



SOUTH ASIA

Beyond the
Global Financial Crisis

Edited by
Amitendu Palit

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Preface

The financial crisis of 2008 was in several ways a crisis for globalisation. The globalised modern world had not experienced a crisis of this magnitude before. The Asian meltdown of 1997 was an event which was confined to Southeast and Northeast Asia. The latest crisis, however, took on a much greater geographical shape. Although it began as a ‘trans-atlantic’ crisis, it soon spread rapidly to various parts of the world, including Asia. This happened on account of the substantial links that the world had developed through financial globalisation channels of trade and banking. Asia was not an exception in this regard. Thus, the crisis was largely interpreted as a catastrophe arising from the close interconnectedness of financial and commercial systems which successfully transmitted the damage from its core to the periphery.

South Asia is an unusual part of the world in terms of its patchy connectedness to the rest of the globe. Some segments of the region developed strong trade and financial linkages with other countries. But there are several countries in the region whose integration with global trade, and particularly global finance, is limited. In that sense, the region was not expected to be a major casualty of the financial crisis. However, concerns about the region and the challenges that it may face following the crisis stem from the vulnerabilities that it was already nursing. South Asia’s traditional vulnerabilities have been ethnic conflicts, insurgencies, poverty, natural disasters and political instability. Domestic economic slowdown inflicted by partial setbacks experienced by trade and financial sectors on account of the financial crisis can create enabling conditions for further accentuation of the

existing vulnerabilities. These issues prompted South Asia's concern about the ramifications of the crisis.

The Institute of South Asian Studies (ISAS) organises an annual international conference that brings together distinguished academics, professionals and policymakers from different parts of the world to analyse emerging prospects and challenges for the region. The 5th international conference held on 4 November 2009 was devoted to the impact of the financial crisis on the region. The emphasis of the conference, in line with the institute's emphasis on studying contemporary issues in South Asia from a multi-disciplinary perspective, focused on gathering a range of perspectives on economic, social and political implications for South Asia. This volume puts together those diverse perspectives. The authors of the papers are distinguished experts in the respective subjects they have written on.

The focus of the papers include a wide variety of issues ranging from financial implications of the global financial crisis to concerns pertaining to efficient performance of local governments, terrorism, conflict management, the role of extra-regional actors in the regional strategic matrix, and the possibility of countries cooperating for building efficient regional architectures. The papers not only analyse contemporary aspects of their respective themes, but also reflect upon futuristic perceptions. In this sense, the current collection emerges as a volume that not only documents contemporary challenges in the region, but also possible options for addressing these challenges.

Editing the volume has been an enlightening and intellectually gratifying experience. I express my sincere thanks to Professor Tan Tai Yong, Director of ISAS, for giving me the opportunity to edit the book. His guidance and advice at every step has been crucial to the successful completion of the project. The conference could not have taken place without untiring efforts of my good friend and former colleague Hernaikh Singh, the former Associate Director of ISAS. The ISAS administration led by Asha Choolani has extended all possible support to the project and I express my sincere thanks to all my administrative colleagues. My research colleagues, Sasidaran Gopalan, Suvi Dogra and Gayathri Lakshminarayan, have chipped in with spirited efforts whenever required. This entire project would not have

seen the light of the day had it not been for the painstaking and tireless efforts put in by my colleague Sithara Doriasamy at ISAS and Samantha Yong at World Scientific. My sincere thanks are also due to V Sandhya at World Scientific for initiating the project. Finally, I wish to express my sincere thanks and deep gratitude to Ambassador Gopinath Pillai, Chairman of ISAS, for his continuous support and encouragement to all research and outreach activities at ISAS.

Amitendu Palit
25 October 2010

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Introduction

South Asia: Beyond the Global Financial Crisis*

K. Shanmugam

Introduction

The topic here is “South Asia: Beyond the Global Financial Crisis”. Let me make two preliminary points before I set out my views.

Economic focus

The focus of the question posed is primarily economic. The unstated assumption behind the question is that the recent economic crisis was the major hurdle that had to be crossed, and the question now is: What next?

That paradigm may not fit easily with the problems currently being faced by some of the countries in South Asia. For example, in the case of Pakistan, the threats it is facing from terrorism and insurgencies are probably more pressing than the consequences of the world economic crisis. In the case of Sri Lanka, the more pertinent question is: Will the peace be won and if so how? The country, with its well-educated population and abundant resources, will move forward quickly, if the peace is managed well, the world economic crisis and its after effects notwithstanding. The reconstruction of the country alone can be a major factor in progress. Similar points can be made in respect of some of the other countries in South Asia.

* This is an edited transcript of the keynote address by Minister K. Shanmugam at the 5th International Conference on South Asia, 4 November 2009.

The question that has been posed in this conference can however be asked of India, at this point in time: it is the biggest economy in South Asia, it is plugged in relatively more to the world economy and has therefore felt more of the impact of the crisis; and while it has some very serious non-economic challenges, on the whole, its economic transformation can be expected to have some impact on the world. I will therefore speak on India.

“Beyond the crisis”

The second preliminary point I want to make is this: The title is “*Beyond the Crisis*”. I do hope that the optimism in that title, at this juncture, will be borne out by events — we hope that the organisers are indeed prescient, and that we will not face the various letters that have been thrown at us: a “W” or an “L”, or a very fat “U”.

India: Beyond the Crisis

Now, let me turn to the topic of India, beyond the crisis. Anyone wanting to speak about India faces a challenge or an opportunity, depending on how you look at it; anything you say about India is likely to be true, however contradictory the statements. It is so vast, so varied, with people of so many different persuasions, attitudes, beliefs and talents.

This amazing mix, in the context of its geography and history, has produced extremes: of phenomenal human achievement; and at the same time, there is serious underachievement for some as well.

So you can focus on the glass being half full or it being half empty.

In this context, how should one try and understand India and its economic potential, and what it will be like after the current crisis?

Many of you are experts on India. It is therefore unnecessary for me to go into a detailed discussion of India’s economic potential. Instead, I will take an outsider’s perspective and consider how outsiders often perceive India. And I will touch on one of the aspects that should inform such a perspective, for a better understanding of India. Second, I will touch on how one can expect India to perform after

this crisis. Third, I will also touch on India's economic engagement with this region, post-crisis.

Outsider's Perspectives of India

Observers of the Indian economy often recount some well-known facts: It is a US\$1.2 trillion economy and has been growing in the recent past at between 6 to 9 percent per annum. It has an almost inexhaustible supply of labour as well as high-quality human capital. Its people are hardworking, industrious and are motivated to make a better life for themselves. English is widely spoken and there is a high premium on education. It has natural resources. It has a large domestic market including a growing middle class.

Based on these facts, it is possible to project certain straight-line economic outcomes, and people often do so. Such projections are based on the experiences of other societies.

When such projections are made they are also usually accompanied by a list of things that need to be tackled by India: infrastructure, inclusive development, education, female empowerment, urban management, environment management and so on.

These are all true. Outsiders know it. Indians know it. Most sensible people can see what is needed to fully release India's energies and harness those energies towards progress. It is not rocket science.

But these straight-line projections, assumptions based on the experience of other societies, the logical list of things to do, all of these often lead to expectations of performance. And in the case of India, there has been a discernible gap between the projections and actual performance. That gap increases or decreases at various times depending on various factors — and is usually accompanied respectively by either euphoria or extreme angst. Eventually, some throw their hands up in despair.

India's Unique Experiment

The angst and despair can be avoided, and elation tempered, if one is able to make a more realistic assessment of how India will progress.

For that, it is necessary to appreciate that India is engaged in a unique political experiment that has not been tried by any other society; and that in the abstract, a political scientist may well consider that experiment to be a near impossible one.

To explain what I mean, it is useful to contrast the Indian experiment with two other models: the Anglo-Saxon model and the East Asian Tiger model.

The Anglo-Saxon model

The UK and the US rose to great preeminence and economic strength. Their societies developed under a liberal political model.

But it is important to note some key facets of that progress: The political model was liberal, but in the early years of development, the class of people who could take part in politics was limited and largely restricted to: landed, white, male. In Britain, before the Reform Act of 1832, only 1.8 percent of adults in Britain had the vote. After that Act, 2.7 percent got the vote. After the Second Reform Act of 1884, 12.1 percent got the vote. When we talk about the development of British democracy, these facts are not usually appreciated. It was not until 1930 that Britain got universal suffrage. The US did not get universal suffrage until 1965.

Thus, in both countries, in the early years and for a long period thereafter, you had people with similar value systems, similar backgrounds and often similar economic interests who had the franchise. In this environment, there was relative stability, laws were made, there was economic growth, a middle class grew. Eventually, larger and larger sections of the population obtained the franchise. In the US, when the economic interests diverged sharply, there was a civil war.

The East Asian model

On the other hand, the East Asian model took a different path in its form: a group of men (usually men) centralised power, planned in the long-term interests of the country and executed those plans quite smoothly. Some of these countries did not hold elections.

This is not to say there were no abuses of power in some of the East Asian societies which adopted this approach. There were. But on the whole, the countries progressed. People received education, were empowered, the infrastructure developed, the economies grew steadily. And there was, as a result, tremendous progress.

The system required often huge sacrifices in the longer-term interests of the country.

I will make another point as an aside. There is no clear correlation between dictatorship and progress and I am not suggesting that there is such a correlation. Outside of East Asia, in the post-World War II period, dictatorships have in fact a poor record in delivering progress to the country as a whole — but then, the sad fact is that democracies also have a poor record in those countries.

I am no political scientist, but the common theme I find in the Anglo-Saxon model and the East Asian Tigers is this: in the early stage of economic development, the political systems were relatively stable. In the Anglo-Saxon model, stability was achieved partly by reason of the limited franchise and the inherent nature of the society; and in the East Asian model, stability was imposed — and the societies were willing to accept that.

Let us now turn to India.

India

Post-World War II, India was one of the poorer countries in the world. Literacy rates were low. The people, particularly women, were not empowered.

In that environment, India gave the franchise to its entire population: the most diverse ethnic, religious mix it is possible to imagine. Since independence, India has been working on keeping intact as a sovereign entity, and modernising itself, while engaged in this unique democratic experiment.

In the annals of human history, I do not think there has ever been such an experiment. Just consider the task: More than one billion people now. It was over 500 million in the early post-independence years. As I said earlier, a most complicated mix of ethnicities and religions, with a

mixed record of social peace. Vast sections of the population economically, educationally and socially disadvantaged. The additional complications of societal hierarchies, including the caste system. Weak infrastructure. A federal structure with devolution of power to the states.

How do you manage a country like this, and with the requirement of a Parliamentary majority? That is why I said a political scientist might, in the abstract, consider such a democratic experiment, with full franchise, extremely difficult in such a society.

But India has defied all naysayers and has proved to be surprisingly resilient. Its very existence as a sovereign entity, despite all the issues it has faced, both externally and internally, is quite a feat. Indeed, reasonable observers may well question if India could have survived as a single entity if it had any other political system.

And as a result of the universal franchise, we get the amazing spectacle known as the Indian General Elections, much romanticised. It is a noble ideal that has been much celebrated.

But that romanticism and idealism should not prevent us from accepting some realities that flow inevitably from this unique experiment — you could call it the price of democracy.

What are these realities? There are many. I will mention three: When such a diverse mix of electorate has the franchise, you are going to get an equally diverse mix of legislators and parties. Many irreconcilably competing interests will find voice and jostle for power.

Second, popularity wins you elections. But those who are popular are not necessarily always those who are best able to deliver governance — particularly when electability depends on being able to champion narrow ethnic/religious causes. The lower literacy levels and level of development has meant that vast sections of the population have not always been able to identify those who are able to govern and separate them from those who can only appeal to emotion. Many will of course remember that Dr. Singh himself had difficulties getting elected.

Third, such a political system encourages a mindset of trying to get a share of existing, scarce resources for a particular community, rather than engaging with others in the broader task of increasing the resources available.

All of this imposes economic costs. But the cost is not only economic. The various other costs are well documented. India ranks 134th in the UNDP Development Index. Infant mortality is high. India has a literacy rate of 61 percent. Female literacy rate is at 48 percent. UNESCO ranks India 102nd out of 129 countries in its Education for All Development Index.

These and many other observations can be made and have been made. But as outsiders, we have to accept the system as it is, and work with it. And we have to accept that such system will mean that the list of things that most people accept needs to be done — infrastructure, education and so on — may appear to be “no brainers” but it is not easy to get them done. Indeed, it will be quite difficult to get them done, because of the unique nature of the political process.

The bottom line therefore simply is this: India is different and unique. Let us accept that it is different and unique. If we apply the yardstick of other societies, we will end up being frustrated. Make a realistic assessment of what is doable in India, given the nature of the political system. Stop prescribing, theorising and romanticising. Understand the difficulties, and accept the realities. Then, there will be no gap between expectation and actualisation. Or at least the gap will be smaller.

That is my first point, as an outsider observing India. Let me now deal with my second point, India post-crisis.

India: Post-Crisis

How will India do after this crisis? The answer is fairly straightforward. The crisis is transient, temporary. Indian growth is a permanent story. India appears to be set on a path of steady growth. It should easily register 6 to 8 percent growth. If it tweaks a few things, a 9 to 10 percent average is very doable.

The *Wall Street Journal* (3 November 2009) made the following points, in part quoting Dr. Manmohan Singh:

- India should aim for 9 to 10 percent growth, as it rebounds from the global downturn.

- India has weathered the crisis better than most countries, registering a more than 6 percent growth despite a drop in exports and a poor monsoon season.
- Now, there is a palpable sense of optimism that India is on a path to return to, or even outstrip, the 9 percent growth rates it enjoyed before the downturn.
- Corporate earnings are improving and foreign institutional investors are placing big bets on India.

There is little doubt about India's growth trajectory. It is going to be one of the stories of the first half of this century, this crisis and other economic crises notwithstanding.

There are threats to this picture. India faces a well-armed, well-trained Maoist insurgency in the Northeast which has spread to the East. This is seen as a serious threat.

India also faces terrorist threats throughout the country; and it faces threats from communalism and other similar social forces.

India's ability to deal with these threats through the exercise of political will has been hampered by the nature of its political system. But its large mass and the innate common sense and nature of the Indian people have allowed it so far to absorb the shocks.

These and other threats could cloud the economic picture. But on the whole, the sense is that India will make steady progress despite all these threats, though the rate of growth may be affected.

Now let me turn to the third of my three points: the level of economic engagement between India and this region, after this crisis.

Engagement Between India and Southeast Asia

From a Southeast Asian perspective, there are at least four major economic powers which seek to play a role in this region: the US, China, Japan and India.

The US of course has long been a partner in this region. Economically, it is a most important presence. Likewise, Japan. Both the US and Japan have had a long history of economic engagement and have very strong ties and influence in this region. They have

invested billions of dollars, there are strategic engagements and they employ hundreds of thousands of people across the region.

China is a relative newcomer to this region, if we start looking at it from the post-World War II period. However, it has quickly established itself as a major player with substantial influence: ASEAN–China trade in 2008 was US\$200 billion and growing. China has strong bilateral ties with many countries and gives a lot of aid and technical assistance to countries in this region. And its open approach to free trade agreements (FTAs) and other similar economic engagements has found resonance and strong support in Southeast Asia.

ASEAN and China agreed to launch negotiations for an FTA in November 2001. A Framework Agreement on Comprehensive Economic Cooperation was signed a year later. In 2005, the Agreement on Trade in Goods entered into force. The Trade in Services Agreement entered into force in 2007. In August 2009, the Investment Agreement, which is the third and final pillar of the ASEAN–China Free Trade Area, was signed. China also started a US\$10 billion China–ASEAN Investment Cooperation Fund to finance investment cooperation, and plans to offer US\$15 billion of commercial credit to support infrastructure development in ASEAN.

Ties with China will deepen and strengthen fairly quickly. China seems to have a clear strategy in this respect, and its strategy (as can be expected of China) is being executed well.

India has been showing increasing interest at a time when the US and Japan have established a strong presence and when China is engaged in a big way with Southeast Asia.

India launched its “Look East” policy in 1992. That policy has had a number of aspects. One is the military aspect. India has sought to play a bigger role in maritime security in this region. It has had some military engagements with some countries in this region.

On the economic front, India has engaged with ASEAN. In 2003, ASEAN and India inked a Framework Agreement to pave the way for an ASEAN–India Free Trade Area. After six years of negotiations, ASEAN and India signed the Trade in Goods Agreement in August 2009, which is the first of three substantive pillars of the FTA.