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1
OVERVIEW OF THE SOUTH ASIAN ECONOMY

Raghbendra Jha

Introduction

This is a handbook on the economics of South Asia. The major countries in this region are Bangladesh, India, Nepal, Pakistan and Sri Lanka. Within this region India is the dominant country in terms of all major indicators including geographical area, population and GDP. According to the World Bank's *World Development Indicators 2009*, for instance, in terms of constant 2000 US dollars Indian GDP accounted for 79.1 per cent of the combined GDPs of the aforementioned major countries in South Asia. In 2008 India accounted for 72.84 per cent of the land area, 72.84 per cent of the land under cereal production and 75.25 per cent of the population in this region. In keeping with the predominance of India in this region this handbook has some chapters that focus exclusively on India.

This chapter has two purposes: to provide a brief overview of the economy of the region, and to introduce the substantial chapters in this volume. In particular, it will focus on economic growth as this has been found to be the principal vehicle for both improving livelihoods and reducing poverty.

South Asia's economic growth

An overview of real GDP growth rates since 1961 in the major countries of South Asia is provided in Table 1.1. Table 1.2 outlines the structure of output in these countries.

Table 1.1 reveals several interesting patterns about the growth experiences of these countries. Bangladesh grew at slightly less than the group unweighted average (henceforth GUA) during 1961–70, when it was part of Pakistan. Following independence from Pakistan in 1971 after a conflict, with the two oil price shocks of 1973–4 and 1979 and the accompanying global slowdown being the other contributory factors, the new country experienced a sharp drop in growth rates during 1971–80. During this period Bangladesh's growth was the lowest of this group of countries. There was, however, a sharp recovery in 1981–90 with the average growth rate nearly back to that of the 1961–70 period. The growth rate accelerated during 1991–2000 and further during the period since 2001, reaching 6 per cent in 2005. Growth dipped mildly between 2006 and 2009. Even during the peak of the global financial crisis (GFC) the growth rate was only marginally below 6 per cent.

Table 1.1 Real GDP growth rates in South Asia

	Average 1961–70	*Average 1971–80*	*Average 1981–90*	*Average 1991–2000*	*Average 2001–04*	*2005*	*2006*	*2007*	*2008*	*2009*
Bangladesh	3.84[a]	1.04	3.72	4.79	5.32	6.0	6.6	6.4	6.2	5.9
India	4.12	3.09	5.57	5.5	6.42	9.4	9.7	9.1	7.1	7.2
Nepal	2.52	2.11	4.78	4.99	3.37	3.1	3.7	3.3	5.3	4.7
Pakistan	7.25	4.72	6.3	3.97	4.35	7.7	6.2	6.0	6.0	2.0
Sri Lanka	4.56	4.42	4.2	5.22	3.45	6.2	7.7	6.8	6.0	3.5
Unweighted Average for these countries	4.45	3.076	4.91	4.89	4.58	6.48	6.78	6.32	6.12	4.66

Note: a: 1962–1970.
Source: For 2009 (estimated by) UNESCAP: Economic and Social Survey of Asia and the Pacific 2010. For all other years *World Development Indicators 2009*.

Table 1.2 Structure of output in South Asia

	Average 1961–70	*Average 1971–80*	*Average 1981–90*	*Average 1991–2000*	*Average 2001–04*	*2005*	*2006*	*2007*	*2008*
	Agriculture Value Added as Percentage of GDP								
Bangladesh			31.48	26.67	22.4	20.1	19.6	19.2	19.1
India	42.5	38.25	31.35	27.04	21.07	19.1	18.2	18.1	17.6
Nepal					38.2	36.3	34.6	33.5	33.7
Pakistan	40.2	33.03	28.18	26.12	23.27	21.5	20.4	20.6	20.4
Sri Lanka	29.98	28.9	27.11	23.01	15.02	11.8	11.3	11.7	13.4
Unweighted Average for these countries	37.56	33.39	29.53	25.71	23.99	21.76	20.82	20.62	20.84
	Industry Value Added as Percentage of GDP								
Bangladesh			21.26	24.32	26.3	27.2	27.9	28.4	28.6
India	20.3	23.05	26.16	26.38	26.55	28.8	29.5	29.5	29.0
Nepal		10.15	14.64	21.52	19.02	17.7	17.2	17.1	16.7
Pakistan	19.89	23.04	23.31	24.17	24.7	27.1	26.9	26.6	26.6
Sri Lanka	21.04	26.66	26.66	26.49	27.95	30.2	30.6	29.9	29.4
Unweighted Average for these countries	20.41	20.72	22.4	24.57	24.9	26.2	26.42	26.3	26.06
	Manufacturing Value Added as Percentage of GDP								
Bangladesh			13.7	15.07	15.85	16.5	17.2	17.8	18.0
India	14.25	16.0	16.56	16.18	15.35	15.8	16.3	16.3	16.0
Nepal		4.17	5.42	9.09	8.7	8.2	7.8	7.7	7.4
Pakistan	14.7	15.87	16.12	16.17	16.05	18.6	19.1	19.0	19.1
Sri Lanka	15.73	19.11	15.09	15.87	17.95	19.5	19.2	18.5	18.0
Unweighted Average for these countries	14.89	13.78	13.37	14.47	14.78	15.72	15.92	15.86	15.7

Table 1.2 (continued)

	Average 1961–70	Average 1971–80	Average 1981–90	Average 1991–2000	Average 2001–04	2005	2006	2007	2008
Services etc. Value added as percentage of GDP									
Bangladesh			47.29	49.02	51.32	52.6	52.5	52.4	52.3
India	37.2	38.72	42.5	46.59	52.4	52.2	52.4	52.4	53.4
Nepal		22.97	30.35	36.07	42.77	46.0	48.2	49.4	49.6
Pakistan	39.87	43.91	48.52	49.7	52.05	51.4	52.8	52.8	53.0
Sri Lanka	48.97	44.44	46.23	50.5	56.97	58.0	58.0	58.4	57.3
Unweighted Average for these countries	42.01	37.51	42.97	46.37	51.1	52.04	52.78	53.08	53.12

Source: World Development Indicators 2009.

During 1961–70 India's growth rate was above 4 per cent yet below the GUA growth rate. India's average growth rate fell sharply during 1971–80 as a result of the Bangladesh war and external shocks from the oil price crises, but was still above the GUA growth rate for that period. During 1981–90 the average growth rate picked up sharply largely because of a revival in agriculture and an expansion of government expenditure, financed by deficit financing. The average growth rate was largely unchanged during 1991–2000 and accelerated sharply during 2001–04 despite the drought of 2002–03. Growth picked up very sharply again and was in excess of 9 per cent until the global financial crisis hit in 2008. Nevertheless, growth rates in 2008 and 2009 were in excess of 7 per cent. During 2010 this growth rate is expected to be in excess of 8 per cent.[1]

Nepal has had low GDP growth rates for quite some time (during 1961–80). Growth rates picked up in 1981–2000 but slipped again in the new decade with a pickup in 2008 and 2009. Almost throughout this period Nepalese growth rate has been below the GUA growth rate.

Pakistan's growth rate was the highest in South Asia during 1961–70 but slipped sharply during 1971–80 as a consequence of external shocks and war. There was a sharp pickup during 1981–90 but from then until 2005 Pakistan's growth rates were below GUA growth rates. Growth started slipping again in 2007 and in 2009 was estimated to be only 2 per cent.

In line with the other South Asian countries Sri Lanka's growth rate slipped in the period 1971–80 after being slightly above the GUA growth rate in 1961–70. It was also decidedly low during 2001–04 and again in 2009. This growth rate was below GUA in 2005, 2006 and 2008. It was above GUA during 1991–2000 and in 2007. Thus, for most of the period Sri Lankan growth rates have been close to the GUA.

India stands out as the best performer for the period since 1991–2000, with its high and even accelerating growth rates consistently above the GUA. Jha (2008) shows that not only have Indian growth rates accelerated but they have also become more stable over time in the sense that the standard deviation of year to year growth rates has come down over time.

Underpinning this new-found stability in growth rates is the drop in the share of agriculture in GDP over the years. In the early part of the time span under study the share of agriculture was high. Table 1.2 shows that it was 42.5 per cent in 1961–70 and even higher in the 1950s. With agricultural output heavily dependent upon the vagaries of the monsoons, economic growth in this period was very volatile. With a diversification of the composition of output (agricultural output was only 17.6 per cent of GDP in 2008) growth rates have become more stable. Other countries in the region have also experienced diversification in the composition of output. In Bangladesh the share of agriculture in GDP fell from 31.48 per cent in 1981–90 to 19.1 per cent in 2008. In Pakistan and Sri Lanka the drops were significant — from 40.2 per cent in 1961–70 to 20.4 per cent in 2008, whereas the drop in Sri Lanka over the same period was from 29.98 per cent to 13.4 per cent. In Nepal the drop was less significant — from 38.2 per cent in 2001–04 to 33.7 per cent in 2008. Thus, there seems to be some association between the share of agriculture in GDP and growth performance.

Commensurate with this trend there has been a rise in the share of industry and particularly services value added in GDP. Within industry there has been a less spectacular rise in the share of manufacturing thus indicating that the non-manufacturing component of industry has grown faster. International trade in goods and services has also expanded rapidly across the region.

Explanations for enhanced growth performance

The aforementioned growth performance of these South Asian countries is even more impressive when we contemplate the many growth retarding factors that they face. These include poor human development indicators which, in some regions, compare unfavourably with regions of sub Saharan Africa, corruption, conflict, high fiscal deficits[2] with huge debt overhangs, inadequate and poor quality infrastructure in many of these countries and the like.

The impressive growth performance in some of these countries has also been a result of substantial economic reforms. Thus, Sri Lanka started liberalizing industrialization policies and policies towards international trade in the 1980s. India started some (mainly administrative) reforms in the mid 1980s and enjoyed a spell of government deficit led spurt in economic growth. More substantial policy reforms were initiated in the early 1990s and have continued almost unabated since then. These included industrial and trade policy, exchange rate policy and deep financial and banking sector reforms. Sri Lanka also initiated financial sector reforms in the 1990s. Pakistan followed somewhat later and then Bangladesh. In the area of economic reforms Nepal has not kept up with its South Asian neighbours.

In Pakistan external assistance has played a major role in improving its growth performance. In the 1990s Pakistan was faced with severe macroeconomic imbalances because of the need to service a large debt and sharp declines in external flows both remittances as well as private capital flows. However, the war in Afghanistan after the 11 September 2001 attacks in the US changed all this completely. Substantial international aid, from the US and international agencies, flowed into Pakistan and its debt was substantially reduced. Pakistan policymakers took advantage of this development to undertake deep reforms in the financial and banking sectors.

During this period most South Asian countries enjoyed substantial inflows in the form of remittances from workers working abroad. World Bank data indicate that remittances to South Asia increased from $13.35 billion in 1998–99 to$43.8 billion in 2007. In 2006 remittances accounted for 3.5 per cent of South Asian GDP. Bangladesh received $76 million as remittances in 1998 which increased to $140 million in 2007 and in 2006 remittances accounted for 4.5 per cent of Bangladesh GDP. Corresponding figures for India were $9.479 billion in 1998 and $27 billion in 2007 whereas remittances accounted for 2.8 per cent of India's GDP in 2006. For Nepal the corresponding figures are $68 million in 1998, $1.6 billion in 2007 and as much as 18 per cent of Nepalese GDP in 2006. For Pakistan these figures were $1.17 billion in 1998, $6.1 billion in 2007 and 4 per cent of GDP in 2006. Finally, for Sri Lanka the corresponding figures were $1.023 billion in 1998, $2.7 billion in 2007 and 8.7 per cent of GDP in 2006.

A final factor contributing to the high growth rates in South Asia, particularly since 2001, was the relatively benign external environment. Interest rates were low in the US, the global economy and global trade were recording unprecedented levels of growth. However, in 2004 South Asia was subjected to one of the most severe tsunamis in recorded history. Further, the rapid growth of the global economy was leading to high prices for commodities in general and petroleum products in particular. Hence, even prior to the Global Financial Crisis beginning in 2008, the region was subjected to considerable natural as well as economic shocks. The food price crisis in 2007–08 followed by the Global Financial crisis, the trigger for which occurred with the collapse of Lehman Brothers in September 2008, reduced the growth performance of the region. However, even then the major economy in the region, India, recorded growth rates in excess of 7 per cent in 2008 and 2009 and is on track to record even higher growth in 2010.

Growth accounting analyses of high growth rates in India (e.g. Kelkar, 2004, and Jha, 2008) have indicated that contributory factors include higher capital (a rise in the rate of savings to a third of GDP and a rise in the rate of investment to more than 36 per cent of GDP in 2007–08), a younger and better equipped labour force (the so-called population dividend) and higher productivity growth. Indeed, the entire landscape of production in India has gone through a

major change with services and high value added manufacturing contributing most significantly to growth performance.

Challenges to sustaining growth in South Asia

Despite the recent spurt in economic growth there are many challenges to sustaining and accelerating economic growth in the region. I comment on some of these only briefly as they are all dealt with exhaustively in the literature.

Rising regional and personal inequality, stubborn poverty and hunger

One of the key aspects of recent economic growth in the South Asia region has been the exacerbation of regional inequality. For example, for the period 1980–2000 Milanovic (2005) computes two indices of regional inequality for five large federations: Brazil, China, India, Indonesia and the US. The first index involves computing inequality between mean state gross domestic products (SGDP) of various states in these federations and therefore involves assessing regional convergence separately in each of these countries. The second involves computation of population-weighted regional mean incomes and is thus an indicator of inequality as perceived by the populations in these countries. India showed rising incidence of inequality according to both concepts over this period. There was lack of convergence of means SGDP across states in India. Using National Sample Survey data Jha (2004) formally tests for convergence in per capita expenditure and indices of poverty and inequality, and concludes that in most cases convergence does not occur and wherever it does occur it is weak.

More recent evidence from the Reserve bank of India's *Handbook of Statistics on the Indian Economy* indicates that the standard deviation of SGDP rose from Rs. 9313.72 in 1999–2000 to Rs. 13,846.85 in 2006–07 all in 1999–2000 prices. This amounts to an increase of almost 50 per cent (48.67 per cent) in the standard deviation in just seven years. In terms of individual states the SGDP of a large, poor, densely populated state such as Bihar remained around 36 per cent of the national average throughout this period. The SGDP of an even larger and more populous state (Uttar Pradesh) was 61 per cent of the national average in 1999–2000 but this had fallen to 50 per cent by 2006–07. For another poor state, Rajasthan, the SGDP was 85 per cent of the national average in 1999–2000 and this had fallen to 72.8 per cent by 2006–07. In contrast Tamilnadu's SGDP was 122 per cent of the national average in 1999–2000, which rose to 125 per cent by 2006–07. Corresponding figures for Maharashtra were 144 per cent in 1999–2000 and 137 per cent in 2006–07.

Table 1.3 indicates the dispersion in the incidence of inequality and poverty in various states in India and the country as a whole. There has been a mild increase in the rural Gini and a much sharper rise in the urban Gini. This is true for most states as well as the country as a whole. Jha (2004) argues that the rise in inequality has been the result of three factors: a shift in earnings from labour to capital income, the rapid growth of the services sector — particularly the FIIRE sector[3] — with a consequent explosion in demand for skilled workers and a drop in the rate of labour absorption during the reform period.

In the 21-year period 1983 to 2004/5 poverty in rural India came down from 46.5 per cent of the rural population to 28.7 per cent. In urban India poverty fell during the same period from 43.6 per cent to 25.9 per cent. These are not remarkable rates of decline in poverty. Unsurprisingly, the poorer states have higher and more stubborn incidences of poverty in terms of the headcount ratio, the poverty gap and the squared poverty gap. Hence, there is a growing concentration of poverty in the poorer states.

Table 1.3 Comparable estimates of poverty and inequality: India and major states

	Rural															
	Head Count ratio (% HCR) Uniform 30-day rule (using official poverty lines)				*Poverty Gap using official poverty lines*				*Squared Poverty Gap using official poverty lines*				*Gini Coefficient*			
	1983	1987–88	1993–94	2004–05	1983	1987–88	1993–94	2004–05	1983	1987–88	1993–94	2004–05	1983	1987–88	1993–94	2004–05
India	46.5	39.0	37.2	28.7	12.36	9.29	8.5	5.8	4.87	3.23	2.84	1.76	30.4	29.9	28.6	30.5
Andhra Pradesh	26.8	21.0	15.9	10.8	5.86	4.35	2.9	2.0	2.00	1.41	0.87	0.65	29.7	30.9	29.0	29.4
Assam	44.6	39.4	45.2	21.7	8.75	7.45	8.3	3.5	2.63	2.04	2.21	0.90	20.0	23.0	17.9	19.9
Jharkhand	65.5	52.8	62.3	42.9	22.0	13.56	16.2	8.9	9.8	5.03	5.59	2.55	27.2	26.6	23.4	22.7
Bihar	64.7	54.2	56.6	42.2	19.54	12.74	14.2	8.3	7.86	4.32	4.9	2.30	25.9	25.2	22.2	20.7
Gujarat	28.9	28.3	22.2	19.4	5.64	5.44	4.1	3.4	1.69	1.59	1.16	0.91	26.8	26.1	24.0	27.3
Haryana	21.9	15.3	28.3	13.6	4.28	3.62	5.6	2.2	1.37	1.30	1.75	0.61	28.5	29.2	31.4	34.0
Himachal Pradesh	17.0	16.7	30.4	10.9	3.58	2.63	5.6	1.5	1.16	0.71	1.62	0.35		27.1	28.4	31.1
Karnataka	36.3	32.6	30.1	20.0	9.73	7.88	6.3	2.7	3.69	2.80	2.01	0.63	30.8	29.7	27.0	26.5
Kerala	39.6	29.3	25.4	13.2	9.98	6.30	5.6	2.8	3.62	2.05	1.85	0.98	32.0	32.1	30.1	38.3
Chattisgarh	50.6	46.7	44.4	42.0	12.49	10.38	8.6	9.4	4.47	3.36	2.47	3.43	24.4	24.5	21.7	29.8
Madhya Pradesh	49.0	40.1	39.2	35.8	13.95	10.64	9.8	7.8	5.54	3.97	3.58	2.31	31.5	30.6	30.0	26.8
Maharashtra	45.9	40.9	37.9	30.0	11.95	9.56	9.3	6.4	4.3	3.21	3.35	1.99	29.1	31.2	30.7	31.2
Orissa	68.5	58.7	49.8	46.9	22.72	16.30	12.0	12.1	10.17	6.24	4.07	4.24	27.0	26.9	24.6	28.5
Punjab	14.3	12.8	11.7	10.0	3.03	1.97	1.9	1.3	1.06	0.51	0.48	0.26	29.2	29.7	28.1	29.5
Rajasthan	35.0	33.3	26.4	19.0	9.65	8.64	5.2	2.9	3.81	3.40	1.56	0.72	34.7	31.5	26.5	25.1
Uttaranchal	25.2	13.2	24.8	14.9	4.0	1.99	4.4	1.9	1.04	0.46	1.08	0.42	29.2	28.3	24.4	28.5
Uttar Pradesh	47.8	43.3	43.1	33.9	12.70	10.25	10.6	6.7	4.7	3.4	3.64	1.93	28.9	28.5	28.3	29.0
West Bengal	63.6	48.8	41.2	28.5	21.06	11.58	8.3	5.4	9.46	3.99	2.45	1.42	30.0	25.8	25.4	27.4

Table 1.3 (continued)

	Urban															
	Head Count ratio (% HCR) Uniform 30-day rule (using official poverty lines)				*Poverty Gap using official poverty lines*				*Squared Poverty Gap using official poverty lines*				*Gini Coefficient*			
	1983	1987–88	1993–94	2004–05	1983	1987–88	1993–94	2004–05	1983	1987–88	1993–94	2004–05	1983	1987–88	1993–94	2004–05
India	43.6	38.7	32.6	25.9	11.4	10.2	8.0	6.2	4.4	3.8	2.9	2.0	33.9	35.0	34.4	37.6
Andhra Pradesh	41.2	41.1	38.8	27.1	10.9	10.6	9.3	6.1	4.1	3.9	3.2	1.9	33.2	36.1	32.3	37.6
Assam	25.9	11.3	7.9	3.7	5.6	1.5	0.9	0.5	1.7	0.3	0.2	0.1	26.1	31.0	29.0	32.1
Jharkhand	40.5	34.6	26.5	20.7	10.9	7.8	5.2	4.7	4.2	2.6	1.6	1.5	30.9	32.1	32.5	35.5
Bihar	61.6	63.8	40.7	38.1	18.5	16.6	9.7	9.3	7.1	5.9	3.4	3.0	28.5	26.6	28.2	33.3
Gujarat	41.9	38.5	28.3	14.2	9.7	8.2	6.2	2.5	3.6	2.6	2.0	0.7	28.5	27.8	29.1	31.0
Haryana	26.4	18.4	16.5	15.6	5.8	3.6	3.0	3.2	1.9	1.1	0.9	1.0	34.8	28.7	28.4	36.5
Himachal Pradesh	11.0	7.2	9.3	5.0	2.8	0.7	1.2	1.0	1.1	0.1	0.3	0.3	35.8	29.2	46.2	32.6
Karnataka	43.6	49.2	39.9	33.3	13.3	14.1	11.4	8.9	5.5	5.7	4.4	3.1	34.2	34.0	31.9	36.8
Kerala	48.0	38.7	24.3	20.6	14.7	10.0	5.5	4.7	6.2	3.9	1.9	1.6	38.9	36.9	34.3	41.0
Chattisgarh	50.7	36.0	44.2	40.7	14.5	9.8	11.5	12.9	5.6	3.6	4.1	5.4	32.2	32.1	30.6	44.0
Madhya Pradesh	56.1	50.0	49.0	42.3	16.1	14.5	13.9	12.4	6.2	5.6	5.3	4.8	29.8	33.3	33.6	39.7
Maharashtra	41.1	40.5	35.0	32.8	12.1	12.4	10.2	9.2	4.9	5.2	4.2	3.5	34.6	34.8	35.7	37.8
Orissa	54.0	42.6	40.6	43.7	16.7	11.1	11.4	14.1	7.1	4.2	4.3	5.8	29.0	31.0	30.7	35.4
Punjab	22.9	13.7	10.9	5.0	5.9	2.3	1.7	0.6	2.3	0.6	0.4	0.1	33.9	28.8	28.1	40.3
Rajasthan	41.2	37.9	31.0	28.5	11.5	9.6	7.0	6.2	4.7	3.4	2.2	1.9	33.9	34.6	29.3	37.2
Uttaranchal	22.4	20.4	12.7	17.0	5.9	4.2	3.2	3.0	2.0	1.2	0.9	0.7	30.5	35.1	27.5	32.9
Uttar Pradesh	52.7	46.4	36.1	30.7	15.1	12.7	9.3	7.2	5.9	4.7	3.4	2.3	31.5	33.5	32.6	36.9
West Bengal	33.5	33.7	22.9	15.4	8.5	7.4	4.5	2.6	3.2	2.4	1.4	0.6	33.5	34.6	33.9	38.3

Notes: Results for 1983, 1987–88, 1993–94 are based on household level data and those for 2004–05 on group data. NSS dates chosen refer to thick samples which yield more reliable estimates. 1999–2000 is omitted because of problems of comparability. Samples in intermediate years are small and are hence omitted from the analysis.
Source: Himanshu (2007).

Mahbub ul Haq Human Development Centre (2007) provides information on poverty in the other South Asian countries. In Bangladesh 35.6 per cent of the population lived below the national poverty line during 1984–99. During 1995–2004 this had climbed to 49.8 per cent. The corresponding figures for Nepal, Pakistan and Sri Lanka were 42, 34 and 25 per cent respectively in 1984–99 and 30.9, 32.6 and 25 per cent respectively in 1995–2004. Thus the progress in poverty reduction in these countries has been even more disappointing than in India. Clearly, poverty reduction in the South Asian countries has been inadequate.

So far as hunger goes between 1980 and 2005 in India real GDP per capita grew at a rate of 3.9 per cent per annum whereas this growth between 2000 and 2005 was an even more impressive 5.4 per cent. Even though less spectacular, real per capita consumption growth in the period 2000–2005 has also been strong at 3.9 per cent per annum. Yet, as Deaton and Dreze (2009) indicate, more than 75 per cent of the population has daily per capita calorie consumption below 2,100 in urban areas and 2,400 in rural areas. These magnitudes are cited as minimum requirements for Indians. Apart from the consequences of such deprivation for health and wellbeing there is evidence (Jha et al., 2009) to support the contention that this deprivation is actually leading to a poverty nutrition trap where low nutrition leads to low productivity, which leads to low wages, which lead to low nutrition, thus completing a vicious cycle. Jha (2008) provides an overview of progress in human development indicators in India.

Clearly, notwithstanding the impressive growth performance of the South Asian countries, there is much left to be attained in terms of human development indicators. In the context of a democratic polity this often amounts to an exacerbation of pressures to address redistributive concerns rather than economic growth. Hence, the political consensus in favour of continuing reforms gets diluted. This is true in most of the South Asian countries but especially so in India, which has a long-standing tradition of representative democracy.

Infrastructural constraints

Infrastructure has at least three characteristics that make it central to sustaining economic growth and poverty reduction (Jones, 2006): infrastructural services involve substantial economies of scale since these have to be combined with other inputs to produce output; infrastructure has important network externalities; and infrastructure involves lumpy investment and, therefore, high sunk costs.

World Bank (2005) summarizes well the infrastructural constraints faced by South Asian countries. The first such problem is inadequate access. This is particularly true in the area of electricity. An inadequate and unreliable supply of electricity is routinely rated as the biggest obstacle to business growth in South Asia, ahead of corruption and taxes. Less pressing but nevertheless serious problems exist with roads, ports and water supplies. In fact apart from telephone and ICT services there is hardly any infrastructure item in adequate supply in South Asia.

A second problem is the structure of supply of infrastructural services. Most of the utilities in the region are in the public sector making them inefficient and beset with problems of bad governance. This also impedes investment in infrastructure and indeed in developing models for private sector participation in the huge infrastructural investment needs of the South Asian countries.

Finally, the legacy of mutual suspicion prevents the South Asian countries from exploiting the mutually beneficial opportunities from trade in energy and other infrastructure items. Bangladesh's reluctance to sell natural gas to India is a case in point. Further, such mutual suspicion prevents South Asian countries from exploiting, in tandem with each other, the immense energy resources in Central Asia.

Environmental constraints

The South Asian region also faces considerable environmental constraints. Major areas of concern include toxic contaminants: mainly organo-chlorines, dioxins, pesticides, grease and oil, acid and caustic metals; discharges from mines, chemical producers, pulp and paper plants, and leather tanning factories; untreated fluid waste being discharged into rivers; poorly managed domestic waste; and smoke and burning. In addition there are issues of degradation related to soil erosion, open access resources and congestion/traffic. Jha and Whalley (2001) report that in 1992 the environmental cost to India was $13.8 billion, or 6 per cent of GDP. This estimate does not include traffic-related costs, pollution costs from toxic wastes and biodiversity losses. In addition there is the big issue of climate change threatening Himalayan glaciers and, indeed, the periodicity and the intensity of the monsoons as well as temperature patterns. These are threats for the entire region.

Shocks: natural and external

In addition the South Asian region is vulnerable to shocks both natural and external/economic. Natural shocks include earthquakes, tsunamis, cyclones, floods, drought and extreme weather events. External economic shocks include financial crises, propagation of international business cycles, commodity price swings and exchange rate shocks. Further, the region is beset with its fair share of environmental problems.

Short run prospects for the region

Against this background it would be perilous to make any firm predictions for the future of the region. Over and above the aforementioned constraints to economic growth is the major concern of how security issues including domestic insurgency and terrorism will play out in the region. These are to be remembered as important caveats to the brief overview of the short-run prospects for the region that follows. This narrative is punctuated by some prescriptive analysis as well.

Overall, the prospects for economic growth appear sanguine in India and, to a lesser extent, in the other South Asian countries. In the case of India, economic growth will probably diversify from the yet narrow bases of services and high value-added manufacturing to labour-intensive manufacturing. As Chinese incomes rise following decades of high economic growth, Chinese wages might begin to rise and China might lose its comparative advantage in labour-intensive manufacturing. If India is able to put in place labour market reforms that permit flexibility in decisions to hire and fire labour, small and medium enterprises (SME) may finally enter into an era of high growth. Currently the distribution of firms by size of the labour force is largely bipolar with small-scale enterprises and large firms occupying most of the industrial space. Small-scale enterprises are not subject to the currently prevalent laws restricting hiring and firing labour, and large firms hire largely from the organized labour market. This is particularly anomalous for a country like India where nearly 90 per cent of the labour force works in the unorganized sector. The design of laws to permit more flexibility in the labour market would have at least four beneficial effects:

- it would draw more workers into the organized labour market and reduce the insecurities associated with working in the unorganized sector,
- it would diversify the base for economic growth,

- it would reduce the problem of urban unemployment and accelerate poverty reduction, and
- since the infrastructural demands of medium-scale enterprises would be lower than those of large enterprises there would be greater regional diffusion of industrial activity leading to a more balanced regional growth.

One of the factors sustaining high economic growth in India has been the large domestic base for economic expansion. The growth of the middle class would enhance this outcome. However, much depends on the extent and speed of integration of the domestic economy with the international economy. In particular, a too hasty adoption of capital account convertibility would expose the Indian economy to systemic risks. In any case, the lack of full capital account convertibility was one of the factors providing some insulation to the Indian economy from the financial market storms of 2008 and 2009. These would need to be supplemented with measures to continue restrictions on the operation of foreign banks in India.

Another important reform which could sustain rapid economic growth in India is the liberalization of domestic markets and the freeing up of internal trade from state and other sub-national barriers. Jha et al. (2006) show that rice markets in India are quite fragmented in that there is greater integration between markets in the same state than across state boundaries. The fact that India has been able to put in place a harmonized central and state value-added tax augurs well for this integration but many regulations and restrictions remain to be addressed.

Attaining energy security will also be an essential ingredient of a strategy for attaining sustainable growth rates in India. Currently India is heavily reliant on imported petroleum with inadequate known reserves. With half the population not having access to reliable sources of electricity a substantial increase in electricity generation capacity, mostly from coal-powered thermal power plants, can be expected. In the absence of substantially improved technology this would inevitably lead to substantial carbon emissions. Nuclear energy is a recent entry into the energy mix but at the moment it does not appear poised to make a substantial contribution to India's energy needs. Some effort is being directed toward renewable sources of energy but costs are high and substantial subsidies would be needed to make these sources of energy viable on a large enough scale.

Another area of concern and opportunity is agricultural production and productivity. For a substantial time now, India's policymakers have been increasing current subsidies (e.g. on fertilisers and electricity) to agriculture at the expense of investment in agriculture (Mullen et al., 2005, Purohit and Reddy, 1999). Some subsidies may be justified but there is a widespread view that most of these subsidies are usurped by the more affluent section of farmers. Current subsidies, apart from being inefficient, have also had an inequitable impact. At the same time they contribute to large deficits both at the central and state levels and reduce the funds available for servicing the accumulated public debt. This problem can no longer be ignored because of the sharp rise in food prices since August 2007 and continued pessimism, in the absence of substantial policy intervention, about prospects for a return to stability on this front.

An introduction to the chapters in this handbook

The *Handbook* portends to provide an overview of some of the key issues and challenges facing the economies of South Asia and is divided into six sections:

- *Part I Economic growth*: Bishnupriya Gupta in her chapter entitled 'India's growth in a long-run perspective' traces the structure and basic contours of India's economic growth since

colonial times and provides an explanation of this growth performance. Sambit Bhattacharyya, in his chapter entitled 'Five centuries of economic growth in India: the institutions perspective', argues that institutional change and other deep factors may have played a very significant role in the transformation that India's growth performance underwent from Mughal to British rule to the slow growth of the immediate post-independence years and the spurt in growth since liberalization. In her chapter entitled 'India's two-track economy: an exploration into the dualism of India's complex economic structure', Rimjhim M. Aggarwal uses the notion of complex adaptive systems (CAS) to understand the persistent duality in India's economy with a traditional and a modern sector co-existing side by side. She argues that this ensuing dualism has the implication, among other things, of decoupling growth from poverty alleviation.
- *Part II Human development issues*: Takashi Kurosaki, in 'Economic inequality in South Asia', provides an overview of the evolution of inequality in South Asia, particularly in the past twenty years or so. He also analyses links between inequality, poverty and economic growth in this region. In their chapter entitled 'The importance of education and literacy skills: perspectives from labour markets and health in South Asia', Urvashi Dhawan Biswal and Bagala Biswal provide an overview of India's attainments in the areas of education and literacy and implications thereof for labour markets and health in the country. They provide an evaluation of current policy in these areas and are prescriptive about how to better approach these issues in the future. In his chapter entitled 'Improving schooling quality as a human development strategy in India', Anil B. Deolalikar emphasizes that, although access to schooling remains a challenge in India, the single most important problem facing the Indian school education sector is the quality of education. He reviews current policy towards the quality of schooling and suggests reforms to facilitate better outcomes. In their chapter entitled 'Natural disasters in South Asia', Raghav Gaiha, Kenneth Hill and Ganesh Thapa catalogue the increasing incidence of natural disasters in South Asia and underscore the implications for human vulnerability in the region. They outline the contours of a policy of development assistance that would combine speedy relief with durable reduction in vulnerability.
- *Part III Monetary and fiscal issues*: In their chapter entitled 'Monetary policy framework in India: past, present, and future', Takeshi Inoue and Shigeyuki Hamori review the literature on monetary policymaking in India. They also consider the potential and shortcomings of alternative monetary policy regimes for India. In 'Exchange rate regimes and macroeconomic performance in South Asia', Ashima Goyal emphasizes the effect of supply side factors in determining exchange rate behaviour in India. She argues in favour of implementing countercyclical policy more suited to structure, and removal of distortions raising costs, in order to enable better coordination of monetary and fiscal policies to support exchange rate policies. In 'South Asia and the global financial crisis: impact and monetary policy responses', Rabin I. Hattari, Mohammad Shahidul Islam and Ramkishen S. Rajan review the impact of the ongoing global financial crisis on South Asian economies. They also review the role of monetary policy in the region in addressing the fallout from the crisis and make a number of policy suggestions. In my chapter, 'Fiscal policies and challenges in South Asia', I present an overview of the extant fiscal situation in South Asian countries, review the sustainability of their debt and make suggestions for fiscal policy reform.
- *Part IV Sectoral issues*: in 'Infrastructure issues in South Asia', Sanjay Kumar Singh reviews the status of major infrastructure items (including, among others, transport, electricity and water) in South Asia. He emphasizes the enormous needs for infrastructural investment in

South Asia and discusses managerial and finance models that could facilitate these. Simrit Kaur, Vani S. Kulkarni, Raghav Gaiha and Manoj K. Pandey, in 'Prospects of non-farm employment and welfare in rural areas', emphasize the importance of non-farm employment in India's agricultural sector. Using data from the latest thick round of the National Sample survey they model the determinants of such employment and make policy recommendations.

- *Part V International trade and financial flows*: Garry Pursell, in 'Trade policies in South Asia', considers trade policy changes in the South Asian region as well as individual countries in the region since the mid-1980s. He considers both tariff and non-tariff barriers to trade and indicates that, from the point of view of trade liberalization, most of the changes have been negative. In 'Foreign capital flows and development: lessons from the South Asian experiences', Nagesh Kumar reviews the attractiveness of the South Asian economies in terms of their attractiveness for foreign direct investment and foreign portfolio investment. He shows that, although such inflows have gone up, their development potential has not been fully tapped and makes policy recommendations to improve the utilization of such inflows. In 'Trade, growth and poverty in South Asia', Keshab Bhattarai concludes that increasing trade has led to higher growth rates in Bangladesh, India, Bhutan and Sri Lanka, but not in Nepal or Pakistan. The increased trade integration has been associated with lower poverty rates in India and Sri Lanka but actually higher poverty rates in Nepal, Bangladesh and Pakistan. In 'Impact of South Asia on global institutions: economic and social perspectives', Shandre M. Thangavelu and Sanja S. Pattnayak review the importance of South Asia in the emerging global economy. They also underscore a number of conditions that South Asian countries must fulfil in order to fully contribute to the evolving global economic order.
- *Part VI Environmental issues*: in 'State of environment in South Asia', K.V. Bhanu Murthy analyses global environmental degradation at the South Asia regional level. He suggests that these countries are well below the threshold of the developed world in the area of environmental degradation and are, hence, justified in exploiting more of their environmental and natural resources. Vijay P. Ojha, in 'Climate change mitigation strategies in South Asia', considers policies towards CO_2 emissions in the South Asian region, particularly India. He underlines the necessity for these countries of addressing their own carbon emissions without much support from developing countries or global institutions. He also evaluates options for CO_2 reduction in India.

Notes

1 The IMF forecasts India's growth rate during 2010 and 2011 to be 9.4 per cent and 8.4 per cent respectively. See <http://www.imf.org/external/pubs/ft/survey/so/2010/RES070710A.htm> (accessed 8 July 2010). This compares favourably with global (emerging and developing economies) growth forecasted for the two years to be 4.6 per cent and 4.3 per cent (6.8 per cent and 6.4 per cent) respectively.

2 Sri Lanka and India have run fiscal deficits of over 9 per cent of GDP for decades.

3 FIIRE is an acronym for finance, insurance, Internet and real estate.

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