Lessons S Asia can learn from E Asia

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

By **RAZEEN SALLY**

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

Bangladesh, dismissed as a basket case in the 1970s, has a thriving garments industry, as does Sri Lanka. The latter is enjoying a "peace dividend" after 25 years of civil war. Nepal's internal peace still holds. And Pakistan is opening up trade with India.

Thus South Asia is very much part of "globalising Asia" and the world economy's shift to the East. Alongside East Asia, South Asia has enjoyed catch-up growth and narrowed the yawning economic gap with the West. This has accelerated since the global financial crisis. Even accounting for the current global growth slowdown, the International Monetary Fund (IMF) forecasts China to grow 8 per cent, India 6 per cent and developing Asia 7 per cent this year – compared with 1.4 per cent growth for advanced economies. Between 2007 and 2012, advanced economies grew 2 per cent, China 56 per cent, India 43 per cent and developing Asia 50 per cent (all at purchasing power parity, or PPP).

Development gap

Yet the "Asian century" is overwhelmingly an East Asian, not a South Asian, century: The development gap between East Asia and South Asia is huge and widening. And South Asia's political and economic conditions remain much more fragile than they are in East Asia. What success factors from East Asia can South Asia emulate to strengthen its political and economic foundations, and boost growth and broad-based prosperity?

Start with comparative numbers. East Asia (comprising Japan, South Korea, Greater China and the Asean countries) has a combined population of 2.15 billion; South Asia's population is 1.6 billion. East Asia's combined gross domestic product (GDP) is US$22 trillion (at PPP); South Asia's GDP is US$5.5 trillion. East Asia's per capita GDP is almost US$20,000 (at PPP); in South Asia it is US$3,000. East Asia has a 30 per cent share of world trade and a 16 per cent share of the world's stock of inward foreign direct investment (IFDI); South Asia accounts for less than 3 per cent of world trade and just over 2 per cent of IFDI stock.

China's GDP, at US$11.4 trillion, is over twice the size of South Asia's combined GDP, and its GDP per capita is almost three times as large. China does US$4 trillion of international trade, over four times the number for South Asia. Its IFDI stock of over US$700 billion is three times the amount for South Asia. China and India had similar levels of output and real incomes in 1990. Today, China's output and living standards are 2.5 times higher than India's.

East Asia is also a much more integrated economic space. Intra-regional trade is over 50 per cent of total trade and 30 per cent of regional GDP. South Asia is the least integrated region outside the West. Intra-regional trade is 4 per cent of total trade and 2 per cent of regional GDP.

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

The best South Asian performer is Sri Lanka (in 89th place), with India bringing up the rear (in 132nd place). Last, the World Bank's governance indicators on "government effectiveness", "regulatory quality", "rule of law" and "corruption" show most East Asian countries way ahead of South Asia.

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

But "revisionists" argue that industrial policies of "developmental states" made a crucial difference. "Vertical" policies of selective intervention promoted targeted industrial sectors, restricted imports and foreign investment, and directed the financial system to channel cheap credit to favoured sectors. According to the revisionists, these policies worked particularly well in Japan, South Korea and Taiwan.

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

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

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

But growth has not benefited the poor nearly as much as in East Asia. That is because India has much bigger reform gaps; it has not "got the basics right" nearly as much as most East Asian countries. Public finances are shaky due to persistent budget deficits. Internal and external trade barriers, price controls and hugely wasteful subsidies throttle agriculture.

Apart from headline success with business process outsourcing and software exports, services sectors are weighed down by myriad restrictions. India has recently developed niche skill and capital-intensive manufacturing industries, but it has conspicuously failed to develop labour-intensive manufacturing. Unlike China, it has not become an FDI-driven export powerhouse in sectors such as toys, garments and IT products. Extremely restrictive labour laws are partly to blame. Infrastructure lags behind East Asia. Last, the Indian state is much more corrupt and dysfunctional than most East Asian counterparts.

Pakistan, Nepal and Bangladesh have even worse problems with politics, economic policies and institutions. Pakistan and Nepal have states that veer between "fragile" and "failed". At independence, Sri Lanka was the golden boy of South Asia. But, since the 1970s, it has had chronic ethnic strife, progressively weaker institutions and a beleaguered civil society. Politics has become more corrupt and violent, and power has become extremely centralised and arbitrary.

Finally, South Asia, unlike East Asia, has not integrated into global supply chains, apart from Sri Lanka and Bangladesh in garments, and India in a few other niche manufacturing and services sectors. Intra-regional trade barriers are much higher than they are in East Asia, and cross-border infrastructure much worse.

Reducing poverty: *Over the last 20 years, market reforms in India have lifted the growth rate to 6 per cent per annum in the 1990s and 8 per cent in 2004-11. This has delivered significant poverty reduction. But growth has not benefited the poor nearly as much as in East Asia.* PHOTO: REUTERS

Shopping list

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

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

Second, avoid a "picking winners" industrial policy.

Third, liberalise markets bottom up rather than top down. Don't rely on international and regional organisations and their grand designs to do the job. Rather market reforms must come in the first instance from national capitals, and sub-national regions and cities. Then they will spread by competitive emulation. That is how East Asia opened up trade and foreign investment, enabling the emergence and expansion of manufacturing supply chains.

Fourth, improve governance and the rule of law. Easier said than done, of course. But they have deteriorated over time in Pakistan, Nepal, Sri Lanka and some Indian states.

Fifth, deepen structural and institutional reforms for productivity-led growth in the wealthier parts of the region, especially the first-tier Indian cities and states, and Sri Lanka.

Sixth, expand labour-intensive manufacturing. Attracting FDI and developing export capability are critical. This is potentially a big engine of growth and employment for the poor, and the surest way of linking up with East Asian and global supply chains.

South Asia has a golden opportunity now that low-cost manufacturing is migrating away from the relatively wealthy Chinese coastal provinces. But this window of opportunity will be missed unless further market reforms are forthcoming, notably labour-market deregulation.

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

Eighth, boost cross-border sub-national links, for example between Sri Lanka and the southern Indian states and cities.

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

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Four lessons from the fall of Lance Armstrong

By **SALVATORE CANTALE**

THE fall of Lance Armstrong, the seven-time winner of the Tour de France, is a momentous event for cycling and sport in general. It also carries four lessons for business leaders.

Corporate boards need to step up

Like performance-enhancing drugs in cycling, markets develop much faster than efforts to regulate them. In the same way that Armstrong passed hundreds of drug tests before his downfall, some banks and corporations passed standard financial tests and published immaculate financial reports before eventually admitting to massive wrongdoing.

It's not enough for companies and financial institutions to comply with laws, accounting standards and transparency requirements. They must also stick to the principles shaping their vision and mission. Corporate boards have a big role to play here in making sure that companies do the right thing. The buck has to stop somewhere, and it needs to stop with the board.

Resources, capabilities . . . and guts

The limited financial resources of the Union Cycliste Internationale (UCI), cycling's ruling body, were one of the reasons why Armstrong's wrongdoing went unchecked for so long. Similarly, internal risk committees and external regulators in the business world also need the financial resources and capabilities to deal with bad behaviour.

Both the UK Serious Fraud Office and the US Securities and Exchange Commission (SEC) have suffered in this respect in recent years – for example in the SEC's decision not to file charges against Bernard Madoff for running a Ponzi scheme.

Guts are crucial too. Until recently, some observers felt that US Anti-Doping Agency (USADA) chief executive Travis Tygart was on a private crusade against Armstrong. Now, they are praising his perseverance and his goal of drug-free sport.

Avoid conflicts of interest

The UCI says that it has nothing to hide, but critics point to Armstrong's previous donations to the body (which were apparently used to buy equipment to detect illegal substances in cyclists). Even in the eye of the storm, UCI head Pat McQuaid refused to rule out future donations from cyclists despite the obvious potential for conflicts of interest. It's also best for business leaders to be free from actual and perceived conflicts.

Put your company's legacy before your own

Besides demolishing Armstrong's cycling achievements, the UCI ruling could jeopardise his work to raise money and awareness in the fight against cancer. Armstrong must make some tough decisions on what to say and do next, just like business leaders who find themselves in tough situations. Take Bob Diamond, the former CEO of Barclays. In January 2011, he said: "There was a period of remorse and apology for banks, and I think that period needs to be over."

But in July 2012, he was forced to resign amid the growing London Interbank Offered Rate (Libor) interest rate scandal surrounding Barclays. This time, his tone was much more subdued: "The external pressure placed on Barclays has reached a level that risks damaging the franchise – I cannot let that happen."

Mr Diamond did the right thing – when he had to make a choice, the company came first.

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