

Preface

South Asia has attracted global attention because it has experienced rapid GDP growth since 1980, averaging nearly 6 percent per annum. Yet, it faces many challenges. There are two faces of South Asia. The first South Asia is dynamic, growing rapidly, highly urbanized, and is benefiting from global integration. The second South Asia is largely agricultural, land-locked, exhibits high poverty, suffers from many conflicts, and is lagging. The divergence between the two faces of South Asia is on the rise. Many policy and institutional constraints contribute to this dichotomy. One important constraint is regional conflict that has made South Asia one of the least integrated regions of the world. While progress has been made in reducing trade barriers with the rest of the world, intraregional trade is a mere 5 percent of total official trade as compared with over 50 percent in East Asia. Capital flows through legal channels are negligible, transit arrangements are cumbersome and expensive, and the physical connectivity is limited and restrictive. Additionally, lack of effective cooperation has constrained progress on a range of public goods including climate change, water management, HIV/AIDS control and disaster management.

The cost of weak regional cooperation tends to hurt the poor more than the other segment of the population. Two of the poorest South Asian countries are Afghanistan and Nepal; both are land locked. Several lagging regions in the larger South Asian countries of Bangladesh, India and Pakistan are located in the border areas and suffer from lack of market integration. Over 500 million people, most of them very poor, live in the Indus and the Ganges-Brahmaputra river basins. These great basins are shared by six nations and are characterized by almost no cooperation and, instead, marked political sensitivity and tension. Several attempts to promote cooperation have failed. Climate change is predicted to have serious impacts on the monsoon, on river flows, and on the rising sea level, with increased incidence of floods and droughts in areas where current

shocks already regularly and severely affect the lives and livelihoods of large numbers of people.

In addition to policy and institutional reforms aimed at removing domestic constraints to growth and job creation, market integration and regional cooperation ought to be key elements of a regional strategy for removing the dichotomy between the two faces of South Asia and eliminating poverty over the longer term. South Asia needs two types of market integration—providing countries, especially the land-locked ones, with a broader access to regional and global markets; and integrating the lagging regions within each country with the growth centers without regard to boundaries. The geography of South Asia is such that both types of market integration will require regional cooperation. After Europe, South Asia has the second largest number of cities in the border region. Most countries share a common border with India.

The unique geography of South Asia—distance and density—has the potential to raise growth through increased trade. South Asia has the highest population density in the world. Distance of cities from the border is low. These features naturally propel trade between countries, but presently this is hindered by policy barriers. For example, currently at US\$1 billion, trade between India and Pakistan could jump to US\$9 billion if trade restrictions are removed. Similarly, estimates suggest that intraregional trade in South Asia could increase from US\$5 billion to US\$20 billion if restrictions on trading with neighbors are removed.

The benefits of scale economies could be even bigger, particularly to the small land-locked countries. As in Africa, the smaller countries in South Asia do not have the necessary scale economies to invest in infrastructure (energy, telecom, transport). Regional market integration could provide the benefit of scale economies to the smaller countries to invest in infrastructure. Nepal, for example, could double its GDP if it could export hydro-based electricity to India, an energy thirsty country.

Benefits of cooperation on water and climate would be immense. From the Himalayas, where glacier melt is already changing water flows in ways that remain to be fully understood, to the coastal floodplains of Bangladesh and Pakistan, South Asian countries need to adapt to climate change. This can provide the much-needed trigger for opening a dialogue on regional water cooperation. For example, cross-border cooperation on water between India, Bangladesh, and Nepal offers the only long-term solution to flood mitigation, and would benefit over 400 million people.

The benefits of regional cooperation for South Asia are obvious. Yet a range of political constraints prevent cooperation from happening.

The political dynamics will need to change as the opportunity cost of non-cooperation for South Asia's poor is large. A part of this change will come from leadership from the civil society in terms of much more informed knowledge and debate of the underlying opportunities, issues, and constraints.

The objective of the First South Asia Economic Summit was to provide a forum for this public debate on economic cooperation in South Asia. The South Asia Economic Summit was held in Colombo during 28–30 August, 2008, as a follow-up to the 15th SAARC Heads of State Summit, also held in Colombo. This was organized by the Institute of Policy Studies, Sri Lanka, and the Federation of Chambers of Commerce and Industry of Sri Lanka in partnership with RIS (Research and Information Systems, New Delhi, India), SACEPS (South Asia Center for Policy Studies, Kathmandu, Nepal), SAWTEE (South Asia Watch on Trade, Economics, and Environment, Kathmandu, Nepal), World Bank, Commonwealth Secretariat, UNDP-RCC (United Nations Development Program-Regional Center of Colombo), and Asian Development Bank. The Conference brought together academics, private sector, civil society, and policy makers from Afghanistan, Bhutan, Bangladesh, Pakistan, India, Nepal, Maldives, and Sri Lanka.

This book draws selectively from the range of papers and presentations made at the Economic Summit. In selecting the papers, we looked at both the quality and direct relevance to the theme of this collected volume. We also thought it useful to include a few hitherto unpublished papers that were prepared for another conference on regional cooperation sponsored by the World Bank. These concern the private sector's perspectives on cooperation. The Colombo Summit did not have a large participation from the private sector and as such the other conference papers helped meet this gap and thereby enrich the story on regional cooperation presented in this book.

The book is organized into three parts. Part I talks about the imperative for cooperation in terms of the development context of why cooperation is necessary for South Asia. Part II then looks in some depth at a number of specific areas of options and opportunities for cooperation, including trade, trade facilitation, transport, financial and food crises, migration, and tourism. Part III provides the private sector's perspectives on regional cooperation based on contributions from business leaders of Bangladesh, India, Pakistan, and Sri Lanka. Finally, Part IV deals with a number of political economy issues relating to distribution of gains from cooperation

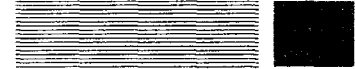
among participating countries and how to make SAARC more effective in implementing agreed programs.

We would like to convey our special thanks to all the sponsoring institutions for their support in making this Summit successful. We would also like to thank all the individual authors for their contributions to the book. Thanks are due also to Marjorie Kingston (World Bank) and Sharmini De Silva (IPS) for their help in processing the book.

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Part I

The Imperative for Cooperation



A Perspective on Peace and Economic Cooperation in South Asia

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1. INTRODUCTION

This is the moment of reckoning in South Asia. The economic dynamism and innovativeness of its people is catapulting the region into a leadership position as the seismic change in the global economy shifts its center of gravity from the West to Asia. Yet at the same time, the region is threatened by the specter of a nuclear holocaust, the rupturing of the social fabric by religious extremism, persistent poverty of the masses amid the affluence of elites and the destabilization of the life support systems of its ecology. In this context, regional cooperation has become an important framework for addressing the grave challenges and utilizing the great opportunities. In this chapter, we begin in Section 2 by indicating the economic opportunity now available to South Asia and its rich cultural tradition that can be brought to bear to build a better world. In Section 3, we discuss the need for a new policy paradigm to address the multiple challenges of peace, poverty, and environmental degradation in a holistic fashion. We discuss the need to bring to bear a new sensibility rooted in the South Asian tradition of human solidarity,

harmony with nature, and the values of sharing and caring. We also discuss a new policy paradigm of cooperation for economic welfare and ecological survival. This paradigm is an alternative to the existing policy paradigm of competition and conflict to achieve economic welfare and power over other states. In Section 4, we analyze the relationship between the peace process, development, and human security. In Section 5, we analyze the constraints to the peace process between India and Pakistan, the nature of path dependence, and some of the short- and medium-term initiatives that can be undertaken to catalyze the peace process and to achieve regional cooperation.

2. CAN SOUTH ASIA LEAD THE WORLD?¹

South Asia is likely to play a key role in the global economy in this century. In doing so, the people of this region could help address the challenges of poverty, peace, and environmental degradation that confront the world. In this chapter, we will indicate the economic, political, and cultural issues involved in addressing these challenges.

South Asia is at a historic moment of transforming the economic conditions of its people and playing a leadership role not only in the global economy but also in the development of human civilization in the twenty-first century. For the first time in the last 350 years, the global economy is undergoing a shift in its center of gravity from the continents of Europe and North America to Asia. If present trends of gross domestic product (GDP) growth in China, the United States, and India continue, then, in the next two decades, China will be the largest economy in the world, the United States the second largest, and India the third largest. If South Asian countries develop an integrated economy, however, then South Asia could become the second largest economy in the world after China. Given the geographic proximity and economic complementarities between South Asia, on the one hand, and China, on the other, this region could become the greatest economic powerhouse in human history.

Yet the world cannot be sustained by economic growth alone. Human life is threatened by the environmental crisis and conflicts arising from the culture of greed, endemic poverty, and the egotistic projection of military power. Societies in this region have a rich cultural tradition of experiencing unity through transcending the ego, of creative growth through human solidarity and a harmony with nature (Nehru 2004; Perry 1995; Schuon

1995; Syed 1968, 9–22). In bringing these aspects of their culture to bear in facing contemporary challenges, the people of this region could bring a new consciousness and institutions to the global-market mechanism. In so doing, South Asia and China can together take the twenty-first-century world on to a new trajectory of sustainable development and human security. It can be an Asian century that enriches human civilization.

3. CHANGING THE POLICY PARADIGM: HUMANITY, NATURE, AND ECONOMIC GROWTH

As South Asia acquires a leadership position in the global economy over the next two decades, a change is required in the policy paradigm of nation-states: from conflict to cooperation, from the production of new weapons as the emblem of state power to the nurturing of a new sensibility that can sustain life on earth.

We will suggest that if sustainable development is to take place in the global economy—indeed, if life itself is to survive on this planet—a new relationship will have to be sought between human beings, nature, and economic growth. South Asia with its living folk tradition of pursuing human needs within the framework of human solidarity and harmony with nature may be uniquely equipped to face this challenge.

3.1 The Global Ecological Crisis

In perhaps the largest collaborative scientific effort in the world history, some of the leading environmental scientists recently worked together to produce the United Nation's Intergovernmental Panel on Climate Change (IPCC) assessment report (IPCC 2007). Earlier, a similarly comprehensive audit was conducted on the state of the life support systems of planet Earth by the Millennium Ecosystem Assessment. Both reports present evidence that indicates an ecological crisis. The results show that over the past 50 years, humans in the process of economic growth have caused "substantial and largely irreversible loss in the diversity of life on Earth": 25 percent of the species living on earth have gone extinct in the last 50 years. The crisis is made even graver by the fact that "60% of the ecosystem services that were examined in the study are being degraded ... including fresh water ... air and the regulation of regional and local climate" (Millennium Ecosystem Assessment Report 2005).

The IPCC assessment of the impact of global warming and associated climate change provides evidence that the adverse changes in the life support systems of the planet have been directly caused by human intervention (IPCC 2007). It can be argued that this intrusion into the ecosystem is associated with the levels and forms of production and consumption associated with the economic growth over the last three centuries within the framework of capitalism.

The IPCC report projects with a high degree of confidence that the increased global average temperatures will result in major changes in "ecosystem structure and function," leading to "negative consequences for biodiversity and ecosystem goods and services e.g. water and food supply" (IPCC 2007, 11). It is projected that climate change associated with global warming could decrease crop yields in South Asia by 30 percent by the mid-twenty-first century. This could result in an increase in the intensity and extent of the food crisis and sharply increased poverty that is already being observed.

The IPCC assessment shows that approximately 20–30 percent of plants and animal species are at increased risk of extinction (IPCC 2007, 11). The consequent reduction in biodiversity would make the ecosystem more fragile and therefore more susceptible to exogenous shocks.

The existing process of production and consumption of goods involves releasing toxic gases and materials into the air, land, and water systems. Since the Earth's ecology has a maximum-load capacity, it is clear that the present consumerist culture, patterns of economic growth, and underlying institutional structure cannot be sustained indefinitely into the future without undermining the life support systems of the planet. *For sustaining life on Earth, a new relationship will have to be sought between human beings, nature, and economic growth. Thus, we may be on the threshold either of ecological disaster or the construction of a new human civilization. In this situation, for South Asia to lead the world means introducing new cooperative forms of social and interstate relations to achieve sustainable development, human security, and freedom from hunger. This will require new forms of social organization, technologies, and institutions underpinned by a new consciousness that can sustain life on earth.*

3.2 The New Sensibility

Today, the market is being apotheosized as the mythical space in which the individual can be free and yet provided with plenty by the hidden hand of the market. Yet, inherent in the capitalist accumulation process is the

systematic inculcation of an insatiable desire to possess goods (Hussain 2002). As Marx (1990), writing in the nineteenth century, pointed out, "The capitalist system not only produces goods that satisfy needs, but also the needs that these goods satisfy." The subliminal language of advertisement does not *represent* goods, but rather *fantasizes* goods such that they appear to us not in terms of their material attributes, but as magical receptacles of such qualities as beauty, efficacy, and power (Barthes 1973). Thus, qualities that we actually possess as human beings are transposed into goods, and the individual gets locked into an endless pursuit of acquisition (Hussain 2002).

The culture of consumerism, which the market systematically inculcates, is inconsistent with conserving the environment. The life support systems of our planet cannot be sustained beyond a certain limit in the levels of global output growth despite any foreseeable development and adoption of green technologies. As Mahatma Gandhi said, "There is enough in the world for everybody's need but not for everybody's greed."

Contemporary market culture is marked by the atomization of society, the inculcation of greed, egotism, and the estrangement of the individual from his humanity. A new, more humane sensibility must form the basis of a sustainable process of economic growth, forms of production, distribution, and societal as well as interstate relations. Perhaps South Asia can contribute to the contemporary world by weaving from the golden threads of its folk cultures the tapestry of a twenty-first-century sensibility.

In South Asia, the interaction of diverse civilizations across millennia has brought to the surface certain fundamental features of each civilization, which while being rooted in its specific linguistic, religious, and cultural *form*, are essentially of a universal nature. Underlying the diversity of religious beliefs is a universal spiritualism of love, beauty, and truth. Associated with this sensibility is a set of values of caring and sharing. In this context, three characteristics of a South Asian sensibility can be articulated:

- The *other* constitutes the essential fertilizing force for the growth of the self. The *other*, when brought into a dynamic counterposition to the *self*, helps to transcend the ego and thereby enlarge the experience of the *self*. To recall the words of Shah Hussain, the Punjabi Sufi poet, "You are the woof and you the warp, you are in every pore, says Shah Hussain Faqir, I am not, all is you." In the tradition of the Sufis, or the Bhaktis, or the Buddhists, or the Christians, it is through the act of giving that the self is enhanced.

- In the South Asian tradition, whether the Muslim Sufis, the Bhaktis, or the Buddhists, the self is detached from the *desire* for commodities, which are seen as merely *useful*. The Greek philosopher Aristotle held a similar view when he observed in his *Nicomachean Ethics* that goods cannot have value since they are merely useful. It is human functioning that is of value (Aristotle 1998). The voice of the Sufis still echoes in contemporary South Asian folk culture: "Those who have accumulated millions that too is mere dust" (Shah Hussain); and the Tamil poet Kambar in describing a good society says, "There was no one who did not have enough, there was no one who had more than enough" (Wignaraja et al. 1991).
- Nature in the South Asian tradition is treated not as an exploitable resource but as a reference point to *human* nature. Nature is the context within which we experience our connection with the eternal, and sustain economic and social life. The Bishnoi community in Rajasthan and the peasants of Bhutan still conduct their production and social life in harmony with nature, as part of their spiritual beliefs. Najam Hussain Syed, the contemporary Sufi poet of the Punjab, writes, "Plant the moonlit tree in your courtyard, nurture it, and thereby remain true to the beloved."

Amid its diversity, South Asia has shared civilizational propensities of transcending the ego as a means of fulfillment, of locating the need for goods in the context of human responsibility, and of harmonizing economic and social life with nature. It is this South Asian sensibility and the associated human values that could be brought to bear in building a new relationship between humans, nature, and production to sustain life in the twenty-first-century world.

3.3 South Asia and the New Policy Paradigm

All great epochs of economic and cultural achievement are associated with a critique of the received wisdom of the day and a rediscovery of a universal humanity that lies at the root of specific ideological and religious traditions. So must it be for South Asia as it faces the prospect of a leadership role in the twenty-first century. Let us begin with a critical examination of the theoretical postulates that have formed the basis of economic and foreign policy of modern nation-states.

The policy paradigm underlying the last three centuries of economic growth within nation-states and political relations between states has

been characterized by two propositions that are rooted in conventional social science theory:

- Maximization of individual gains in terms of continuous increases in production and consumption within a competitive framework ensures the maximization of social welfare at the national as well as global levels (Gilpin 2001).
- The economic and political interests of a nation-state are best achieved by translating economic gains into military power.² The assumption here is that a state can enhance national welfare by initiating, or being part of an initiative for projecting, hegemonic power over other states.

These propositions now need to be questioned because of the increased interdependence of people and states on each other and on the ecology within which they function. As this region develops a leadership role in the world, let us briefly critique the following propositions as the basis for an alternative policy paradigm:

- First, the idea that competition alone ensures an efficient outcome may not be necessarily true in all cases in view of the work by Nobel laureate, economist John Nash, who proved mathematically that in some cases the equilibrium, which maximizes individual gains, could be achieved through cooperation rather than competition (Nash 1996).

The Nash equilibrium solution may be particularly relevant in the context of India–Pakistan relations. Consider. India, if it is to sustain its high growth rate, will require sharply increased imports of oil, gas, and industrial raw materials from West and Central Asia, for which Pakistan is the most feasible conduit. Similarly, India's economic growth, which has so far been based on the domestic market, will, in the foreseeable future, require rapidly increasing exports for which Pakistan and other South Asian countries are an appropriate market.³ Thus, the sustainability of India's economic growth requires cooperation with Pakistan. Conversely, peace and cooperation with India is essential for Pakistan if it is to achieve and sustain a GDP growth rate of about 8 percent, overcome poverty, and build a democracy based on a tolerant and pluralistic society. It is clear that governments in India and Pakistan will need to move out of the old mind-set of a zero-sum game, in which gains by one side are made at the expense of the other. Now the welfare of both

countries can be maximized through joint gains within a framework of cooperation rather than conflict.⁴

The missing dimension of the relationship between competition and welfare in conventional economic theory is that of institutions. The recent work of another Nobel Prize-winning economist, Douglass North, has shown that if competitive markets are to lead to efficacious outcomes, they must be based on a set of underlying institutions (North 1990). He defines institutions in terms of constraints to behavior for achieving shared objectives within an appropriate combination of incentives and disincentives. We can apply North's principle to suggest that emerging economic powers need to seek a broad framework of cooperation for the efficient functioning of a competitive global economy.

Our proposed logic of locating competitive markets within broader institutional structures of cooperation at the regional and global levels is necessitated by the integrated ecology of the planet. Global cooperation in environmental protection, poverty reduction, and defusing the flash points of social conflict and violence will become the essential underpinning of sustainable development and human security in this century.

- The second proposition in conventional social science theory and political practice is that the economic welfare and political influence of a nation-state can be best achieved by translating economic gains into military power. This is also questionable. In the new world that is now taking shape, the influence of an emerging power will be determined not by the magnitude of the destruction it can wreak on other countries but by its contribution to enhancing life in an interdependent world. Thus it is not the military muscle of a state that will be the emblem of status, but its contribution to meeting the challenge of peace, overcoming global poverty, and protecting the planet from environmental disaster.

Meeting these challenges will require a deeper understanding of the processes that shape nature and human societies, as well as a deeper awareness of our inner self and our shared civilizational wellsprings. Thus, as South Asia pursues a leadership position in the global economy, it will also have to strive to reach the cutting edge of human knowledge in the natural and social sciences. At the same time, it will have to bring to bear its value system rooted in the experience of humanity that is evoked in its diverse literary and philosophical traditions (Nehru 2004; Pallis 1995; Syed 1968).

4. HUMAN SECURITY, DEVELOPMENT, AND THE PEACE PROCESS

4.1 Peace: A Question of Life and Death

South Asia today stands suspended between the hope of a better life and fear of cataclysmic destruction. The hope emanates from its tremendous human and natural resource potential: the rich diversity of its cultures that flourish within the unifying humanity of its civilization. The fear arises from the fact that South Asia is not only the poorest region in the world but also one whose citizens live in constant danger of a nuclear holocaust. At the same time, the structures of state and the fabric of society are threatened by armed extremist groups who use hate and violence to achieve their political goals.

It can be argued therefore that interstate peace in the region rather than enhanced military capability is the key to national security, indeed, to human survival. We will propose in this chapter that peace between India and Pakistan not only is necessary for sustaining economic growth but also is vital for building pluralistic democracies and thereby sustaining the integrity of both states and societies in the region.

4.2 Militarization, Human Security, and National Integrity

States in South Asia have primarily pursued "national security" through the building of the military capability for mass annihilation of each other's citizens. It is not surprising that South Asia is the poorest and yet the most militarized region in the world (Haq 1997). It contains almost half the world's poor and has the capability, even in a limited nuclear exchange, to kill more than 100 million people immediately, with many hundreds of million more dying subsequently from radiation-related illnesses (Barry and Hirsh 1998).

The arms race between India and Pakistan (two countries that account for 93 percent of the total military expenditure in South Asia) is responsible for this cruel irony. India, which is ranked at 142 in terms of per capita income, ranks first in the world in terms of arms imports. Pakistan is not far behind, being ranked 119 in terms of per capita income and 10th in the world in terms of arms imports (Haq 1997). These military expenditures whose scale is unprecedented in the developing world are being undertaken

in the name of achieving national security in a situation in which the majority of the population in South Asia is living below the international poverty line (US\$2 a day) (Haq 2006, 51), 46 percent of the children are malnourished (Haq 2006, 70), and 35 percent of the population is suffering from health deprivation (measured in terms of lack of access to safe water and undernourished population) (Haq 2006, 68). The trade-off between military expenditures and the provision of basic services is worth considering. For example, a modern submarine with associated support systems costs US\$300 million, which would be enough to provide safe drinking water to 60 million people. These figures call into question the logic of increasing military expenditures to achieve national security.

The deadly nuclear dimension that since 1998 has been added to the India–Pakistan arms race is seen by the respective governments to reinforce national security through a presumed “deterrence.” In this context, it can be argued that three features define the India–Pakistan strategic nuclear environment, which imply a high probability of an accidental nuclear war, thereby making nuclear deterrence unstable: (a) the flying time of nuclear missiles between India and Pakistan is less than five minutes; (b) the unresolved Kashmir dispute fuels tensions between the two countries, making them susceptible to disinformation about each other’s intentions; and (c) intrastate social conflicts in each country feed off interstate tensions.

Apart from the danger of an accidental nuclear war, the current structure of the India–Pakistan tension is such that a terrorist attack can induce military mobilization and repeatedly bring both countries to a point at which the nuclear button could be deliberately pressed by one, then the other side. Consider the elements of the structure: First, armed militant groups continue to conduct what they see as a war of liberation in Kashmir. Pakistan’s government claims that such groups are not under its control, while India continues to accuse it of being involved in “cross-border terrorism.” Second, when a high-profile terrorist attack occurs in India, Pakistan is held responsible, as occurred following the outrageous attack on the Indian Parliament (December 2001) and the barbaric train bombings in Bombay (July 2006). In the former case, India actually mobilized its military forces in a warlike deployment on the India–Pakistan border. Third, in the case of an Indian incursion into Pakistani territory following a terrorist attack, if the territorial gains of Indian forces reach an unspecified critical level, Pakistan has made clear that it will use nuclear weapons to defend itself. At the same time, the declared Indian nuclear doctrine involves, in response, an all-out nuclear attack on Pakistan. As

the Indian Defense Minister George Fernandes clarified in December 2002, such an all-out nuclear retaliation will occur even if Pakistan drops a nuclear bomb on Indian forces operating within Pakistani territory (Global Security Newswire 2002).

These elements of the Pakistan–India problem could spark a military confrontation between the two states at any time. Moreover, given the relative lack of geographic depth in the Pakistan case, a conventional war could quickly reach the nuclear threshold. That this prospect is terribly real was illustrated on at least three occasions: The first occasion was India’s Operation Brass Tacks in 1986. This military exercise, which Pakistan saw as a prelude to an Indian invasion, led to a threat of nuclear war by the then Pakistani Foreign Minister Sahibzada Yaqub Khan, given explicitly to his old college mate I. K. Gujral, the Indian foreign minister, during a meeting in Delhi. The second illustration is the Kargil conflict in 1999. This conflict quickly escalated to a mobilization of military forces along the international border. The danger of an all-out war became so grave that Prime Minister Nawaz Sharif had to rush to Washington to get President Clinton’s support to avoid it. Bruce Reidel,⁵ who was present during the Nawaz–Clinton meeting, claims the United States had information that Pakistan was preparing its nuclear arsenal for possible use. Furthermore, he claims that Clinton actually asked Sharif, “if he knew how advanced the threat of nuclear war really was” (Reidel 2002). The third occasion came after the attack by armed militants on the Indian Parliament in 2001. India mobilized its military forces along the international border with Pakistan and tension rose to a point at which Pakistan threatened “unconventional” military retaliation if war broke out.⁶ Thus the very structure of the India–Pakistan situation suggests that wars between the two countries cannot be localized or conventional.

With the stakes of catastrophic destruction as high as they are in the region, any nonzero probability of nuclear war should be unacceptable. Yet, as we have argued, the defining features of the nuclear environment in South Asia make the probability of an intentional or accidental nuclear war perhaps higher than in any other region of the world.

In contrast to the preoccupation of governments to achieve “national security” within a paradigm of conflict, the citizens of even adversarial states share a common concern for human security: They seek security from the threats of war, religious extremism, economic deprivation, social injustice, and environmental degradation. Bridging this gap between the preoccupations of state and civil society is necessary to maintain the social contract that underlies the writ of the state and sustains national integrity.

Thus, establishing a new framework of lasting peace for the provision of human security to civil society is essential for the stability of states in South Asia. The questions are, what are the constraints to such a lasting peace and what factors can drive the peace process? These questions are addressed in the following section.

5. THE CONSTRAINTS AND DRIVERS OF THE INDIA–PAKISTAN PEACE PROCESS

Let us start with the strategic dimension of the political economy of India and Pakistan, respectively, within which both the constraints to and the drivers of the peace process can be examined. India's economic strength lies in the fact that having established a heavy industrial base during the Nehru period in the 1950s, and reconfigured India's policy framework in the 1990s to play a role in a globalized economy, India's economy has been launched on a high-growth trajectory. With a domestic technological change capability, international competitiveness in selected cutting-edge sectors like software and electronics, and large capital inflows, India has achieved impressive GDP growth over the last two decades. Yet it has been predominantly based on the home market, with India's exports as a percentage of world exports still less than 1 percent. Continued growth in the future will require acceleration in export growth. To sustain GDP growth, India will need to establish (a) markets for its manufactured exports in South Asia and abroad and (b) an infrastructure for the supply of oil, gas, and electricity. It is in this context of sustaining GDP growth that three strategic imperatives for India become apparent: (a) achieving a regionally integrated economy through an early implementation of the Islamabad South Asian Association for Regional Cooperation (SAARC) Summit Declaration on the South Asian Free Trade Agreement (SAFTA) in January 2004; (b) securing oil and gas pipelines and rail and road transportation routes from Central Asia to India through Pakistan; and (c) overcoming political disputes with Pakistan and other South Asian neighbors to establish a political framework of lasting peace that would be integral to economic union.

Peace and economic cooperation with Pakistan are necessary for India not only to secure its strategic economic interests but also to maintain its secular democratic polity. A high-growth, open economy framework for India today is inseparable from a liberal democratic political structure.

Therefore, the existing social forces of Hindu nationalism, intolerant of minorities, will undermine India's secular democratic structure as much as its economic endeavor. Continued tension between India and Pakistan will only fuel extremist religious forces in both countries, to the detriment of their economy and polity.

Pakistan, by contrast, is faced with an economic crisis whereby it is unable to sustain high GDP growth due to an aid-dependent economic structure, inadequate export capability, and recurrent balance-of-payments pressures. The persistent high levels of poverty and continued tension with India fuel the forces of religious extremism. Armed militant groups have now emerged as rival powers to that of the state within its territorial domain, thereby threatening the structure of the state as well as the fabric of society. Peace with India will mean a substantially improved environment for the much-needed foreign and domestic investment. This could play an important role in accelerating and sustaining GDP growth and poverty reduction in Pakistan.

It is clear that through peace, both India and Pakistan can reap economic benefits for their people and secure their respective democratic structures against the forces of religious extremism. The national security of both countries is threatened not by the neighbor across the border but by internal social forces of intolerance, violence, and poverty. A new structure of peace would reduce the danger of cataclysmic destruction from nuclear war and also provide the two nations with economic and political stability. Thus, by providing increased security of life and livelihood to both countries, national security in their respective nations will be enhanced.

Trade and investment historically has been both the cause and consequence of institutional change. So it can be for Pakistan, India, and indeed South Asia as a whole. Thus, with respect to SAFTA, implementation of the Islamabad SAARC Declaration (SAARC 2004) would be another strategic step toward achieving regional economic integration and peace and strengthening the institutional structures of democracy in the region.

Pursuant to SAFTA, Pakistan ought to quickly establish free trade and investment with India and other South Asian countries, together with an easing of travel restrictions within the region for the people of South Asian countries. Free trade and investment within South Asia and particularly between India and Pakistan could be a driver of change in the institutional structure of the economy, polity, and society: (a) it would be a powerful economic stimulus; (b) it would create stakeholders for peace and the demilitarization of the polity in Pakistan, which would strengthen the struggle for civilian supremacy in Pakistan; and (c) it would help build a

tolerant and pluralistic democratic culture. Let us briefly examine each of these dimensions of institutional change resulting from an India–Pakistan peace settlement.

5.1 Economic Cooperation

5.1.1 Free Trade and Sustainable Growth with Equity

An economic opening up with India would sharply accelerate GDP growth in Pakistan through increased investment by Indian entrepreneurs. Moreover, import of relatively cheaper capital and intermediate goods from India could reduce capital-output ratios in Pakistan and thereby generate higher GDP growth for given levels of investment. At the same time, the import of food products during seasonal shortages could reduce food inflation and thereby improve the distribution of real income in Pakistan. Easing of travel restrictions would give a massive boost to Pakistan's tourism, services, and retail sectors, which could stimulate growth. It also would increase employment elasticities with respect to GDP growth (since the tourism sector is labor intensive), thus increasing employment and improving income distribution. Thus, free trade relations with India would enable Pakistan to achieve a higher and more equitable GDP growth.

5.1.2 Free Trade and Civilian Supremacy

As free trade and investment bring substantial economic dividends to the middle and lower middle classes, a large constituency will be created in Pakistan to change the existing perspective of Pakistan as a "national security state," which is presumed to be "threatened by India" and hence requires the dominance of the military in the polity and national policy. Shifting from the ideology of a national security state to a democratic perspective will make it possible to acknowledge that the security and welfare of citizens is primarily achieved through peace and development. This change in the national perspective can be an important factor in achieving civilian supremacy within the polity.

5.1.3 Free Trade and Democratic Culture

An important constraint to building a democratic polity and indeed the principal threat to state structures in South Asia arises from internal

conflicts such as religious extremism; ethnic, communal, and caste conflicts; and linguistic sub-nationalism. Containing these conflicts requires institution building for a pluralistic society. In such a society diverse identities between individuals can coexist, and at the same time, multiple identities can be maintained by each individual.⁷ For example, Muslims and Hindus not only should be able to live in peace, but also a particular individual could be a Muslim, a Balochi, a Karachiite, a Pakistani, a South Asian, and a Commonwealth citizen concurrently.

Underlying the cultural diversity in South Asia is the unity of shared wellsprings of human civilization. It is a unity that is nurtured by its diversity. Thus national integrity is strengthened not by the denial of multiple identities but by creating a democratic polity within which they can blossom. Essential to the building of pluralistic democracies in India and Pakistan, respectively, is the opening up of new economic and cultural spaces within which the people of the two countries can encounter the "other." In so doing, citizens of the two countries can experience the diversity and richness of the self. In the past, state-sponsored mutual demonization has sustained interstate conflict. Demonization involves a narrowing of the mind and a constriction of the identity that places the self and the other into a mutually exclusive and conflicting dichotomy. Nurturing one's richness requires a human relationship within which the other is experienced as a vital fertilizing force in the growth of the self. Liberating the dynamic of such a human contact between erstwhile "enemies" could be vital to the enrichment of identities and the building of pluralistic democracies in Pakistan and India.⁸

5.2 The Dialectic of Cooperation and Confrontation

The constraints to the peace process can be understood in terms of the dialectic between the strategic political and military imperatives for peace on the one hand and the pressures for path dependence within the military establishment on the other. We will briefly discuss this dialectic within the power system to explain the stop-go nature of the peace process and to review the opportunities now available for triggering medium-term change.

5.2.1 The Strategic Imperatives for the Peace Process

The decision by the Musharraf government to engage with India in a peace process was predicated on three power system imperatives:

- Reducing tensions with India in order to focus on economic growth was seen by the new military regime as a means of achieving political legitimacy.
- After 2001, when Pakistan joined the West in the war against terrorism in Afghanistan, closure of the front (at least temporarily) was a rational military necessity to avoid a two-front situation.
- The military government thought it politic to accede to what had now become a popular demand for peace with India.

These strategic military and political imperatives induced General Musharraf to engage with India on the basis of a new and innovative policy formulation constituted by three elements:

- A shift away from the traditional Pakistani position of making a plebiscite in Kashmir the precondition for normalizing economic relations with India was replaced by a new position: a *composite* dialogue was to be conducted within which economic relations with India were to be discussed side by side with the resolution of outstanding political and territorial disputes, including Kashmir.
- The dynamics of each of these two tracks were different: the potential for trade relations produced results relatively rapidly, while the process of resolution of the Kashmir dispute, given its intractable nature, was expected to be much slower. It was initially thought that success in economic relations and the resultant peace dividend would not only create constituencies for lasting peace in both countries but also would help build confidence between the two contending states, resulting in a positive synergistic effect on the political dispute resolution process.
- There was a significant and innovative change from Pakistan's traditional "plebiscite or nothing" Kashmir position in which a plebiscite was seen as the "unfinished business of partition" and hence essentially a bilateral dispute. This was replaced by a more rational policy whereby General Musharraf proposed that the following:
 - Both Pakistan and India should set aside their traditional rigid positions and seek common ground.
 - The resolution of the dispute should be acceptable to India, Pakistan, and the people of Kashmir, making the earlier bilateral dispute a trilateral one.

5.2.2 The Power System Constraints to Peace

General Musharraf's stated policy initially produced encouraging results, with a substantial increase in trade volumes between India and Pakistan and confidence-building measures, including increased visa permits for a larger number of travelers across the border. The structural restrictions to trade and, indeed, to investment could be overcome only if Pakistan granted Most Favored Nation (MFN) status to India. This status would enable trade, instead of being restricted to a few officially negotiated items, to be opened up for a free flow of goods and capital, as in the case of other countries under the World Trade Organization (WTO) regime. These structural constraints to freer trade persisted even as Pakistan under the SAARC umbrella signed the Islamabad Declaration making a SAFTA a national objective.

It is at this point that the power system constraints to the peace process kicked in. Influential elements in the establishment regarded a rapid improvement in economic relations and a permanent peace with India as ultimately a threat to the *raison d'être* of a large military establishment, The military was getting a lion's share of the budget on the basis of the "Indian threat" and the ideology of a national security state. Fears of Pakistan's economy being swamped by India began to circulate, as did the notion that the very identity of the state would be threatened by normalization of relations with India.

These considerations acted as a brake on the peace process, and Prime Minister Shaukat Aziz pointedly declared that improvement in economic relations was dependent on progress on the Kashmir dispute. Thus, the policy of delinking the economic and political tracks was reversed and progress in economic relations once again made hostage to the intractable Kashmir dispute. This setback in the peace process was reinforced as President Musharraf's political position weakened and his reliance on support from his military constituency increased amid the gathering storm of the judicial crisis. The peace process went on hold as President Musharraf faced the double threat to his government from the democratic opposition on the one hand and the intensified attacks from militant extremists on the other.

The new democratic government in Pakistan, which emerged after the February 2008 elections, holds promise to pursue what Foreign Minister Shah Mahmood Qureshi recently called a "comprehensive settlement" with India. Earlier the co-chairperson of the People's Party of Pakistan, Asif Ali Zardari, declared the government's intentions to accelerate the

peace process and focus on economic cooperation.⁹ The imperatives of peace for building a dynamic economy and a democratic polity are clearly apparent to the leadership of Pakistan's fragile democracy.

5.2.3 Path Dependence and the Short-term Triggers for Accelerating the Peace Process

The concept of path dependence was conceived by Douglass North as a tendency of individuals and groups to resist institutional change where such a change threatens their interests. Such individuals and groups are willing to invest their energy, resources, and time to resist institutional change (North 2005, 51). Thus, as North points out, path dependence is "the constraints on the choice set in the present that are derived from historical experiences of the past" (North 2005, 52).

The problem of path dependence in this context is located in the mind-sets of the respective bureaucracies in the two countries that have emerged through many years of mutual demonization. These mind-sets were reinforced by the wars between India and Pakistan in 1965 and 1971, the more limited Kargil conflict in 1999, and the protracted insurgency in Indian-occupied Kashmir. The recurrent military confrontations and the perception of each other as adversaries in a zero-sum game have bred attitudes of mutual mistrust and suspicion among the military establishments, the bureaucracies, and to some extent the political leadership of the two countries. The attitudes of the political leadership in Pakistan and India have changed significantly during the last decade as a result of the popular pressure to pursue peace. "The trust deficit," however, in the respective military and bureaucratic establishments remains unchanged.

The problem of path dependence in this context is illustrated by an observation made by Prime Minister Manmohan Singh in August 2004, when he graciously invited members of the South Asia Center for Policy Studies to his house in New Delhi for a discussion over tea. When it was suggested that the gains of peace were great for both India and Pakistan and that history had placed the prime minister and the Pakistani leadership in a position to make history by actualizing these potential gains for the people of both countries, the prime minister responded with an incisive remark: "The gains from peace are immense, yet old attitudes of strife, mistrust, and suspicion could lead us to a sub-optimal solution." He went on to say that he is willing, however, to make a "new beginning." Any ideas for peace would have his "fullest support, and I hope that of

my government,"¹⁰ he said, turning hesitantly to his National Security Adviser (at that time Mr Dixit).

These "old attitudes" are evident in the power system constraints to peace, which primarily are located in the bureaucratic and military establishments of the two countries. These constraints are locked in the "old attitudes" not only because of the persistence of modes of thought now considered obsolete but also because of their present economic power and influence over the political leadership based on what are regarded as "national security considerations," which may depend on maintaining the status quo. The possibility of overcoming "old attitudes" and taking initiatives for peace is located in the space available to democratic governments within the power structures of the bureaucracy and military and their ability to translate the will of their people for economic welfare and peace into policy action.

Clearly, free trade between Pakistan and India would be an important medium-term objective that could sustain and substantially accelerate the long-term political process for institutionalizing a lasting peace between the two countries. In the context of the power system discussion above, it can be argued that the short-term initiatives required for the medium-term objective in the Pakistan case are integrally linked with the initiatives for strengthening and deepening democracy that are proposed in the preceding section. Achieving free trade essentially would be an act of persuasion, whereby a popular consensus is created among civil society organizations, think tanks, and a responsive parliament. Free trade also would involve persuading the military establishment that such trade would be in the best interest of Pakistan and therefore of the military. Moreover, it would enlarge the corporate gains of the military within its economic sphere.

Four specific short-term initiatives could be undertaken to trigger the process of achieving economic cooperation between India and Pakistan:

- **Host a Conference of South Asian Parliamentarians.** Host a conference focused on the issue of regional economic cooperation.¹¹ The issue of free trade and implementation of SAFTA ought to be the main item on the agenda. The participants of the conference could include representatives from regional think tanks, experts who have worked on regional cooperation, representatives of civil society advocacy organizations for peace and economic cooperation, civil servants involved in the peace process, lawyers, the media, and representatives from the faculties of the Command and Staff College and the National Defence University.

- **Establish a Network of South Asian Institutes for Regional Cooperation.** Create a network of regional institutes in South Asia that are devoted to policy research and advocacy for peace and economic cooperation through a series of workshops. These workshops would bring together the latest thinking on issues of peace and economic cooperation in South Asia and specifically the dynamics of the peace process.
- **Establish an Advocacy Program for South Asian Parliaments and Governments.** Establish an institutional base to unite representatives of civil society organizations in Pakistan and India as well as representatives from regional think tanks to undertake a short-term advocacy program with their respective parliaments and governments to create the basis for a definitive decision on SAFTA implementation in the SAARC Summit of 2010.
- **Ease Travel Restrictions for Tourism in South Asia.** Ease travel restrictions for South Asians traveling in South Asian countries to enable greater economic, cultural, and social interaction among the citizens of India and Pakistan, in particular, and South Asia, in general. The sharp increase in the magnitude of tourism following an easing of travel restrictions would be a powerful economic stimulus to the economies of the region, and tourism could become one of the largest industries in Pakistan and some of the smaller South Asian countries. Moreover, the secondary multiplier effects of tourism would be to increase incomes of wide strata of the population as porters, restaurant and hotel staff, and transporters.

5.2.4 Medium-term Drivers of Peace and Economic Cooperation

The following medium-term initiatives could be undertaken by the private sector and civil society in South Asian countries with support from SAARC and could help overcome path dependence:

- **South Asia Health Foundation.** Establish a South Asia Health Foundation (SAHF) to make the benefits of peace and cooperation in South Asia palpable to people through improved health care. The objective of the SAHF would be to establish high-quality model hospitals, together with satellite clinics and outreach programs for preventive health care, in selected districts in each of the countries of South Asia.¹²

- **South Asia Education Foundation.** Create a South Asia Educational Foundation (SAEF) on the basis of contributions by individual SAARC member countries, individual philanthropists, and (more substantially) multilateral donor agencies. The purpose of SAEF would be to create a network of high schools at an international standard in every *tehsil* (at least one in each *tehsil*) of each of the countries of South Asia. These SAARC schools could act as role models and set the standards for both the private sector and the individual governments to follow.

An important dimension of setting up the SAARC network of schools in Pakistan would be to counteract the growing influence of *madrassas* and militant religious groups that are enlarging their dragnet of indoctrination, particularly in the rural areas and small towns of the North West Frontier Province (NWFP) and the Punjab. One of the factors that attract students to the *madrassas* is that, in most cases, they get free lodging and board, with the parents having to pay only nominal fees. The SAEF schools, which would provide a broad-based liberal education, ought to have a differential fee system wherein children from affluent families pay higher fees to partially subsidize those from poor families. An endowment fund for scholarships could be created to provide free education to students from poor families. Additionally, the schools should have a residential facility for out-of-town students and a provision for free lunch to day scholars.

- **Energy Cooperation in South Asia.** Establish a system for energy cooperation in South Asia through the following initiatives:
 - In the context of developing energy markets of these resources, power trading in the region calls for establishment of high-voltage interconnections between the national grids of the countries of the region. India, Pakistan, and Bangladesh should cooperate in establishing a gas pipeline for transporting gas from Iran, Qatar, Turkmenistan, and even Myanmar.
 - The precondition to create a competitive power market is to allow freedom for generators to produce electricity and distributors to sell in the market. In this context, the joint development, trading, and sharing of energy should be pursued.
 - Apart from electricity production and distribution through large hydroelectric projects, it is time to undertake joint efforts to develop innovative new technologies, such as solar and wind energy and single turbines on the canal system, for use in both

the national and regional grids as well as at the village and *tehsil* levels.

- **Investment within South Asia through Joint Venture Projects.** Increase regional investment and growth through the following key joint venture projects:
 - Facilitate joint private sector projects to build a network of motorways and railways to international quality standards throughout South Asia. These modern road and rail networks would connect all the major commercial centers, towns, and cities of SAARC countries with each other and with the economies of Central Asia, West Asia, and East Asia.
 - Facilitate regional and global joint venture projects to develop new ports along both the western and eastern seaboard of South Asia, and at the same time upgrade existing ports to the highest international standards.
 - Facilitate regional investment projects to build a network of airports, together with cold storage facilities and warehouses, which could stimulate not only tourism but also the export of perishable commodities such as milk, meat, fish, fruits, and vegetables.
 - Facilitate regional joint venture projects to build dams to utilize the huge untapped potential for energy and irrigation in the mountain ranges of South Asia. These dams should be designed and located strictly in accordance with the existing international treaties, such as the Indus Basin Treaty.
 - Facilitate regional joint venture projects to improve the irrigation efficiency of the networks of canals and watercourses in South Asia.
- **Regional Cooperation for Environmental Protection.** Pursue the following specific areas in which regional cooperation could encourage protection of the environment:
 - Institutionalize cooperation in the face of growing water scarcity to undertake innovative joint efforts for water conservation, and improved delivery and application efficiency of irrigation. This could include constructing medium- and small-size dams for increased water availability in the off-season and water distribution on an equitable basis between countries and provinces,

lining the canals and water courses, and improving on-farm water management.

- Pursue joint efforts to reduce emissions of greenhouse gases within South Asia and joint diplomatic efforts to achieve the same objective on a global scale to combat global warming.
 - Pursue joint efforts to develop heat-resistant varieties of food grains and to conduct biotechnology research to achieve a new green revolution in South Asia as the old green revolution comes to an end.
 - Pursue joint efforts at reforestation of watersheds. The treatment of industrial and urban effluent waste could reduce soil erosion, devastating flash floods, and toxicity of rivers.
 - Share biosaline research and technical know-how on controlling desertification of soils (for example, the use of plants such as halogenic phradophytes to control salinity).
 - Share know-how on ecologically sound industrial technologies and cost-effective and safe methods of effluent disposal.
 - Share information on water flow of rivers, especially flood forecasting.
 - Engage in joint projects for the development of Himalayan resources, especially the prevention of deforestation and soil erosion on the mountain slopes.
 - Collect, systematize, and subject to scientific evaluation the traditional knowledge systems of South Asian communities, which have experience of innovative techniques to conduct their economic existence in a harmonious relationship with nature.
- **Restructuring Growth for Faster Poverty Reduction.** A rapid improvement in the material conditions of the people of South Asia requires not only a faster economic growth rate but also a restructuring of growth to make it pro-poor.¹³ This requires providing the institutional basis and economic incentives to change the composition of investment toward those sectors that generate relatively more employment and that enable increased productivity and incomes of the poor (Hussain 2003b).¹⁴ In this context of achieving pro-poor growth, three sets of measures can be undertaken at the country as well as regional levels:
 - Undertake joint venture projects to rapidly accelerate the growth of those subsectors in agriculture and industry, respectively, which have relatively higher employment elasticities and which

can increase the productivity and hence put more income into the hands of the poor. These subsectors include production and regional export of high-value-added agricultural products such as milk, vegetables, fruits, flowers, and marine fisheries.

- Facilitate a regional network of support institutions in the private sector to enable small-scale industries located in regional growth nodes, with specialized facilities such as heat treatment, forging, quality control systems, and marketing facilities in country-specific and regional economies.
- Establish a SAARC Fund for vocational training to create a network of high-quality vocational training institutes for the poor. Improved training in market-demanded skills would enable a shift of the labor force from low-skill to higher-skill sectors and thereby increase the productivity and income-earning capability of the poor. At the same time, it would generate higher growth for given levels of investment by increasing factor productivity.

6. CONCLUSION

South Asia in the twenty-first century has an opportunity to lead the world by addressing the challenges of poverty, peace, and environmental degradation through cooperation in a region where these challenges are manifest in their most intense form. Regional cooperation in South Asia could enable a new form of equitable and sustainable economic growth. This would involve new initiatives for restructuring the growth process to make it pro-poor and accelerating the process of peace and economic cooperation. Innovative initiatives are required to develop new institutions and technologies for use at the regional, national, and local levels in the fields of water resource management, energy production, heat-resistant seed varieties, reduced soil depletion, and reduced greenhouse gas emissions. Equally important, this process of achieving sustainable development could be catalyzed by capitalizing on South Asians' rich cultural tradition of seeking unity in diversity, human solidarity, and harmony with nature.

Never before in history was the choice between life and comprehensive destruction as stark as it is today. The question is, can we grasp this moment and together devise a new path toward peace, freedom from hunger, sustainable development, and regional cooperation? There is

an urgent need to move out of the mind-set that regards an adversarial relationship with a neighboring country as the emblem of patriotism that views affluence of the few at the expense of the many as the hallmark of development, that sees nature as an exploitable resource, and that embraces individual greed as the basis of public action. We have arrived at the end of the epoch when we could hope to conduct our social, economic and political life on the basis of such a mind-set.

NOTES

1. This section is based on a more elaborate paper presented by the author before the Parliamentarians from South Asian countries at the South Asian Free Media Association (SAFMA) Conference on Evolving a South Asian Fraternity, Bhurban (16 May 2005).
2. "[E]ach of the leading states in the international system strove to enhance its wealth and its power to become (or remain) both rich and strong" (Kennedy 1988, i).
3. India's exports as a percentage of its GDP (at purchasing power parity) are 2 percent. For details, see <http://www.cia.gov/cia/publications/factbook/geos/in.html#Econ>. India's share in total global exports increased by 0.26 percent—from 0.41 percent in fiscal year 1992–93 to 0.67 percent in 2000–01. In the next 5 years beginning fiscal year 2002–03, India aims to raise the share further by 0.33 percent by 2006–07 to have a 1 percent share of total world exports. For more details, see http://www.indiaonestop.com/tradepartners/indias_trade_partners.html (accessed on 6 October 2009).
4. For a more detailed discussion of this proposition, see Hussain (2008a).
5. Bruce Reidel was at that time President Clinton's Special Assistant for Near Eastern and South Asia Affairs at the National Security Council.
6. President Musharraf was reported to have said that Pakistan was not afraid to use unconventional weapons if attacked according to the daily *The Hindu* (see Global Security Newswire 2002).
7. For a discussion on multiple identities, see Sen 2006, 3–5.
8. This subsection is drawn from Hussain 2006, 233–34.
9. In an interview with CNN-IBN's program *Devil's Advocate*, Asif Ali Zardari said that good relations with India would not be held hostage to the Kashmir dispute. He said that the two countries would wait for future generations to resolve the issue and the two countries should focus on trade ties for now (reported in the *Daily Times*, Sunday, 2 March 2008).
10. This discussion was first reported in my article, "Taking the Peace Process Forward" (Hussain 2004b). Significantly, Prime Minister Manmohan Singh repeated his remark about subsequently making a "new beginning" in the United Nations.
11. A few years ago, SAFMA organized a highly successful conference in Bhurban of Parliamentarians from each of the countries of South Asia in which it was agreed that the peace process should be made irreversible through institutional mechanisms in both government and civil society.

12. For an elaboration of this concept, see Hussain 2004a.
13. For a detailed discussion on pro-poor growth, see Hussain 2003a.
14. For a more recent discussion on the subject, focused on the institutional basis of pro-poor growth, see Hussain 2008b.

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Making Regional Cooperation Work for South Asia's Poor

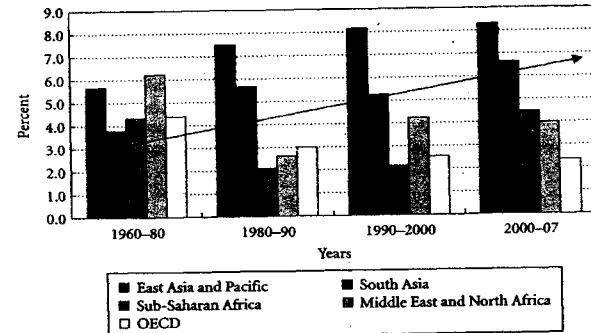
*Sadiq Ahmed and Ejaz Ghani*¹

1. INTRODUCTION

South Asia continues to grow rapidly, and its largest economy, India, approached near double-digit growth in 2006–07. This is a remarkable transformation of a region whose countries have been infamously dubbed a “basket case.” Well up to the late 1970s, South Asia, which includes eight countries—Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka—was known for conflict, violence, and widespread and extreme poverty. In the initial years after independence, the South Asian countries adopted import substitution growth strategies with heavy trade protection, curbed the growth of private firms, and introduced restrictive labor laws to protect workers. After some 30 years, the outcome of these policies turned out to be quite different from what the leadership had in mind. South Asia delivered sluggish growth, continued dependence on low-productivity agriculture, low levels of industrialization, weak export performance, and inadequate creation of good jobs. Between 1960 and 1980, South Asia grew at only 3.7 percent per year. Much of the labor force was engaged in low-income activities in agriculture and informal services, and some 45 percent of the population lived below the poverty line.

South Asia's prospects changed in the 1980s as it adopted pro-growth policies. It opened up markets to international competition, replaced the public sector with the private sector as the engine of growth, and improved macroeconomic management (Ahmed 2006). The results were impressive. South Asia's annual gross domestic product (GDP) growth rate climbed to around 5.7 percent during 1980–2000, and further accelerated to 6.5 percent during 2000–07. It is now the second-fastest-growing region in the world, after East Asia. Growth rates in South Asia and East Asia appear to be converging (Figure 2.1). In 2007, India experienced a remarkable GDP growth of 9 percent, close to that of China. Other South Asian countries such as Bangladesh, Pakistan, and Sri Lanka experienced growth rates of 6.5 percent. Private investment has boomed, supported by rising national saving rates in South Asia. The region now attracts global attention because of rapid growth, global outsourcing, and skill-intensive service exports. Rapid growth has been instrumental in reducing poverty in South Asia. Poverty has come down sharply in all countries (Figure 2.2). Progress has been made in improving human development, and social indicators compare favorably with countries in other regions with similar income levels (Ahmed 2006).

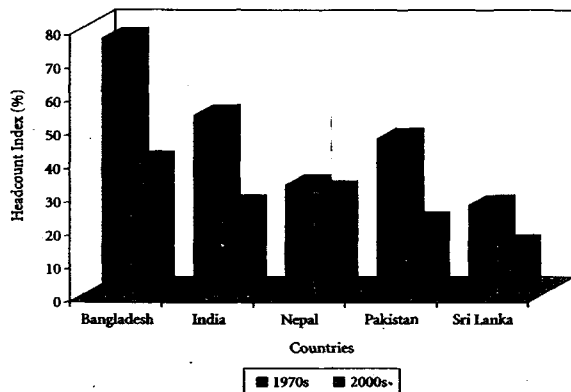
FIGURE 2.1 Real GDP Growth



Source: World Bank's World Development Indicators.

Note: Data are averages. South Asia's data include the 2007 growth rate, while the rest of the regions do not.

FIGURE 2.2 Poverty Reduction in South Asia, 1970s–2000s



Source: World Bank regional database.

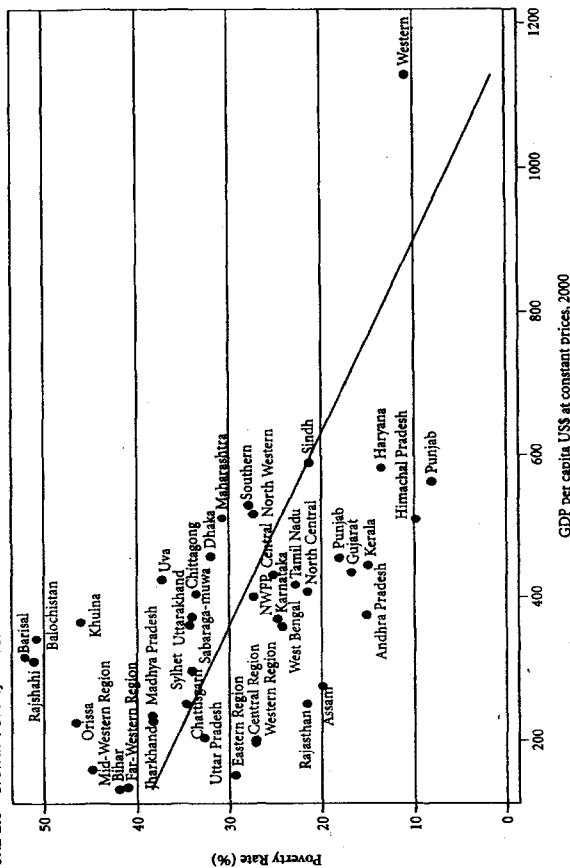
Note: Poverty estimates use national poverty lines. The respective dates are as follows: Bangladesh (1975 and 2005); India (1974 and 2005); Nepal (1977 and 2004); Pakistan (1970 and 2005); and Sri Lanka (1976 and 2005).

While there is much to celebrate, two negative developments have emerged: (a) evidence of growing income inequality in South Asia, and (b) a growing imbalance among regions within countries and among the countries themselves. With fairly large and open borders, the growing imbalances in incomes and opportunities among South Asian countries present similar social and economic problems to the prosperous neighbors as the imbalances within these countries.

Poverty, income growth, and lagging regions are interrelated. South Asia's experience shows that the incidences of poverty and income growth are strongly and negatively correlated (Figure 2.3). With few exceptions, lagging regions exhibit a higher than average rate of poverty and lower than average per capita incomes. The growing divergence between lagging and leading regions suggests that lagging regions on average are growing more slowly than leading regions.

So, a substantial part of the poverty and lagging regions challenge is a growth challenge. Two major development issues face South Asia: (a) How can South Asia grow even faster than in the recent past? (b) How can

FIGURE 2.3 Growth–Poverty Correlation in South Asia



Source: Staff estimates using data from Figures 2.4 and 2.5.

lagging regions accelerate growth to catch up with growth in the leading regions?

The problem of inequality is, however, a more complex challenge. Growth acceleration in the lagging regions might help reduce inequality. But this is only part of the larger task of making growth more inclusive. A pattern of growth that benefits income growth for the poor, higher employment elasticity of growth, and strengthened public service delivery, including better social protection policies, all need to be core elements of a strategy to lower income inequality.

2. GROWTH ACCELERATION, LAGGING REGIONS,² AND INEQUALITY: A FRAMEWORK

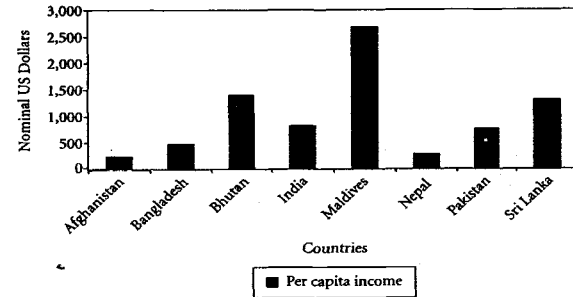
The experience of East Asia shows that growth supported by factor accumulation as well as productivity improvements can lead to higher growth (Gill and Kharas 2007). South Asia's experience is similarly positive (Ahmed 2006). Additionally, it has two key assets—demography and geography—that have not yet been fully utilized. It has a young labor force. More workers will join the labor force over the coming decades.

Though the small size of the manufacturing sector has prevented the region from converting this demographic dividend into an opportunity, the large and potentially productive labor force could be the catalyst that attracts regional and global production centers to South Asia, as firms move in response to wage differences and globalization benefits low-income countries. South Asia's geography also has the potential to accelerate growth. It has the highest population density in the world, and the second largest proportion of population living in the border areas after Europe. High population density and better access to markets can benefit growth by allowing South Asian firms to take advantage of agglomeration economies.

Despite these benefits of geography—density and distance—South Asia's true growth potential has not been realized because of the lack of market integration within and across countries. South Asia accounts for only 3 percent of the world surface area, but it sustains an extraordinary 20 percent of the world population, nearly 1.5 billion people. It has the highest population density in the world, yet it has one of the lowest urbanization rates. There are indeed large differences across countries in South Asia. In 2005, India (which accounts for 74 percent of the regional

population) produced close to 80 percent of the South Asian GDP. Pakistan (13 percent of South Asian population), Bangladesh (10 percent), Sri Lanka (1 percent), and Nepal (2 percent) accounted for 11 percent, 6 percent, 2.3 percent, and 0.7 percent of the regional GDP, respectively. Afghanistan, Bhutan, and Maldives collectively accounted for less than 1 percent of South Asia's GDP. The differences in per capita income are large, ranging from a high of US\$2,700 for Maldives (for 2006 measured in current US dollars) to a low of only US\$250 for Afghanistan (Figure 2.4). Even if the small economies of Maldives and Bhutan are excluded, the per capita income gaps are quite large.

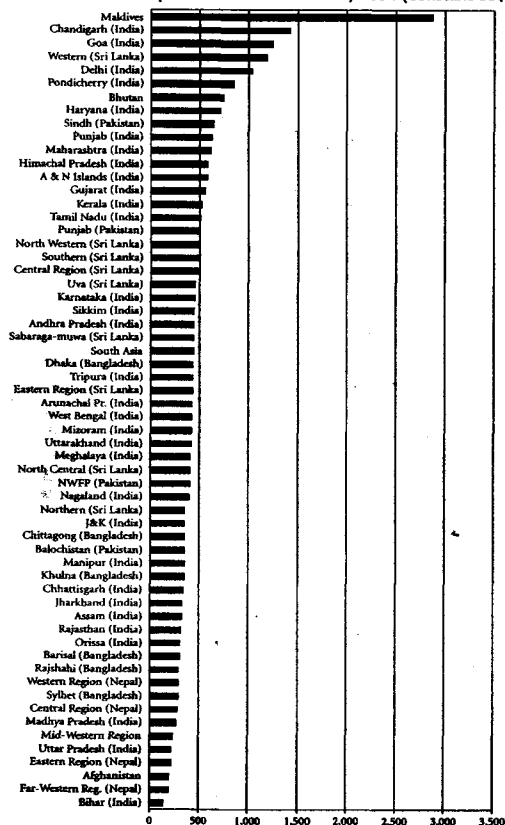
FIGURE 2.4 South Asia Per Capita Income, 2006



Source: World Bank 2008e.

The income gap at the national level carries through at the subnational level (Figure 2.5). During the period 1993–2004, GDP growth in the leading states in India grew at twice the rate of the lagging states. The average annual growth rate for the leading states (Andhra Pradesh, Gujarat, Haryana, Karnataka, Kerala, Maharashtra, Punjab, Tamil Nadu, and West Bengal) was 5.9 percent. The average growth rate for the lagging states (Bihar, Madhya Pradesh, Orissa, Rajasthan, and Uttar Pradesh) was 3 percent per year. In Sri Lanka, the leading regions grew at an annual average rate of 6.5 percent during 1996–2005, while the lagging regions (Sabaragamuwa, Central, Uva, and North Western) grew at an average rate of 1.5 percent per year. In Pakistan, the difference in the growth rates between the leading and lagging regions is less striking. The leading

FIGURE 2.5 Per Capita Income in South Asia, 2004 (Constant US\$)



Sources: India, Directorate of Economics and Statistics of respective State Governments; Sri Lanka, Central Bank of Sri Lanka; Bangladesh, *Statistical Yearbook of Bangladesh*; Nepal (household income per capita), CBS (Central Bank of Sri Lanka) and World Bank staff calculations using NLSI and II; Pakistan, World Bank staff; Bhutan, Afghanistan and Maldives, *World Development Indicators*.

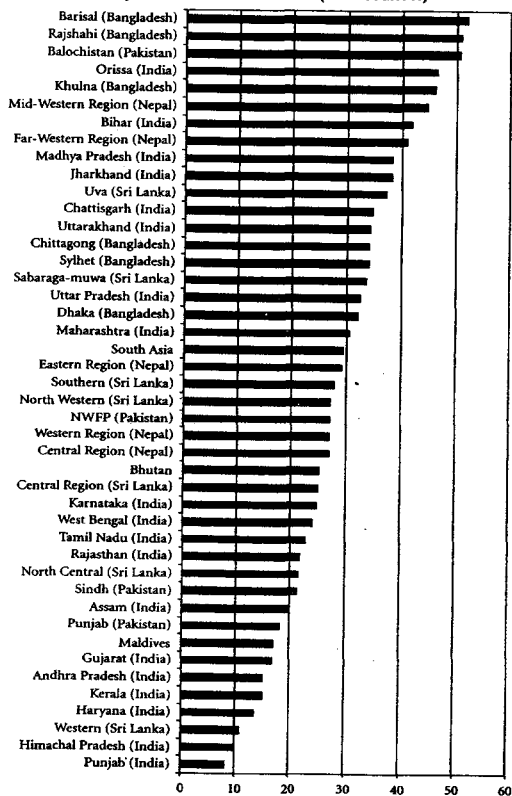
regions of Punjab and Sindh experienced an average annual growth rate of 2.3 percent during 1991–2000, while the lagging regions of Balochistan and the North West Frontier Province (NWFP) grew at an average annual rate of 1.8 percent. In Bangladesh, the leading regions (Dhaka and Chittagong) grew at an annual average rate of 3.15 percent year while the lagging regions (Barisal, Rajshahi, Khulna, and Sylhet) grew at an average annual rate of 2.73 percent during 1990–99. Nepal's growth since 2000 has averaged a paltry 3 percent, around half of the South Asian regional average. Conflict, poor road connectivity, and urban bias associated with earlier growth spurts have resulted in a clear divide between lagging regions and the Kathmandu valley.

The above picture suggests that, despite the differences in economic size and population, South Asian countries face similar development challenges arising from large spatial disparities. South Asia's leading regions are leaving lagging regions behind, as exemplified by the phrase "two South Asias." The leading regions are characterized by rapid GDP growth, urbanization, and integration with the global economy. The lagging regions remain rural, rely on low-value activities, and are not well integrated with the national, regional, and global markets.

The development experience of South Asia, where rapid GDP growth has been accompanied by high regional disparities, contrasts with the regional experience of high-income market economies. There is evidence of strong convergence among regions in the European Union, Japan, and the United States.³ The income gap between the leading and lagging regions in South Asia is much larger compared with the spatial disparities in industrial countries. In India, GDP per head in the state where it is highest (Haryana) is five times greater than in the state where it is lowest (Bihar). In the United States, the difference is only 2.5 times, and in Japan only two times. Regional disparities are indeed expected to change over time with the level of development. The big issue is whether future developments in South Asia will bring about convergence or divergence between the leading and lagging regions.

Given the strong negative relationship between income and poverty illustrated in Figure 2.3, it is hardly surprising that most lagging regions show higher than average rates of poverty (Figure 2.6). Nearly half a billion people live in the lagging regions of South Asia. Nearly 60 percent of the poor in India live in the lagging states. Every seventh poor Indian lives in Bihar, a lagging state. Sri Lanka shows disturbing regional disparity in poverty rates between the western region (a leading region) and the rest of the country. Nepal's western region (lagging region) has a substantially higher poverty incidence than the more prosperous Kathmandu valley.

FIGURE 2.6 Poverty Incidence in South Asia (Headcount %)



Sources Pakistan, World Bank staff; Sri Lanka, HIES 2002; Nepal, NLLS 2003–04; Bangladesh, HIES 2005; Bhutan, International Monetary Fund; Maldives, Asian Development Bank.

Notes For India, data for poverty headcount rates are based on 2004–05; for Sri Lanka data for poverty are based on 2002; Pakistan on 2005–06; Bangladesh on 2005; Nepal on 2003–04; Bhutan on 2000; Maldives on 2004.

In Pakistan, interprovincial disparities in poverty incidence between the leading regions (Sindh and Punjab) and the lagging regions (NWFP and Balochistan) are huge.

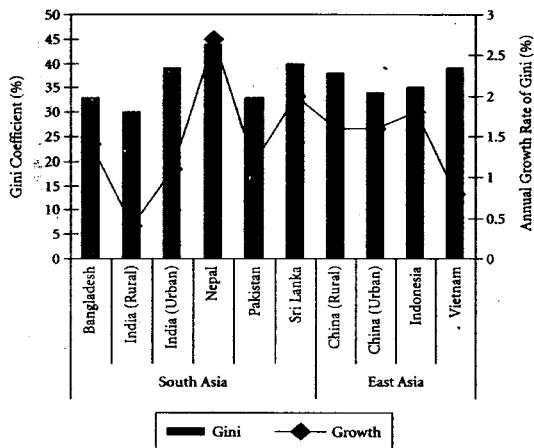
Why some areas develop and others remain underdeveloped is determined by three key drivers: movement of productive factors, transportation costs, and scale economies. These drivers are derived from spatial economics—that is, the study of where economic activity takes place and why (Fujita et al. 1999; World Bank 2008d). Drawing on these works, an ongoing World Bank study is looking at the interactions between geography, institutions, and trade, and how these interactions promote or constrain growth in the lagging regions of South Asia. Geographic, institutional, and trade differences are larger in South Asia than in Europe, Japan, and the United States. In Japan, nearly 97 percent of people live within 100 kilometers of the coast. In Europe, more than half the population lives within 100 kilometers of the coast or an ocean-navigable waterway. The United States is more like India, with a large proportion of the land area away from coast. But because of high labor mobility and efficient agriculture in the United States, a high proportion of the population lives close to the coast. In India, factor mobility has not been able to arbitrage geographic disparities. Disparities between the leading and lagging regions are high not because of geography but because of poor market integration resulting from high transportation costs, poor connectivity between regions and countries, low factor mobility, and regulatory restrictions that prevent firms from taking advantage of the scale economies.

There are two types of geography—first- and second-nature geography. First-nature geography favors some regions by virtue of proximity to rivers, coasts, ports, and borders. Economic activity may concentrate in coastal urban areas because of proximity to the domestic and external markets, and better logistical links between foreign suppliers and customers. First-nature geography explains why some leading regions are located in coastal areas (Maharashtra, Gujarat, and Tamil Nadu in India, and Karachi in Pakistan). Real GDP per capita growth rates for the coastal states in India grew at 4.5 percent per year during the 1990s compared with 2.5 percent for the landlocked states. Second-nature geography is determined by human-made infrastructure. Physical infrastructure influences the interactions among economic agents. Improved infrastructure lowers transportation costs, encourages mobility of labor, goods, capital, and ideas, and increases the size of the market. These interactions give rise to scale economies. As agricultural productivity increases, it releases labor and capital from rural areas, which migrate to urban areas to take advantage

of agglomeration forces. Regions with a higher urbanization rate tend to have higher productivity. These forces can generate virtuous circles of self-reinforcing development. Empirical studies identify second-nature geography (physical infrastructure) as a *key* causal factor in explaining levels and trends in regional disparities (Kanbur and Venables 2005a). Clearly, South Asia has yet to take advantage of the growth benefits of its demography and geography.

In addition to the lagging regions problem, South Asia also exhibits growing income inequality. Figure 2.7 shows economic inequality as measured by the Gini Coefficient.⁴ Inequality in South Asia is rising but less than in East Asia.⁵ This is apparent when comparing the growing inequality between the rich and the poor in India versus China. Nepal

FIGURE 2.7 Gini Coefficient (the Latest Available) and the Annual Growth Rate of Gini

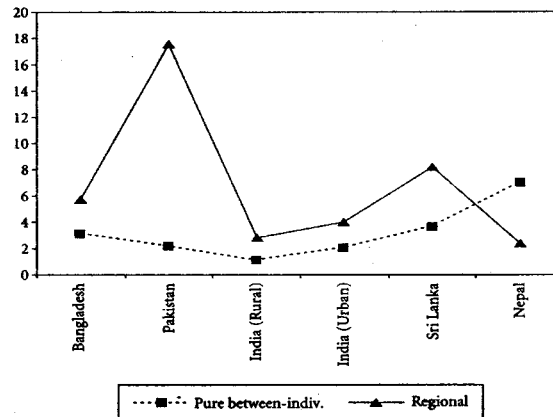


Sources World Bank staff estimation using household income and expenditure surveys of each country. Source data for Bangladesh, HIES 1991–92 and 2005; Pakistan, PIHS 1998–99 and PSLM 2005–06; India, NSSO 50th and 55th rounds; Sri Lanka, HIES 1990–91 and 2002; Nepal, NLLS 1996–97 and 2003–04. Data for all East Asian countries are in the World Bank’s data department; and survey years are 1993–2004 for China; 1999–2004 for Indonesia; 1992–2004 for Vietnam.

and Sri Lanka have the highest levels of inequality in South Asia. They also have the highest growth in inequality. Pakistan and rural India have the lowest levels of inequality. Is inequality between regions, that is, spatial inequality, also rising?

For most countries, growth in inequality across leading and lagging regions is rising faster than growth in inequality across individuals. Figure 2.8 reports regional inequality at the sub-national level using the Theil inequality measure.⁶ The Figure shows that *regional inequality* is rising at a much faster pace than *pure inequality* in all countries except for Nepal and, to some extent, India. Regional inequality generally increases as an economy shifts from agriculture to manufacturing. Some signs of regional convergence are evident in Nepal and India, as the extremely poor areas in Nepal and India have achieved faster growth rates in consumption. Poorer parts of Nepal and India have benefited from remittance flows as workers have moved to areas of higher economic density either at home or abroad.

FIGURE 2.8 Annual Growth Rate of Regional Inequality and the Pure Individual Effect for Selected South Asian Countries



Source World Bank staff estimates using household income and expenditure surveys of each country.

Can South Asia achieve both high and inclusive growth? Good examples of factors that can contribute to high and inclusive growth include labor mobility, better job creation, skills and education, and resolution of internal conflict. Inclusive growth is not about balanced growth but shared opportunities. Spatial disparities in growth are inevitable when growth accelerates and countries make the transition from being an agricultural to an industrial economy. The challenge for public policy is to identify the growth constraints in the lagging regions and remove them.

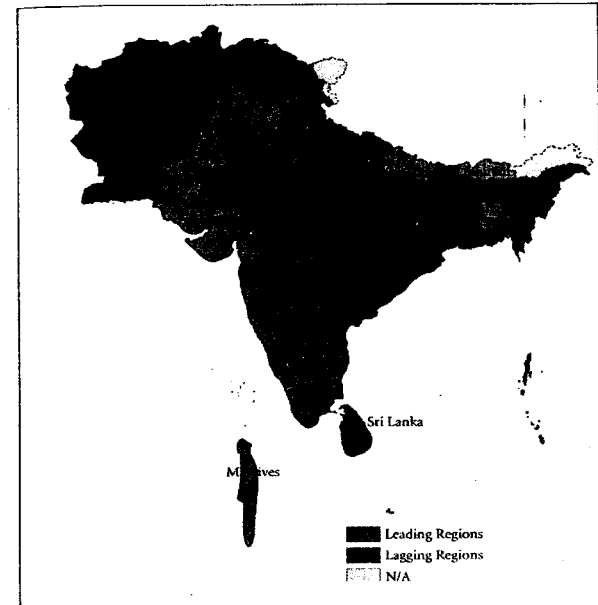
The strongest indicator of inclusive growth is poverty reduction. As mentioned earlier, all South Asian countries have reduced poverty. Going forward, however, poverty reduction is likely to be complicated by the fact that growth is increasingly concentrated in the leading regions, while poverty is concentrated in the lagging regions. The large concentration of poor in the lagging regions suggests that public policy must concentrate on raising growth and improving human development in these lagging regions. The evidence that regional inequality is rising also suggests that higher income growth in lagging regions might help reduce income inequality.

3. CROSS-BORDER CONSTRAINTS TO GROWTH AND POVERTY REDUCTION

The lagging regions challenge requires recognition of another factor of geography that has been largely neglected in public policy debates: many of the South Asia's lagging regions are either landlocked countries (for example, Afghanistan and Nepal) or are border districts, states, or provinces of the three larger countries of Bangladesh, India, and Pakistan. This is obvious from Figure 2.5, Map 2.1, and Table 2.1, which show the following results:

- o The landlocked countries of both Afghanistan and Nepal are among the lowest per capita income group in the region (Figure 2.5).
- o Out of 14 states of India that have borders with neighbors, 12 have per capita income levels that are at or below the national average (Arunachal Pradesh, Assam, Meghalaya, Mizoram, Nagaland, Tripura, Manipur, West Bengal, Bihar, Uttar Pradesh, Jammu and Kashmir, and Rajasthan). The only exceptions are Punjab and Gujarat (Figure 2.5 and Map 2.1).

MAP 2.1 Per Capita Income in South Asia



Source Created by the author. Based on Figure 2.5.

Notes (a) Leading/lagging regions are defined at the national level based on per capita incomes above or below the national average. (b) Afghanistan, Bhutan, and Maldives show national averages because sub-national data are not available. (c) This map is not to scale and does not depict the authentic boundaries of India.

- o In Pakistan, per capita income is lower than average in the border provinces of NWFP, Balochistan, and rural Sindh. As in the case of India, Pakistan's Punjab is an exception. Similarly, urban Sindh is richer than the national average because of the dominance of the port city of Karachi (Figure 2.5 and Map 2.1).

TABLE 2.1 Population Mass, Economic Mass, and Poverty Mass: Bangladesh Districts Bordering India's North-east and West Bengal, 2000

Districts	Population	Per capita income (US\$)	Economic mass (US\$)	Human poverty index		Poverty mass	Literacy rate (age 7+)	
				poverty index	poverty mass		Both sexes	Female
<i>Bordering north-east</i>								
Bardhaman	298,120	339	101,062,680	39.77	118,562	31.66	23.67	
Brahmanbaria	2,398,254	304	729,069,216	37.65	902,943	39.45	36.68	
Comilla	4,595,557	266	1,222,418,162	26.72	1,227,933	45.98	42.63	
Feni	1,240,384	262	324,980,608	28.15	349,168	54.26	51.18	
Habiganj	1,757,665	299	525,541,833	34.45	605,516	37.72	33.62	
Jamalpur	2,107,209	277	583,696,893	41.87	882,288	31.80	28.02	
Khagrachari	525,664	239	125,633,696	37.58	197,545	41.80	32.65	
Kurigram	1,792,073	282	505,364,386	39.42	706,435	33.45	27.55	
Lalmonirhat	1,109,343	265	293,975,895	35.63	395,239	42.33	36.25	
Maulabazar	1,612,374	280	451,464,720	32.69	527,085	42.06	38.45	
Mymensingh	4,489,726	305	1,369,366,430	34.70	1,557,935	39.11	36.26	
Netrokona	1,988,188	303	602,420,964	37.06	736,822	34.94	31.88	
Nilphamari	1,571,690	261	410,211,090	38.50	605,101	38.84	32.58	
Panchagarh	856,196	277	231,626,292	35.03	292,919	43.89	37.33	
Rangamati	508,182	365	185,486,430	35.74	181,624	43.99	34.21	
Sherpur	1,279,542	277	354,433,134	42.98	549,947	28.55	28.55	
Sunamganj	2,013,738	262	527,599,356	39.44	794,218	34.57	30.47	
Sylhet	2,555,566	315	805,003,290	35.06	895,981	45.59	41.51	
<i>Bordering West Bengal</i>								
Thakurgaon	1,214,376	329	399,529,704	35.87	435,597	40.32	35.87	
Dhajakpur	2,642,850	311	821,926,350	33.31	880,333	36.24	33.31	
Joypurhar	846,696	323	273,482,808	35.70	302,270	37.23	35.70	
Naogaon	2,391,535	305	729,363,275	32.32	772,886	36.91	32.32	
Nawabganj	1,425,322	255	363,457,110	39.66	565,283	41.68	39.66	
Raisahahi	2,286,874	339	775,250,286	33.57	767,704	35.98	33.57	
Kashtha	1,740,155	320	556,849,600	35.78	622,627	36.79	35.78	
Meherpur	591,436	318	188,076,648	36.01	212,976	36.91	36.01	
Chuadanga	1,007,130	305	307,174,650	32.11	323,389	34.02	32.11	
Jhenaidah	1,579,490	317	500,698,330	32.37	511,281	35.74	32.37	
Jessore	2,471,554	357	882,344,778	28.20	696,978	30.77	28.20	
Sahebra	1,864,704	309	576,193,536	31.74	591,857	35.53	31.74	
Dhaka	8,511,228	758	6,451,510,824	26.51	2,236,337			
Bangladesh	124,355,263	355						

Source: Masum 2008.

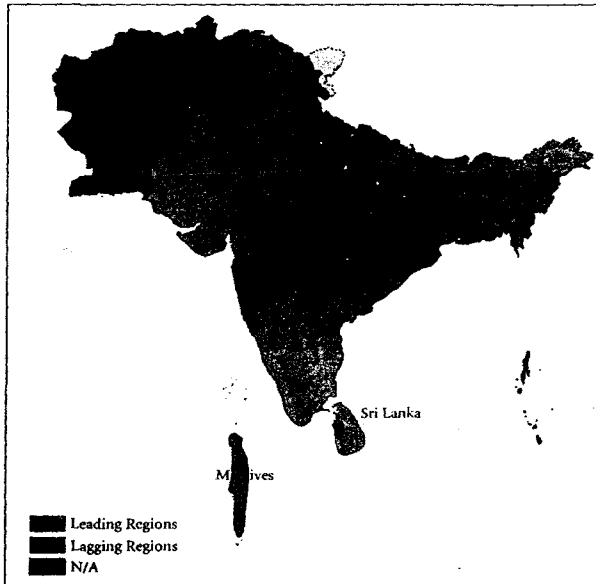
Note: Population data refer to 2001, per capita income data refer to 1999-2000, and human poverty index refers to 2000.

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- o In Bangladesh, the border districts tend to have per capita incomes lower than the national average (Table 2.1). In terms of income, most lagging regions are also lagging in terms of having a higher than average incidence of poverty or poorer human development indicators (Figure 2.6, Maps 2.2 and 2.3, and Table 2.1).

Detailed analyses of these lagging regions indicate the following socioeconomic characteristics (Government of India 2008; Massum 2008; World Bank 2005a, 2005b, 2005c, 2007b, 2008a, 2008b):

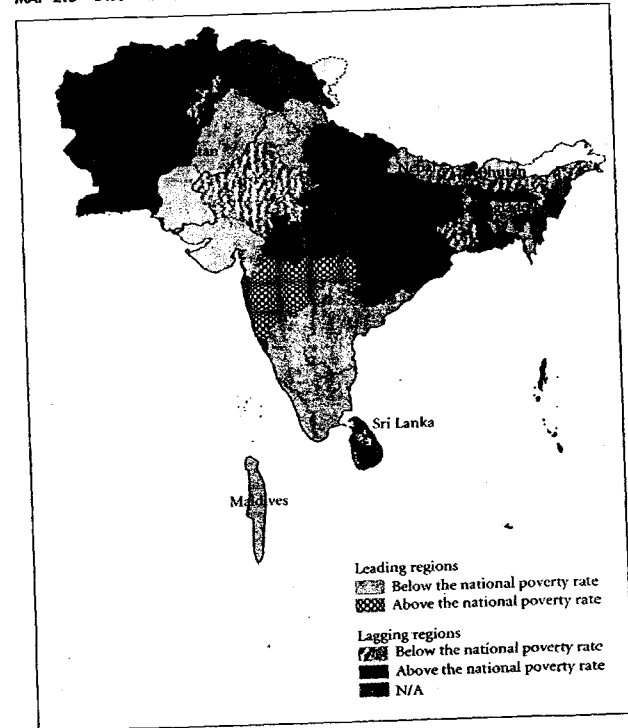
MAP 2.2 Distribution of Poverty in South Asia



Source Created by the author. Based on Figure 2.5.

Notes (a) Afghanistan, Bhutan, and Maldives show national poverty rates. (b) This map is not to scale and does not depict the authentic boundaries of India.

MAP 2.3 Distribution of Poverty by Leading and Lagging Regions



Source Created by the author. Based on Figures 2.5 and 2.6.

Notes (a) Afghanistan, Bhutan, and Maldives show national poverty rates. (b) This map is not to scale and does not depict the authentic boundaries of India.

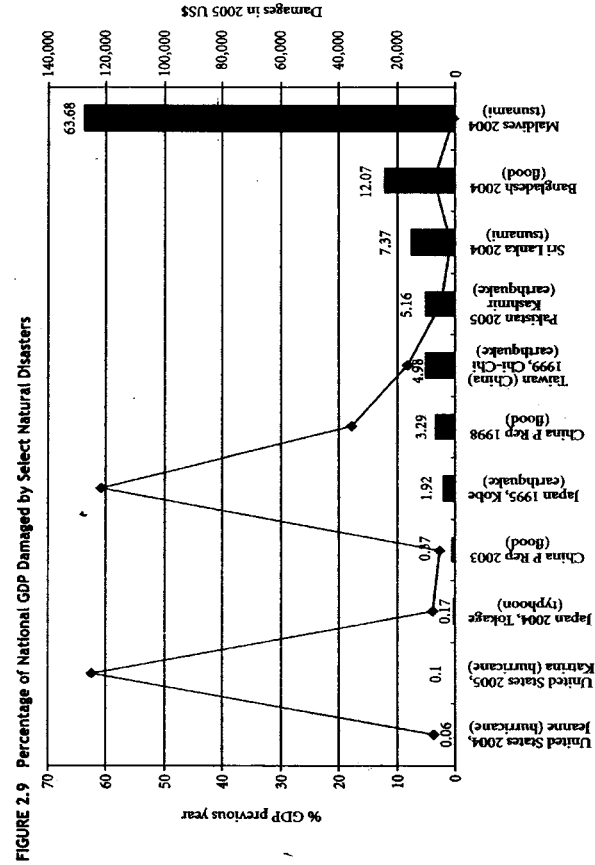
- These lagging landlocked and border countries, states, provinces, and districts have an estimated 400 million people, of whom an estimated 200 million are poor (reference year of 2005). This is

about 50 percent of South Asia’s estimated total number of poor for the year 2005.

- Much of the population is rural (90 percent), and most are engaged in low-productivity agriculture.
- The human development indicators tend to be below the comparable national average, and many indicators are lower than the average in South Asia.
- Infrastructure is, on average, poorer than the rest of the respective countries and poorer than the average for South Asia.
- The border regions, on average, tend to be more vulnerable to water shortages and flooding problems than other parts.

A review of history suggests that not all areas were lagging and poor all the time. For example, both Afghanistan and Nepal prospered in the eighteenth and nineteenth centuries on the basis of free trade and commerce with neighbors, including Central Asia, the Middle East, the Indian subcontinent, and China. Over the years, conflict and border restrictions removed this key source growth. A more dramatic example is that of India’s north-east (the so-called seven sisters). The partition of the Indian subcontinent into Pakistan and India brought havoc to the economies of these seven sisters, especially the booming state of Assam, by cutting off its sea access and sharply increasing the transport distance with the rest of India (Box 2.1). The Kashmir valley was a prosperous and peaceful tourist resort until conflict between Pakistan and India took its toll. The Federally Administered Tribal Areas of Pakistan (FATA) and the NWFP were similarly prosperous and peaceful trading outposts until regional and global conflicts converted many parts of these border areas into conflict-prone, security risk regions with low per capita incomes, high incidence of poverty, and low human development indicators.

Apart from being poor, the lagging regions also share a number of common vulnerabilities. First and foremost is their vulnerability to natural disasters. Figure 2.9 shows the impact of natural disasters in terms of the share of GDP lost. South Asia has lost a significant amount of its GDP because of natural disasters. This loss has been especially significant for Bangladesh, Maldives, Pakistan, and Sri Lanka. The impact of natural disaster is particularly strong in South Asia because of its high population density. The losses typically are not insured in the financial market. It is the poor who are adversely affected by disasters.



BOX 2.1 Bangladesh and India: A Tale of Two Border Regions

India's north-east and West Bengal lag behind the rest of India in per capita gross state domestic product (GSDP). So do the Bangladesh districts adjoining West Bengal and India's north-east. India's north-east and Bangladesh districts bordering the above region and West Bengal have considerable similarity, such as being predominantly agricultural, with agriculture accounting for the largest share of employment; having a narrow manufacturing base; and having low levels of consumption of electricity, which significantly constrain their growth prospects. The three hill districts of Bangladesh have large shares of tribal population, as do three states of India's north-east, and people of both sub-regions have been practicing the same low-productivity agricultural technology that featuring shifting cultivation called *Jhum* for generations. The two regions formed a single economic entity under British rule, shared common infrastructure, and developed close links that contributed to the economic growth of both regions. The partition of British India in 1947 into two separate states (India and Pakistan) and the two regions dividing into two countries that did not maintain friendly relations caused havoc to the economy of India's north-east, as a sudden snapping of all economic ties made its economy extremely vulnerable, in addition to converting it into a virtually landlocked region. The adjoining Bangladesh (then East Pakistan) districts also suffered by losing their traditional sources of supplies and markets for their products; however, because they retained most of the common infrastructure, including access to the sea and thereby to the outside world, their situation was not as bad. Their growth performance, however, indicates that they performed relatively poorly compared with most other Bangladesh districts. Bangladesh districts bordering West Bengal also performed relatively poorly. With the emergence of Bangladesh as an independent country in 1971, it was expected that the linkages earlier lost would be restored, but little progress has been made so far in this direction. It is, however, believed that improved economic linkages between India's north-east and West Bengal, and the adjoining Bangladesh districts, would promote development of all these regions.

Source: Massum 2008.

A second and related vulnerability is access to water for irrigation and transport. An estimated 400 million people, many of whom are poor, directly or indirectly depend on the water flows of the three mighty rivers of Indus-Ganges-Brahmaputra for their livelihood. Frequent water shortages (and floods) create serious challenges to maintaining the income level of these large numbers of poor.

4. REGIONAL COOPERATION TO SUPPORT DEVELOPMENT OF SOUTH ASIA'S LAGGING REGIONS

Cooperation can be a powerful way to raise growth, reduce the gap between leading and lagging regions, and reduce vulnerabilities for the poor. By focusing on the income of the poor both through the growth mechanism and by reducing vulnerability, regional cooperation can be helpful in lowering income inequality. Specifically, in the context of the framework developed in Section 3, it can be argued that South Asia has the potential to accelerate growth and reduce poverty by exploiting four underutilized spatial features of the region: geography, transportation, factor mobility, and scale economies. Regional cooperation can facilitate this process.

- First, as mentioned earlier, South Asia is densely populated, with a significant proportion of the population living close to the borders between countries. After Europe, South Asia has the largest concentration of people living close to the border. It has the maximum "city pairs" within 50 kilometers with a population of more than 25,000 people.⁷ Almost all the South Asian countries share a common border with the largest regional partner (India). Regional integration initiatives will unlock the growth benefit of geography and support income convergence across regions and countries. Regional trade is more sensitive to transport costs, scale economies, and factor mobility than global trade.
- Second, South Asia suffers from high trade and transportation costs compared with other regions because of border restrictions and poor transport. The cost of trading across borders is nearly double for India and Bangladesh compared with China. It is more than three times higher for Afghanistan, Bhutan, and Nepal. The quality of transport infrastructure in South Asia, especially the highway networks, is poor. Truck operating speeds are low, delays at state and provincial check posts are frequent and can be long, and delivery times are consequently subject to significant variation. The regions away from the main trade corridors have the poorest infrastructure and face the greatest constraints. Raising the level of the infrastructure and reducing regulatory barriers to trade, whether international or national, will help integrate the

lagging regions into both the national and global economies, reducing the relative advantages of the coastal states.

- Third, factor mobility, and in particular migration rate, is low in South Asia. Only 2 million people migrate every year in India from rural to urban areas, compared with nearly 20 million people in China. Increased agricultural productivity could reallocate labor and capital from low-value activities (agriculture) to high-value activities (manufacturing and services sectors) and support growth.
- Fourth, South Asian firms are disproportionately small. They are unable to reap the benefits of scale economies because of labor and regulatory restrictions that prevent them from growing. The policy changes aimed at taking advantage of the interactions between geography, transportation, factor mobility, and scale economies not only will lift growth in the lagging regions but also will support higher growth rates at the country level and in South Asia.

These ideas are developed in greater detail next.

4.1 Regional Cooperation for Supporting Growth in the Lagging Regions

In terms of policy focus, the two main ways that regional cooperation can foster higher growth in South Asia, and especially in the lagging regions, are by promoting market integration and by improving infrastructure.

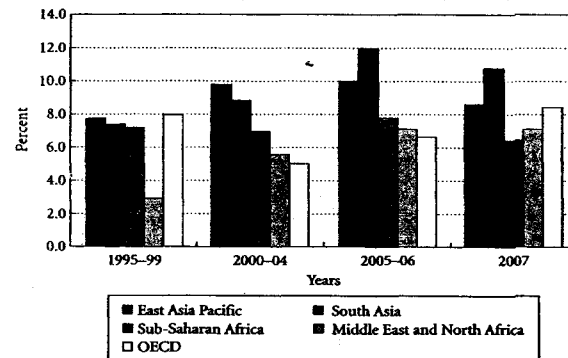
4.1.1 Market Integration

Market integration allows economic agents to interact across spatial scales: local, regional, and international. The extent to which economic agents take advantage of market integration is affected positively by density but negatively by both distance and division (Fujita et al. 1999). A high level of economic density implies “thick markets” in the exchange of goods and services, as well as in the informal exchange of ideas. This creates productivity advantages for firms and welfare advantages for workers. By contrast, a high level of distance to density denies economic agents the opportunity to access these markets with consequent negative impacts on poverty and well-being.³ Likewise, divisions—created by conflict, transport costs, and both formal and informal barriers to trade—separate economic agents in one country from the advantages of density in other countries.

By reducing distance and division, market integration, both within and between countries, brings economic agents in lagging regions closer to the density of leading regions, promoting positive spillover effects that enhance spatial multipliers.⁴ Given that South Asia is the most densely populated region in the world, it is well placed to bring areas close to the market and bolster the value of the spatial multiplier. Market integration (global, regional, and within country) can ignite growth, as countries benefit from increased demand, agglomeration, and scale economies; improved factor mobility; and the free flow of ideas and technology. Market integration can pull weak countries toward income levels that they would be unable to achieve in isolation. Landlocked countries, in particular (Afghanistan, Nepal), can benefit from cross-country growth spillovers and neighborhood effects. Neighboring countries can provide mutually beneficial economic linkages, spillovers, and complementarities that allow groups of countries to increase their incomes.

The region has significantly more room to benefit from market integration globally, across countries within South Asia, and within country. Globally, South Asia's rapid GDP growth benefited from rapid expansion in trade. It has experienced one of the fastest growth rates in trade (Figure 2.10) averaging 10.8 percent in 2007, following growth

FIGURE 2.10 Real Growth in Trade of Goods and Services

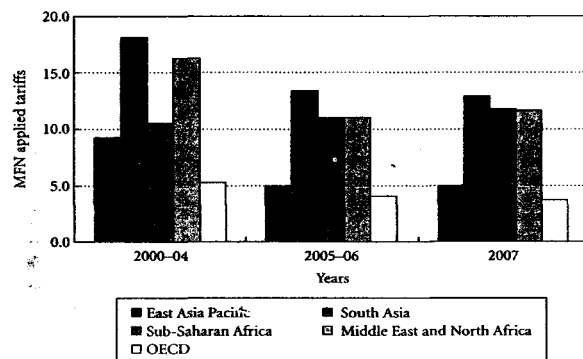


Source: World Bank's World Trade Indicators (World Bank 2008d).

Note: Data for 1995-99, 2000-04, and 2005-06 are averages.

of almost 12 percent during 2005–06, which was the highest among all regions. Yet, the region has more room to benefit from trade. Despite recent reforms, South Asia continues to have the most restrictive tariff policies compared with other regions (Figure 2.11). Among developing countries, South Asia has the most protective agricultural trade policies. South Asia's global integration, measured by trade as a ratio of GDP, was 49 percent in 2007, which although higher than its late 1990s ratio of 20 percent, is the lowest among developing countries (World Bank 2008a).

FIGURE 2.11 Trade Tariff Restrictiveness Index



Source World Bank's World Trade Indicators (World Bank 2008d).

Note Data for 1995–99, 2000–04, and 2005–06 are averages.

Within South Asia, market integration is the lowest in the world as reflected by intraregional trade between countries being less than 2 percent of GDP for South Asia compared with 40 percent for East Asia. Border barriers to trade and services have mostly disappeared in the rest of the world but not in South Asia. Divisions across countries in South Asia have increased dramatically over the last four decades.¹⁰ In 1948, South Asia's share of intraregional trade as a share of total trade was 18 percent. In 2000–07, it fell to 5 percent of total trade. Cost of trading across borders in South Asia is high. At the Petrapole–Benapole, one of the main borders between Bangladesh and India, trucks wait for more than 100 hours to cross the border. It takes 200 signatures in Nepal to trade-goods with India,

and some 140 signatures in India to trade goods with Nepal. It is estimated that trade between India and Pakistan, currently at US\$1 billion,¹¹ could jump to US\$6–10 billion, if divisions were removed. Divisions in South Asia have been aggravated by conflict.

The geographic configurations of South Asia contain huge agglomeration potential to propel growth.¹² East Asia is an example of a region with a high level of intraregional and intra-industry trade that enabled firms to internalize externalities arising from agglomeration. Firms exporting to the regional markets in South Asia are more constrained by the quality of connectivity and productivity-enhancing infrastructure.¹³ It is the seamless interaction of improved trade, better connectivity, and converging institutions that can accelerate growth in the lagging regions and that can benefit the slower-growing and smaller landlocked regions and countries. In Latin America, Brazil's growth creates export opportunities for Bolivia. In Africa, resource landlocked countries piggybacked on the growth of Kenya. In East Asia, Thailand is an important market for Cambodia and Laos People's Democratic Republic.

Growth benefits of market integration are likely to be large but unequal. India, a large country, with a big home market, can get by with more restrictive borders, because the size of its economy and population provides the incentive to importers and exporters to overcome these barriers. It is the small, landlocked countries, like Afghanistan, Bhutan, and Nepal, that will benefit most from improved access to the markets of others. Small countries depend more on openness to overcome the disadvantage of size: small population, small markets, and inability to take advantage of agglomeration and scale economies. Even within India, the peculiar geography that isolates the seven north-eastern states (the so-called seven sisters) from mainland India, with Bangladesh located in between, suggests that market integration requires trade and transit arrangements with neighbors to benefit all regions that are lagging and isolated from the growth centers. Tradable economic activities are inherently scalable in the sense that small economies can expand output without running into diminishing returns (unlike domestic services). Rapid economic growth, associated with modern sector export growth, can be "lumpy" (Venables 2006). Spatially, it can be uneven, with production being concentrated in some countries, regions, or cities. In product space, specialization is likely to increase, with regions specializing in a few tasks rather than production of integrated products. Examples of specialization from South Asia include information and communication technology (ICT) service export from Bangalore in India; shirts, trousers, and hats exported

from Bangladesh; and exports of bed linen and soccer balls from Pakistan. Temporally, rapid growth will happen only once some threshold level of capabilities has been reached. Some countries may experience growth before others, resulting in sequential rather than parallel growth. The benefits of market integration, however, cannot be achieved without improving the infrastructure.

4.1.2 Infrastructure

Infrastructure is like second-nature geography, which can reduce the time and monetary costs to reach markets and thus overcome the limitations of physical geography (Kanbur and Venables 2005a). Improved infrastructure that enhances connectivity and contributes to market integration is the best solution to promoting growth as well as addressing rising inequality between regions. The Ganga Bridge in Bihar in India is a good example of second-nature geography. The bridge has reduced the time and monetary costs of farmers in the rural areas in north Bihar to reach markets in Patna, the largest city in Bihar. The Jamuna Bridge in Bangladesh is another good example of spatially connective infrastructure. The bridge has opened market access for producers in the lagging north-west areas around the Rajshahi division. Better market access has helped farmers diversify into high-value crops and has reduced input prices.

So far, South Asia has achieved impressive growth rates despite poor infrastructure. This growth may be difficult to sustain in the future. Poor infrastructure and restrictive labor laws (to be discussed later) are among the major factors that have restrained the growth of manufacturing sector and prevented firms from growing (Fernandez and Pakes 2008). Table 2.2 shows that the manufacturing share of value added in India is smaller than that share in other large developing economies, although it is similar to that share in smaller countries with GDP per capita similar to that of India (such as Vietnam). As Table 2.3 shows, however, the growth of value added in manufacturing in India is noticeably lower than that in these smaller similar income countries. Indeed the sectoral growth comparisons in Table 2.3 are rather striking. The growth of value added in services in India is comparable to that in China, and about 10 percentage points higher than that in other countries. In rather stark contrast, the growth of value added in manufacturing in India is only about *half* that in China and Vietnam.

The service sector in India has done well because it relies less on transportation and is less energy intensive than manufacturing. South Asia

TABLE 2.2 Industry and Manufacturing Share of Employment and GDP across Countries

	Employment in industry as % of total employment in 2000	Value added in industry as % of GDP in 2000	Value added in manufacturing as % of GDP in 2000	2002 GDP per capita (in 2000 US\$)
India	18.2	26.3	15.6	480
Brazil	19.3	28	17.1	3,473
China	23	45.9	34.7	1,106
Indonesia	17.3	45.9	27.7	844
Pakistan	18	22.6	14.8	532
Vietnam	12.4	36.7	18.6	444
Low-income countries	12.3	26.6	14.1	
Lower-middle-income countries	18.5	38.3	24.2	

Source: World Development Indicators 2005 (World Bank 2005d).

Note: Industry includes not only manufacturing, but also mining and quarrying (including oil production), construction, and public utilities (electricity, gas, and water). Lower-income countries and lower-middle-income countries are defined based on the World Bank classification.

TABLE 2.3 Growth in Sectoral Value Added across Countries

	Growth in value added in manufacturing (%)		Growth in value added in agriculture (%)		Growth in value added in services (%)	
	1995-2000	2000-05	1995-2000	2000-05	1995-2000	2000-05
India	28.1	38.4	13.7	14.9	48.4	50.3
Brazil	5.7	5.6	17.3	23.7	26.5	31.8
China	57.6	67.4	18.5	21.2	57.3	61.2
Indonesia	14.6	27.5	7.0	17.3	-2.4	35.7
Pakistan	17.1	56.6	26.5	12.0	20.9	29.9
Vietnam	70.3	73.8	24.2	20.7	31.9	40.0

Source: World Development Indicators, various years, World Bank.

has the highest share of services in its exports at 31 percent, which is higher than high-income member countries of the Organization for Economic Co-operation and Development (OECD). ICT exports and global outsourcing have benefited from the use of the Internet, which has reduced information transmission costs dramatically. While other countries can emulate India's successful efforts to boost services export, sustained high growth will require a substantial effort to raise manufacturing growth in all South Asian countries. In general, poor infrastructure has constrained the growth of labor-intensive manufacturing firms in South Asia and has

prevented the region from making use of its most important asset, its people.

South Asia suffers from three infrastructure deficits. First, it suffers from a *service deficit*, as the region's infrastructure has not been able to keep pace with a growing economy and population. Power outages and water shortages are a regular occurrence in India and Bangladesh. Rural roads are impassable in lagging regions in India (for example, Bihar, Uttar Pradesh) and Sri Lanka. India has 6,000 kilometers of four-lane highways and China in the last 10 years has built 35,000 kilometers of four- to six-lane highways. Every month, China adds power capacity equivalent to what exists in Bangladesh. Second, South Asia suffers from a *policy deficit*, given highly distorted pricing, poor sector governance and accountability, and weak cost recovery. It is estimated that eliminating the financial losses from the power and water sectors alone would provide a substantial chunk of the incremental funds for infrastructure investment that India needs. Third, South Asia suffers from a *cooperation deficit*. India, one of the energy-thirstiest nations sits next to an immensely energy-rich neighbor, Nepal. Yet, because of inadequate cooperation with India, Nepal has barely exploited its hydropower potential. Similarly, India, which has attracted global attention in ICT, contrasts with other South Asian countries that are lagging in ICT. In South Asia, only 7 percent of the international calls are regional compared with 71 percent in East Asia. South Asia needs to overcome a huge gap in infrastructure. South Asia has invested only 3.5 to 4 percent of GDP per year in infrastructure over the period 2000–05. This is lower than what the East Asian countries have invested: Vietnam and China had investment rates of around 8 percent to 10 percent of GDP. In 1980, India actually had higher infrastructure stocks—in power, roads, and telecommunications—but China invested massively in infrastructure, overtaking India by 1990, and the gap is currently ever widening. It is estimated that for the South Asia region to sustain a growth target of 8 percent, it will require an investment in infrastructure amounting to 7.6 percent of GDP (Harris 2008). To achieve a higher growth rate in the 10 percent range will require an even more rapid pace of investment to modernize the infrastructure.

Much of the infrastructure investment gap has to be financed at the national level along with necessary improvements in sector policies and institutions. Yet regional cooperation can be of great help to meet a significant part of this need. The three priority areas for regional cooperation include telecoms and Internet networking, energy, and transport.

A regional telecom network and a high-bandwidth, high-speed Internet-based network could improve education, innovation, and health. A regional network would facilitate better flow of ideas, technology, investments, goods, and services. It also would facilitate greater interactions between knowledge workers in areas such as high-energy physics, nanotechnology, and medical research. Untapped positive synergies at the regional level would result from information sharing and competition in ideas among universities, non-university research and teaching entities, libraries, hospitals, and other knowledge institutions. It also could aid the building and sharing of regional databases, and could help address regional problems, including multi-country initiatives such as flood control, disaster management, climate change, and infectious disease control. Importantly, such an effort could help spark higher and more sustainable regional growth.

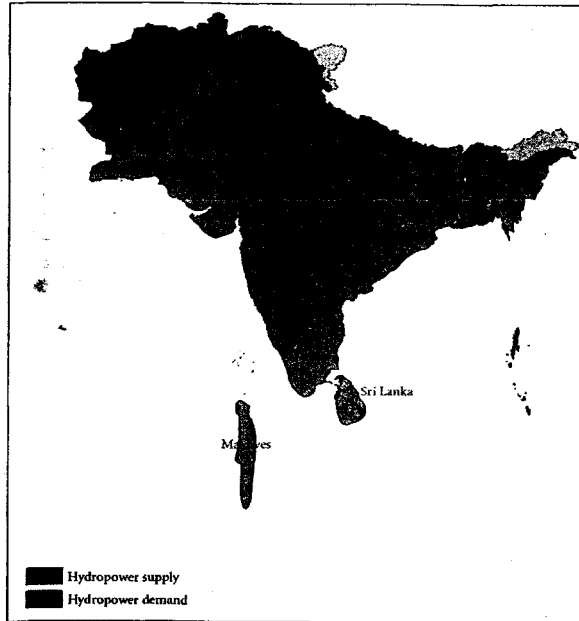
Regional cooperation in telecoms and Internet access could strengthen the competitiveness of South Asia in the services-export sector. India has established itself as a global player in ICT and outsourcing. Other countries in South Asia potentially could benefit from neighborhood and spillover effects. The expansion of services exports would contribute to growth and job creation, and other sectors would benefit from improved technology and management (Hamid 2007). The services-export sector, although less infrastructure intensive than manufacturing, needs different types of infrastructure than the traditional export sectors. For these exports, investment is needed in fiber optic highways, broadband connectivity, and international gateways and uplink facilities. Increased investments in tertiary education and in technical and English proficiency also are needed. South Asia needs to remove barriers to trade in ICT services, eliminate restrictions on the flow of intraregional foreign direct investment (FDI), and remove visa restrictions on the flow of people.

The potential gains from regional trade in energy are substantial. This is best seen by looking at Map 2.4, which shows South Asia's potential sources of hydropower and its demand. Map 2.4 illustrates a powerful story. Afghanistan and Nepal are sitting on water resources that could potentially generate some 24,000 megawatts of electricity from Afghanistan and an estimated 83,000 megawatts from Nepal. These countries together account for 40 percent of South Asia's presently installed capacity. Bangladesh, India, and Pakistan are all power-deficit countries, especially India. The growing electricity constraint is threatening the ability to sustain rapid growth. Yet, less than 1 percent of the region's electricity-generating potential has been used so far. The reason for this



energy constraint is the lack of cooperation and absence of energy trade among South Asian countries. Indeed, if one were to imagine South Asia without borders, perhaps the highest priority investment would have gone to develop the hydropower resources. While all countries would benefit from the development of South Asia's hydropower resources, Afghanistan and Nepal, the two poorest South Asian countries, would benefit most.

MAP 2.4 Distribution of Hydro-power Potential



Source Created by the author. Based on World Bank 2008c.

Note This map is not to scale and does not depict the authentic boundaries of India.

After decades of insignificant cross-country electricity trade and the absence of any trade in natural gas through pipelines, regional political leaders and businesspeople recently have evinced a great deal of interest and enthusiasm in cross-border electricity and gas trade, not only within South Asia but also with its neighbors in the west (Central Asia and Iran) and in the east (Myanmar). South Asia has two regional energy clusters. The eastern market includes India, Bangladesh, Bhutan, Nepal, and Sri Lanka, extending to Myanmar; the western market includes Afghanistan, India, and Pakistan, extending to Central Asia and Iran. India bridges these two clusters. Some activities are under way, including a successful hydropower trade between Bhutan and India in the eastern market and an ongoing project in the western market that will bring electricity from Tajikistan and Kyrgyzstan to Afghanistan and Pakistan.¹⁴

To promote such energy trade, governments need to continue reducing political and security tensions; consider energy trade as an enhancement of energy security and political and economic cooperation; continue energy sector reforms; improve commercial performance of the utilities; improve the credibility, competence, and accountability of regulation; adopt sustainable (cost-reflective) tariffs and a social protection framework; promote commercial approach to energy trade; encourage private sector participation in the form of public-private partnership (PPP) structures in cross-border investments; help the transit countries (especially Afghanistan) integrate; reach water-sharing agreements; seek accession to international agreements (such as the Energy Charter Treaty); strengthen regional institutions at both political and technical levels; and identify priority trade-oriented investment projects and pursue their implementation. The success of the India-Bhutan electricity trade should offer useful lessons to other countries in the region.

Restrictions in transport border crossings are a major constraint to global and intraregional trade in South Asia. Removing these restrictions would boost trade within South Asia as well as lower costs for international trade in general, as many landlocked countries and regions would benefit from access to the closest ports. Currently, efforts to improve trade facilitation and transport networks are being pursued in a fragmented manner, and where cross-border issues are involved, little cooperation exists. Establishing corridor-based approaches for improving the trade, such as a transport arrangement for intraregional trade, would be essential to improve the efficiency of regional transport and to reduce trade costs.

4.2 Regional Cooperation Reducing Vulnerabilities of South Asia's Poor

South Asia's poor would probably gain most from regional cooperation in water and climate. This is again obvious from Map 2.4. From the Himalayas, where glacier melt is already changing water flows in ways that remain to be understood, to the coastal floodplains of Bangladesh and Pakistan, South Asian countries need to adapt to climate change. The melting of Himalayan glaciers, leading to the disastrous prospect of reduced water availability in the South Asian rivers, the frequency of floods and cyclones, and the evidence of rising sea level, have given South Asia a wake-up call for collective action for managing climate change to reduce vulnerability and poverty over the longer term. Actions only at the national level cannot provide sustainable solutions as much of the water flows from upstream countries of Afghanistan, China, parts of India, and Nepal to Bangladesh, most of India, and Pakistan. Finding sustainable solutions for flood control, irrigation, and river transport will require cooperation with upstream countries. Thus, cross-border cooperation on water between India, Bangladesh, and Nepal offers the only long-term solution to flood mitigation. The benefits of cooperation are clear. For example, watershed management and storage on Ganges tributaries in Nepal could generate hydropower and irrigation benefits in Nepal and flood mitigation benefits in Nepal, India (Uttar Pradesh, Bihar) and Bangladesh; water storage in north-east India could provide hydropower and flood benefits in India and Bangladesh; and both would provide increased and reliable dry season flows. Specific cooperation between Bangladesh, India, and Nepal on the Ganges presents an emerging and promising opportunity.

Similar benefits of water cooperation exist between India and Pakistan and between Pakistan and Afghanistan. The success of the Indus Water Treaty between Pakistan and India has already demonstrated that cooperation that benefits people can withstand all political obstacles. Building on this success, other water disputes and potential water markets could be developed through a similar cooperative solution. Afghanistan sits on the upper riparian of some five water basins that have huge potential for irrigation and hydropower benefits that could well transform Afghanistan's economy. Yet, little of the critical investment required to transform this natural resource into a productive asset for the benefit of the people of Afghanistan has been made thus far. As a result, Afghanistan is a severely water-constrained economy with a serious power shortage as well. A key constraint is a lack of a framework for water-sharing agreements with

its neighbors. The Kabul River Water Basin Project is a high-priority project that will yield substantial hydropower and irrigation benefits for both Afghanistan and Pakistan. A key requirement for this project to move forward is a riparian agreement between Afghanistan and Pakistan. Again, a cooperative solution will result in a win-win situation for both countries.

More generally, regional cooperation can be instrumental in facilitating the design and implementation of effective country-level strategies to address a range of global public goods; to improve water management, disaster management, and climate and environmental management; and to combat HIV/AIDS, narcotics and drug trafficking, and security and arms trade. Geographic proximity and common borders mean common action in these areas will eliminate negative externalities, reduce transaction costs of monitoring and implementation, and allow learning from shared best practices.

South Asia needs to strengthen its regional governance institutions. This governance is vital to manage the provision of regional public goods and common pooled resources. South Asia suffers from numerous prisoners' dilemmas, such as free riding and overuse of resources, because of a lack of effective institutions. This problem can be overcome by engaging the government, the private sector, nongovernmental organizations, and communities in formal and informal social institutions (networks, norms, and sanctions) based on collective action.

5. MANAGING THE POLITICS OF COOPERATION IN SOUTH ASIA: THE WAY FORWARD

The potential benefits of economic cooperation are obvious. Global examples of successful cooperation agreements reinforce the point that possible gains for South Asia from effective cooperation and partnerships can be substantial. In particular, the experience of East Asia is illustrative of the potential gains that can be achieved from more and better cooperation. Cross-border physical connectivity has improved tremendously through land-, sea-, and air-based transport networks; private sector-led vertical integration of production networks has spurred industrial productivity and growth; and e-commerce is flourishing. Yet, the actual experience with cooperation in South Asia so far has been rather dismal. Following are the key-constraining factors:

- First and foremost is the prevalence of a number of regional disputes. These include the long-standing conflict between India and Pakistan over Kashmir, which has continued to strain relations between these two large neighbors. The Afghanistan–Pakistan relations are constrained by allegations of support for the Taliban from sources in Pakistan. Similarly, securing the immigration and security issues in the India–Bangladesh border areas is another source of concern.
- Second is the lack of good analysis and information in the public domain about the benefits of regional cooperation. Unfounded populist negative perceptions in the smaller countries contribute to the misconception that increased cooperation will simply result in greater domination of India in the political and economic matters of these countries.
- A third factor has been the internal political interests in countries that are divided along nationalistic, religious, and ethnic lines, which substantially complicates policymaking that involves cross-border dialogue and cooperation.
- Fourth, and perhaps most important, the approach to international cooperation has been seriously flawed in that this has been largely seen as a bilateral politically driven agenda rather than a cross-boundary commercial investment. The bilateral political approach has partly contributed to suspicions in smaller countries of India's dominance.

International experience suggests that political constraints and historical conflicts need not be permanent barriers to development cooperation. Neither is the presence of a dominant member country a necessary threat to cooperation and shared gains. For example, the members of the European Union have fought numerous wars in the past, many of them far more intense, long drawn, and expensive in terms of loss of human lives and material resources than conflicts in South Asia. Similarly, member countries diverge considerably in economic strength. Yet these European countries have found it mutually advantageous to come together and formulate a formidable economic union. In East Asia, the economic dominance of China has not prevented effective regional cooperation with the much smaller East Asian countries.

Fortunately, the political environment for cooperation in South Asia is now changing. Historically, the regional cooperation efforts in South Asia culminated in the formation of the South Asian Regional Cooperation

(SAARC) in 1985. Until recently, SAARC has functioned basically as an annual event for heads of governments to meet with declarations of cooperation intentions but with limited implementation because of conflict and political difficulties. Armed with recent economic successes, the political space for better regional cooperation is now growing in South Asia. The last two SAARC meetings have succeeded in bringing the countries closer than ever in recognizing the merits of regional cooperation and taking significant actions to realize these benefits.

The next step is to identify concrete bankable projects in which multi-country cooperation would yield tangible benefits for citizens. The immediate priority areas are well known: promote trade facilitation by removal of all trade barriers; improve regional transport by removing transit restrictions and opening up port facilities for international trade; promote trade in energy in all possible ways, including hydropower, gas pipelines, and regional grid facilities; and pursue water cooperation to resolve flooding and irrigation problems. Cross-border transactions must be depoliticized and pursued on a commercial basis. Enabling national and international private investors to participate in these transactions holds more promise of success than bilateral political deals. International financial institutions can play a useful role by bringing global good practices, by providing technical assistance to smaller countries, and by mobilizing external financing. Where legal agreements are needed, these can be best pursued multilaterally to avoid any perceptions of dominance.

It is not realistic or necessary to expect that all political and social conflicts will have to be resolved first before meaningful cooperation can happen. Indeed, economic cooperation is a powerful means to resolve political and social conflicts. Trust and goodwill at the citizen level also can be a credible way to resolve conflicts. Economic cooperation by raising citizens' welfare can be instrumental in building this trust. Political forces can provide the impetus by reducing policy barriers to regional integration.

NOTES

1. The authors are with the World Bank in Washington, DC. Parts of the analysis of this chapter draw from an earlier paper (Ahmed and Ghani 2009). The views expressed in this chapter are those of the authors and do not necessarily reflect the views of the World Bank Group. Research assistance from Veronica Milagros Minaya is gratefully acknowledged. Errors are the sole responsibility of the authors.

2. A lagging region is defined as a poor region that does not grow as fast as the others, and its per capita income is low compared with national averages.
3. See European Union 2007, which provides evidence on convergence occurring both at the national and regional levels within European Union.
4. We are grateful to Nobuo for this work.
5. Based on their survey of evidence of more than 50 developing nations, Kanbur and Venables (2005a, 2005b) argue that the uneven spatial impact of trade and globalization played a major role in the increase in regional and urban spatial inequalities in developing countries in recent years. Moreover, they argue that, in addition to geographic remoteness, the backward regions and rural areas suffered from an inequitable distribution of infrastructure, public services, and policies that constrained the free migration of peoples from backward places.
6. The Theil inequality measure has a convenient property: it can be decomposed into inequality across areas, or "regional inequality," and inequality between individuals, after controlling for the former, or "pure between-individual inequality."
7. We are grateful to Souleymane Coulibaly for the data on city pairs.
8. Distance here is to be interpreted as an economic and social concept, rather than a purely physical concept. As such, a location that is physically close to a region of high density can, in principle, still be economically distant. This will be the case, for example, if the quality of spatially connective infrastructure linking the two areas is poor or there are economic, social, and institutional barriers to commuting and the free flow of labor between the areas.
9. A spatial multiplier is a concept that captures the additional beneficial effects that result from a policy change as a result of the feedback from spillovers between neighboring regions.
10. Borders and divisions are not the same thing. Borders define a nation-state whereas divisions influence the flow of people, goods, services, capital, ideas, and technology across borders.
11. Includes both formal and informal trade.
12. For example, given the large economies of scale in services industries (for example, telecoms), incentives to invest are greater if the markets are not segmented from other neighboring countries.
13. Based on data from S. Coulibaly.
14. This is the Central Asia-South Asia (CASA) energy project that seeks to sell 1,000 megawatts of surplus power from Tajikistan and Kyrgyzstan to Afghanistan and Pakistan. The project is being developed in cooperation with a number of multilateral financial institutions, including the World Bank.

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