137	-	-	-	-	-	-	-	-	-	-
Pakistan	80	41	492	0.43	197	1	53	106	-	1081	8319	5117
Sri Lanka	130	72	136	0.19	99	2	-	-	95	189	3989	1773
South Asia	-	-	15429	0.59	-	4	175	1060	6795	11752	8319	5117
World	-	-	708086	2.1	1418509	21	135278	148518	915598	553167	1584746	420729

Table 5.7: Information Technology

	Daily newspapers	Households with television	Information and communications technology expenditures	
	per 1,000 people	%	% of GDP	Per capita $
Bangladesh	-	23	2.7	11
India	73	32	6.1	50
Nepal	-	13	-	-
Pakistan	51	46	6.9	55
Sri Lanka	24	32	5.4	73
South Asia	70	32	6	47
World	105	83	6.7	564

Table 5.8: Information Technology

	Personal computers and the Internet					
	Access		Quality			
	per 1,000 people					
	Personal computers	Internet users				
Bangladesh	2.2	0.3	0	8	0	24
India	1.6	5.5	0.21	24	1	6.6
Nepal	0.5	0.9	0	5	1	8
Pakistan	0.5	7.5	0.04	5	0	9.5
Sri Lanka	3.7	2.2	0.15	25	2	4.4
South Asia	1.4	4.9	0.18	22	1	6.6
World	10.6	21.4	5.46	529	74	12.1

Key Findings

1. Need for Financial Integration in South Asia

- Strong, sound, coherent and synchronized financial system is an integral component of regional economic cooperation
- It creates preferences for increase in cross-border Trade and investment Opportunities and encourages flow of capital amongst SAARC member countries
- It employs investments towards objective targeting economic growth
- It mobilizes and allocates resources efficiently, makes capital more productive and competitive
- It will lead to develop environment for jobs creations and poverty reduction in SAARC member countries;
- Financial integration will help lessen vulnerability to financial crisis in SAARC countries due to installation of common clearing union and currency swap arrangements,

2. Political Economy of Regional Integration

Gradual transformation Process for regional integration stage Degree of Economic Integration Integrated Areas.

01	Preferential Trading Area (PTA)	partial abolishment of custom tariffs
02	Free Trade Area (FTA)	full abolishment of custom tariffs
03	Custom Union	A unified tariffs on the exterior borders
04	Common Market	Inclusion of the movement of services, capital and labor into to an FTA
05	Economic Union	A combination of the customs union with a common market
06	Fiscal Union	Introducing a shared fiscal and budgetary policy
07	Monetary Union	Introducing a shared currency
08	Complete Economic Integration	Unification of economic policies (tax, social welfare benefits, etc.), reductions in the rest of the trade barriers, introduction of supranational bodies, and gradual moves towards the final stage, a "political union"

3. South Asian Journey towards Economic Liberalization

- Signing of SAPTA: April 1993
- Signing of SAFTA: 2006
- Inclusion of services in SAFTA: 2010
- Services under SAFTA: Education, Health, Finance, ICT, Tourism
- Services under WTO: 12 Major Sectors
- Intra-regional Trade: $18 billion
- Trade under SAFTA rules of origin: $ 2.4 billion

4.Challenges towards Regional Financial Cooperation

Regional Financial Cooperation is very challenging although the same is necessary for formulating strategies to achieve goals effectively with minimum political and economic cost.

Some of the challenges faced by region include:

a- Environment of mistrust due to historical and political conflicts
b- Role of non-state actors
c- Lack of political will
d- Bureaucratic hurdles
e- Direction of trade
f- Low level of intra-regional investment
g- Economics remains relatively less priority area
h- Bilateral agreements are not supplementing SAFTA
i- Para-tariff and Non-Tariff Barriers
j- Security and sovereignty of business

5. Regional Financial Cooperation (RFC)

Need and importance of RFC

- RFC has become important to conceive and develop South Asia Regional Financial Cooperation body for better stability of the financial structure and viable working mechanism to support the economic activities in the member countries
- The need of Regional Finance Cooperation (RFC) concept was first conceived by East Asia (EA) economies post 1997 Asian financial crisis in East Asia.
- RFC helps in enhancing risk management abilities; to prevent and resolve future financial crisis.
- RFC can strengthen the financial performance of the region by avoiding over dependence on IMF, World Bank and ADB. We must learn this from the formation of EU in 1999

- We need to learn from East Asia (EA) crisis that prompted EA economies to realize the potential benefits of installing cooperative mechanisms that can help prevent and manage crisis in a way that complements the role of IMF in the global framework.

6. Regional Financial Cooperation Framework

A. Strengthening crisis management regimes

- Creating co-operative schemes for resolving and preventing any future crisis.
- Establishing regional financing arrangements: Setting up Bilateral Swap Arrangements (BSA) by Central Banks of member countries in order to address liquidity demand. (ASEAN+3 Model)
- Strengthening surveillance and monitoring framework

B. Developing regional bond market

- Primary aim is to lessen dependency on funding from outside the region and cultivation of funding from within the region
- Diversifying the investment targets of members' foreign exchange reserves
- Helps in building a common sub-structure of credit guarantee, credit rating and settlement system
- Bond Market can play significant role in developing under achieved economic needs in member countries through financial infusions particularly in the areas of infrastructure including power sector development, and other sectors like education, heath, tourism, IT as envisaged under SAFTA trade and services agreements and other specific sectors to the needs and demands of each member country
- All these sectors offer vast investment opportunities with long term consistent returns. Immense opportunity for all members.

C. Studies on regional foreign exchange cooperation and regional monetary integration

- Basic Goal: Building an emergency funding system in preparation for possible future financial crisis; cooperate in foreign exchange related issues, currency swapping that together would help in preventing competitive devaluations of currencies in times of foreign exchange crisis.
- Consider development of Asian Currency Unit (ACU) in line with comparable practices in other regional blocs

7. Some suggesting measures to address challenges

A. cooperation amongst groups of Government and Central Bank

- Consolidating and bringing consistency in reports and findings that could come from diversity of studies conducted by various groups of government and central bank level.

B. Establishing surveillance and monitoring frameworks

- Establishing surveillance and monitoring frameworks on broader perspective (beyond simple review of economic conditions or indicators of countries) to dilute pick up choice of IMF as the rescue. Important to ensure more rapid information exchanges and decision making.

C. Seek cooperation with major international financial organizations

- Cooperation with major international financial organizations for capacity-building of institutions and to adopt suitable mechanisms to enable regional financial cooperation to proceed smoothly.

D. Experiences of IMF and ADB

- Garnering support from the experiences of IMF and ADB may help in successful setting up of regional financial organization.

E. Political stability

- Instability of political systems in the member countries become strong hindrances in forming a strong RFC. Therefore, political stability is important to share a common vision.

08. Achieving objectives of Regional Financial Cooperation (RFC)

A. Change Requirements

- Reforms to liquidity requirement conducive to the requirements of member countries

- Supportive strong regulatory framework
- Strong corporate governance
- Promote greater integration with the global financial system

B. Financial Cooperation

- Consider to improve working of Asian Clearing Union
- Improve SAFTA deliverables for sustainable development
- Remove barriers to Trade and Investment
- Collective effort to fight financial terrorism

C- Monetary Cooperation

i)- Macro-economic cooperation in;

- Information exchange & surveillance system
- Resource coordination and pooling
- Exchange rate coordination

ii) Strengthening collaboration amongst SAARC desks / units in Central banks of member countries to address Macro-prudential approaches towards regulation, harmonisation and simplification.

iii) The concept of PPP by appropriately integrating Private sector in the process of policy making should be considered as inevitable towards decision-making in the interest of Private Sector, for which decisions are made to facilitate sustainable development

D. Central/reserve Banks to take leading role

While trade remains the dominating factor in dialogue engagements with Ministries of Commerce in SAARC region, the collaborating need of simultaneous harmonizing financial systems in the member countries remains relatively slow

In order to constitute the RFC, following suggestions may include but not limited:

- Central Bank Governors Committee in SAARC should be strengthened and empowered to the lead working collaborations and integration with other organs/ministries and departments of the state
- Board/Ministry of Investment à automatic route of investment
- Ministry of Industries à Advanced recognition of standards/inputs and production processes
- Ministry of Interior à synchronizing visa policy with flow of merchandise
- Ministry of Foreign Office à ensure compliance of above mentioned

09- Conclusion

It took 4 decades of planning to form the EU, muscled ahead by strong economies like Germany and France. South Asia society, being highly heterogeneous in terms of scores of ethnic societies, political approaches, religion, social values, etc, the task would be very challenging. The task of forming RFC can be successful only if large economy like India takes the charge and leads it from heart.

10. Policy Recommendations

1- Need to open investment through automatic route
2- Privileged visa regime for investors
3- Movement of natural persons under article IV- of GATT to promote labour mobility by allowing work visas
4- Integrating transport and warehousing infrastructure
5- Access to financial facility i.e. local subsidies and working capital facility
6- Legal cover in the event of political upheaval/ sovereign Guarantee
7- Avoidance of Double taxation Treaty at regional level
8- Currency Swap- trade and investment provision in local currency
9- Investment-specific Dispute resolution mechanism
10-Opening of Bank branches in all member countries on reciprocal basis
11-Creation of SAARC Bank with branches in all capitals and major commercial cities across the region
12-Allow cross border Investment in capital as well as financial market
13-Allow mutual fund and financing companies to improve across border trade and investment
14- Acceptability of financial services by Mutual recognition of trade/investment financial instruments (e.g. LCs)
15-Access to Local Financial Incentives

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Statistical Annexure

Table 01:Comparison of Basic Requirements for Business Competitiveness

	Overall Basic Requirements		1. Institutions		2. Infrastructure		3. Macroeconomic Environment		4. Health &Primary Education	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Bangladesh	114	3.71	115	3.24	133	2.15	80	4.49	106	4.96
India	81	4.30	58	4.03	86	3.49	73	4.53	104	5.16
Pakistan	132	3.39	112	3.34	110	2.75	133	3.19	123	4.27
Sri Lanka	73	4.42	55	4.06	70	3.82	124	3.60	35	6.18

Source: Global Competitiveness Report

Table 02: Comparison of Efficiency Enhancers for Business Competitiveness

	Overall Efficiency Enhancers		5. Higher Education & Training Efficiency		6. Goods Market Efficiency		7. Labor Market Development		8. Financial Market Development		9. Technological Readiness		10. Market Size	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Bangladesh	7	3.62	126	2.77	102	3.83	108	3.98	66	4.18	126	2.65	47	4.32
India	8	4.42	85	3.85	71	4.13	92	4.18	17	4.95	86	3.33	4	6.10
Pakistan	5	3.66	123	2.91	91	3.94	131	3.45	73	4.09	109	2.94	31	4.63
Sri Lanka	9	4.01	62	4.24	47	4.36	104	4.01	52	4.36	84	3.37	68	3.70

Source: Global Competitiveness Report

Table 03: Comparison of Innovation Factors for Business Competitiveness

	Overall Innovation Factors		11. Business Sophistication		12. Innovations	
	Rank	Score	Rank	Score	Rank	Score
Bangladesh	109	3.01	105	3.42	119	2.61
India	42	3.96	44	4.30	39	3.62
Pakistan	76	3.38	79	3.73	75	3.03
Sri Lanka	40	3.97	39	4.36	40	3.58

Source: Global Competitiveness Report

Table 04: National Regulatory Changes, 2000-2011

(Number of measures)

Item	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Number of countries that introduced changes	45	51	43	59	80	77	74	49	41	45	57	44
Number of regulatory changes	81	97	94	126	166	145	132	80	69	89	112	67
Liberalization/promotion	75	85	79	114	144	119	107	59	51	61	75	52
Regulation/restriction	5	2	12	12	20	25	25	19	16	24	36	15
Neutral/indeterminate	1	10	3	0	2	1	0	2	2	4	1	0

Source: UNCTAD

Table 05: Transparency and Creditability

Economy	Transparency in Government Policy (Ranks) a	Central Bank Transparency Rank b	Strength of auditing & reporting standard	Efficacy of corporate board	Minority shareholders	Investors protection
Bangladesh	101	41	127	116	131	24
India	65	54	44	75	52	39
Iran	127		93	104	78	130
Nepal	116		115	133	110	65
Pakistan	109	43	86	111	81	29
Sri Lanka	66		46	30	23	39
China	51	49	72	91	68	80
UK	13	1	13	15	16	10
USA	56	22	37	23	33	6
Hong Kong	4	39	10	28	13	3

a) Ranking out of 144 countries
b) Ranking out of 64 countries

Table 06: Identifying the Most Problematic Areas (Ranks)

	Bangladesh	India	Iran	Nepal	Pakistan	Sri Lanka	China	UK	USA	Hong Kong
Inefficient Government & Bureaucracy		3		3	2				1	3
Corruption	2	2		2	1					
Access To Financing	3		1				1	1		
Inflation			3			3	2			1
Policy Instability			2		3		3			
Tax Rates						1		2	2	
Tax Regulation						2		3	3	
Inadequate Infrastructure	1	1								
Government Instability				1						
Insufficient Capacity to Innovate										2
Foreign Currency Regulation										
Uneducated Workforce										
Crime and Theft										
Poor Work Ethics in Labor Force										
Restrictive Labor Regulation										
Poor Public Health										

- SOURCE: World Bank/International Finance Corporation, Doing Business 2012: Doing Business in a More Transparent World (This variable is a combination of profit tax (% of profits), labor tax and contribution (% of profits), and other taxes (% of profits) | 2011)
- Number of procedures required to start a business | 2011 (SOURCE: World Bank/International Finance Corporation, Doing Business 2012: Doing Business in a More Transparent World
- In your country, to what extent do tariff and non-tariff barriers limit the ability of imported goods to compete in the domestic market? [1 = strongly limit; 7 = do not limit] | 2011–12 weighted average SOURCE: World Economic Forum, Executive Opinion Survey
- How easy is it to raise money by issuing shares on the stock market in your country
- How easy is it to obtain a bank loan in your country with only a good business plan and no collateral
- Ranking based on 144 countries.

Table 07: Financial Assets by Major Types (Billion US $)

Assets	Bangladesh	India	Pakistan	USA	China
Public Debt Securities	25	697	74	5110	599
Private Debt Securities	0	79	1	22302	583
Bank Deposits	36	762	55	10759	5155
Equity Securities	7	1819	70	19947	6226
Total Financial Assets:	68	3357	200	58118	12563

Table 08: Bank's Profitability

Variable	Bangla-desh	India	Nepal	Pakistan	Sri Lanka	South Asia	World
Return on deposits (%)	9.7	--	2.3	6.9	10.9	--	--
Return on lending (%)	16.4	13.3	8.0	12.9	18.9	--	--
Interest rate spread (%)	6.7	--	5.7	6.0	8.0	6.6	6.0
Real interest rate (%)	7.0	6.7	0.3	-2.9	2.2	--	--
Exchange rate (PK Rs. Per US$)	69.16	46.63	74.54	84.12	114.35	--	--
NPL to gross loans (%)	11.2	2.3	--	9.1	--	9.1	3.2
Bank capital to assets ratio	6.5	6.4	--	10.6	--	6.9	9

Source: National Reserve/central Banks

Chapter 03

Table 09: Stocks of Foreign Direct Investment

(Billion US $)

Country	1990		2000		2008		2009	
	Inward	Outward	Inward	Outward	Inward	Outward	Inward	Outward
World	1942	1786	5757	6070	14909	16206	17743	18982
South Asia	7	0.4	31	3	186	65	218	82
Afghanistan	0	--	0	--	0	--	0	---
Bangladesh	0.5	--	2	--	5	--	5	0
India	2	0.1	18	2	123	62	164	77
Iran	2	--	3	--	21	--	24	2
Nepal	0	--	0	--	0.1	--	0.2	--
Pakistan	2	0.2	7	0.5	31	1	18	2
Sri Lanka	0.7	0	2	0	4	0.3	5	0.3

Source: UNCTAD

Table 10: Inflow of Foreign Investment

Type of Investment	Bangla-desh	India	Nepal	Pakistan	Sri Lanka	South Asia	World
Equities- FDI 1995 (Million $)	2	2144	--	723	56	2931	328496
Equities- FDI 2008 (Million $)	973	41169	1	5438	752	48678	1823282
Equities- Portfolio 1995 (Million $)	-15	1590	0	10	--	1585	127074

Equities- Portfolio 2008 (Million $)	10	-15030	--	-270	-488	-15778	-207952
Debt- Bonds 1995 (Million $)	0	285	0	0	0	285	--
Debt- Bonds 2008 (Million $)	0	1754	0	0	-65	1689	--
Debt- Others 1995 (Million $)	-21	955	-5	317	103	1349	--
Debt- Others 2008 (Million $)	112	10028	-1	652	155	10978	--

Source: World Bank

Table 11: Assessment of Global Linkages

Variable	Bangladesh	India	Nepal	Pakistan	Sri Lanka	South Asia	World
Merchandize trade (% of GDP)	49.3	40.6	370	38.1	55.2	41.3	53
Services trade (% of GDP)	7.2	13.8	12.5	8.3	12.3	12.8	12.3
Financing through international capital market (% of GDP)	0.1	2.7	0	0.4	1	2.2	--
Net FDI inflow (% of GDP)	1.2	3.6	0	3.3	1.9	3.3	3
Net FDI outflow (% of GDP)	--	1.6	--	0	0.2	1.4	3.5
Remittances (% of GDP)	11.3	4.3	21.6	4.3	7.3	4.9	0.8
International migration stock (% of total population)	0.7	0.5	3	2.3	1.9	0.8	3
Immigrants with technical education in OECD (% 25 +)	4.4	4.3	4	12.7	28.2	5.3	5.4
International internet bandwidth bits (seconds per person)	4	32	5	43	190	31	3546
External debt ($ M) 2008	23644	230611	3685	49337	15154	--	--
External debt from IMF ($M) 2008	686	0	77	4352	169	--	--

Table 12: Assessment of the Knowledge-based Economy

Variable	Bangla-desh	India	Nepal	Pakistan	Sri Lanka	South Asia	World
Researcher in R & D (per million people)	--	137	59	152	93	129	1270
Articles in research journals	193	14608	--	492	136	15429	708086
R & D expenditures (% of GDP)	--	0.8	--	0.67	0.17	0.79	2.21
High tech export (M $)	97	6497	--	275	101	--	1856930
High tech export (% of manufacturing exports)	1	6	--	2	2	5	17

Table 13: Information Technology

	Daily newspapers	Householdswith television	Information and communications technology expenditures	
	per 1,000 people	%	% of GDP	Per capita$
Bangladesh	-	23	2.7	11
India	73	32	6.1	50
Nepal	-	13	-	-
Pakistan	51	46	6.9	55

Sri Lanka	24	32	5.4	73
South Asia	70	32	6	47
World	105	83	6.7	564

Table 14: Competitiveness Score in Private Sector Related Fields

Country	Goods Market Efficiency	Labor Market Efficiency	Financial Market Sophistication	Technology Readiness	Market Size	Business Sophistication	Innovation
Pakistan	3.95	3.86	4.32	2.77	4.56	3.85	3.15
India	4.66	4.07	4.93	3.17	6.16	4.81	3.90
Bangladesh	3.84	4.21	4.09	2.25	4.41	3.41	2.56
Sri Lanka	4.35	3.71	4.39	2.84	3.74	4.26	3.58
France	5.03	4.06	5.2	4.88	5.66	5.47	4.69
Italy	4.32	3.5	3.96	4.37	5.61	4.91	3.45
Germany	5.29	4.45	5.64	5.05	5.9	5.93	5.46
Nepal	3.73	3.62	3.64	2.41	3.06	3.29	2.49
United							
Kingdom	5.3	5.29	6.17	5.27	5.74	5.41	4.79
United							
States	5.32	5.71	5.68	5.43	6.83	5.6	5.77

Table 15: Freedom of Business

Variable	Bangladesh	India	Nepal	Pakistan	Sri Lanka	South Asia	World
Time required for dealing (% of management time)	3.2	6.7	6.5	2.2	3.5	--	--
Number of dealing times	1.3	2.6	1.3	1.6	4.9	--	--
Time required to operate a license (days)	6	--	14.5	16.4	49.5	--	--
Informal payments to public offices (% of firms)	85.1	47.5	15.2	27.2	16.3	--	--
Losses due to theft c	0.1	0.1	0.9	0.5	0.5	--	--
Value lost due to electricity (% sales)	10.6	6.6	27	9.9	--	--	--
International quality certification (%)	7.8	22.5	3.1	9.6	--	--	--
Average time to clear export (days)	8.4	15.1	5.6	4.8	7.6	--	--
Firms offer training (%)	16.2	15.9	8.8	6.7	32.6	--	--
No of procedures to start a business	7	13	7	10	4	7	8
Time required to start a business (days)	44	30	31	20	38	28	36
Cost to start a business (% of Per capita income)	36.2	66.1	53.6	5.8	5.9	27	41.5
No. of procedures to register a property	8	5	3	6	8	6	6
Time required to register property (days)	245	44	5	50	83	106	65
No. of procedures to construction permit	14	37	15	12	22	18	18
Time required for construction permit (days)	231	195	424	223	214	241	216
Employment rigidity index	28	30	46	43	20	27	27
No. of procedures to enforce a contract	11	46	39	47	40	44	38

Time required to enforce contract	1442	1420	735	976	1318	1053	607
Investment protection (Disclosure Index)	6	7	6	6	4	4	5
Time to resolve insolvency (years)	4	7	5	2.8	1.7	4.5	3

Table 16: Major Constraint in Investment: Survey of Enterprises

Indicators	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Time to deal with tax authorities as % of management time	3.2	6.7	6.5	2.2	3.5
Average No. of times to met with tax authorities	1.3	2.6	1.3	1..6	4.9
Time required to obtain operating license (Days)	6.0	-	14.5	16.4	49.5
Informal payments to public officials (% of firms)	85.1	47.5	15.2	27.2	16.3
Losses due to theft, robbery, vandalism & arson (% of sales)	0.1	0.1	0.9	0.5	0.5
Firms with female participation in ownership (% of firms)	16.1	9.1	27.4	6.7	-
Firms using banks to finance investment (% of firms)	24.7	46.7	17.5	9.7	26.2
Value lost due to electric outages (% of sales)	10.6	6.6	27.0	9.9	-
Internationally recognized quality certification (% of firms)	7.8	22.5	3.1	9.6	-
Average time to clear direct exports through customs (days)	8.4	15.1	5.6	4.8	7.6
Firms offering formal training (% of firms)	16.2	15.9	8.8	6.7	32.6

Source: World Bank

Table 17: Sources of Central Government Revenues (%)

Countries	Taxes on income,profits, andcapital gains	Taxes on goods and services	Taxes on International Trade	Othertaxes	Social contributions	Grants and other revenue
Bangladesh	12	29	33	4	-	22
India	39	30	15	0	0	16
Pakistan	20	33	13	1	-	33
Sri Lanka	16	51	15	3	1	14
South Asia	16	33	15	2	0	32
Euro area	24	26	0	3	35	7
U.K.	39	31	-	6	21	4
United States	57	3	1	1	36	3
World	21	34	6	2	-	14

TABLE 18: Monetary and Fiscal Policy Indicators

Indicators	Bangladesh	India	Pakistan	South	Asia	USA	China	World
Tax rate on profit (Average)	35.0	64.7	31.6	40.0	46.3	78.5	48.3	
Highest Tax rate on corporate	28.0	34.0	35.0	--	40.0	25.0	--	
Credit to Private Sector as % of GDP	39.2	51.4	29.5	49.5	187.1	108.3	129.7	
Domestic Credit as % of GDP	59.4	71.6	45.9	69.3	216.1	126.2	156.8	
M2 as % of GDP	61.2	73.3	50.0	--	57.2	163.1	--	

Banks Capital to Assets Ratio	6.5	6.4	10.6	6.9	9.3	6.1	9.0	
Interest Rate Spread	6.7	6.3	6.0	6.6	--	3.1	6.0	

TABLE 19: IDA Resource Allocation (Macroeconomic Policy) Indexes

(1 is low 6 is high)

Indicators	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Overall Resource Allocation Index	3.5	3.8	3.3	3.3	3.4
Macroeconomic Management	4.0	4.5	4.0	2.5	2.5
Fiscal Policy	4.0	3.5	3.5	2.5	3.0
Debt Policy	4.5	4.5	3.5	4.0	3.5
Overall Economic Management	4.2	4.2	3.7	3.0	3.0
International Trade	3.5	3.5	3.5	4.0	3.5
Financial Sector	3.0	4.0	3.0	4.0	3.5
Business Regulations	3.5	3.5	3.0	4.0	4.0
Overall Structural Policies	3.3	3.7	3.2	4.0	3.7
Property and Governance	3.0	3.5	2.5	2.5	3.0
Quality of Budget & Fiscal Management	3.0	4.0	3.0	3.5	4.0
Efficient Revenue Mobilization	3.0	4.0	3.5	3.0	3.5
Quality of Public Administration	3.0	3.5	3.0	3.5	3.0
Accountability and Corruption	3.0	3.5	3.0	2.5	3.5
Overall Public Sector Management	3.0	3.7	3.0	3.0	3.3

Chapter 04

Table 20: Structure of output

	Gross domestic product	Agriculture	Industry	Manufacturing	Services
	$ millions	% of GDP			
Bangladesh	61987	20	28	17	52
India	911813	18	28	16	55
Pakistan	126836	19	27	19	53
Sri Lanka	26964	16	27	14	56
South Asia	1146716	18	28	17	54
Low Income Group	1618703	20	28	16	52
High Income Group	36794507	2	26	17	72
World	48461854	3	28	18	69

Table 21: Growth of Output

Gross domestic product	Agriculture	Industry	Manufacturing	Services	
	average annual % growth				
Bangladesh	5.6	2.8	7.7	7.3	5.8
India	7.4	2.7	8	7.7	8.9
Pakistan	5.5	2.5	7.9	10	6.1
Sri Lanka	4.8	1.2	4.4	3.5	6.3
South Asia	7	2.7	7.9	7.8	8.2
Low Income Group	6.5	3.1	7.6	7.7	7.6
High Income Group	2.3	0.5	1.4	1.8	2.4
World	3	2.5	2.6	2.9	2.8

Table 22: Structure of Merchandise Exports

	Merchandise Exports	Food	Agricultural raw materials	Fuels	Ores and metals	Manufactures
	($ millions)	% of total				
Bangladesh	11802	6	1	0	0	92
India	120254	9	2	11	7	70
Pakistan	16930	12	1	5	1	81
Sri Lanka	6886	22	2	0	4	70
South Asia	157637	11	2	9	6	72
Low Income Group	323066	17	4	15	5	59
High Income Group	8451209	6	2	8	4	77
World	12084582	6	2	11	4	73

Table 23: Structure of Service Exports

	Commercial service exports	Transport	Travel	Insurance and financial services	Computer, information, communications, and other commercial service
	$ millions	% of total			
Bangladesh	603	14.7	13.3	57	66
India	75057	10.2	11.9	4.2	73.7
Pakistan	2246	49.6	11.3	3.7	35.4
Sri Lanka	1604	46.8	25.6	3.6	24
South Asia	80602	19.3	13.7	4.2	62.8
Low Income Group	111021	19.7	18.2	3.5	58.8
High Income Group	2200476	23.4	22.7	8.8	45.1
World	2767235	23.2	27.6	7.5	41.7

Table 24: Sources of Electricity

Sources of electricity						
		% of total				
	billion kilowatt hours	Coal	Gas	Oil	Hydropower	Nuclear power
Bangladesh	22.6	0	87.6	6.7	5.7	0
India	699	68.7	8.9	4.5	14.3	2.5
Nepal	2.4	0	0	0.2	99.8	0
Pakistan	93.8	0.1	44	20.3	32.9	2.6
Sri Lanka	8.8	0	0	60.6	39.4	0
South Asia	826.7	58.1	14.9	6.9	16.7	2.4
World	18155.6	40.3	19.8	6.2	16	15.2

Table 25: The Quality of Logistics Services Varies by Income

(Score on logistics performance index)

Regions	Overall (Index)	Customs	Infrastructure	International shipments	Logistics competence	Tracking and racing	Domestic logistics costs	Timeliness
East Asia and the Pacific	2.58	2.41	2.37	2.64	2.54	2.53	3.04	3.01
Europe and Central Asia	2.59	2.39	2.39	2.61	2.53	2.55	2.97	3.04
Latin America and the Caribbean	2.57	2.38	2.38	2.55	2.52	2.58	2.97	3.02
Middle East and North Africa	2.42	2.24	2.27	2.44	2.33	2.35	2.95	2.88
Sub-Saharan Africa	2.35	2.21	2.11	2.36	2.33	2.31	2.98	2.77
South Asia	2.3	2.06	2.07	2.28	2.32	2.32	3.12	2.73
High-income countries	3.67	3.45	3.66	3.52	3.64	3.71	2.58	4.05
Upper-middle-income countries	2.85	2.64	2.70	2.84	2.8	2.83	2.94	3.31
Lower-middle-income countries	2.47	2.31	2.27	2.48	2.4	2.45	3.01	2.93
Low-income countries	2.29	2.12	2.06	2.32	2.29	2.25	2.99	2.71
Note: The maximum score attainable is 5; the minimum is 1								

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