



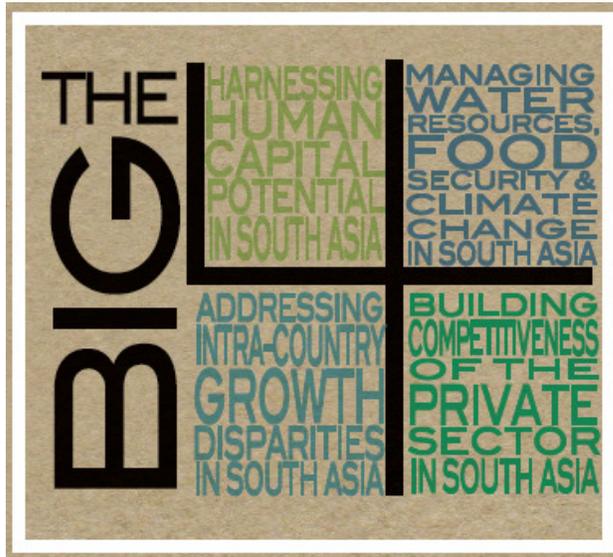
'Towards a Stronger, Dynamic and Inclusive South Asia'

6<sup>th</sup> SAES THEME PAPER

# Managing Intra-Country Growth Disparities in South Asia

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## Managing Intra-Country Growth Disparities in South Asia<sup>1</sup>

### Introduction

While most regions of the world suffered enormously due to the global financial crisis of 2007-08, South Asian economies were better able to cope and it became the fastest growing region over the past decade. South Asian region expanded at 5% in 2012 and the growth rate for 2013 is estimated to be at 5.7% (ADB 2013).

Despite rapid growth, South Asia is home to 35% of the world's poor, 250 million undernourished children, 30 million children out of school, and nearly 600 million people living on US\$ 1.25 a day. Moreover, South Asian region is also dominated by high conflict rate, lowest female labor force participation rate in the world (Ghani, 2010) and low progress towards most of the millennium development goals (World Bank and IMF, 2013).

The growth performance has not been evenly distributed throughout the region, creating a divide between 'leading' and 'lagging' economies within the South Asia. This divide is not only restricted to the regions but can also be observed within countries (in the form of rural-urban, urban-peri urban, and peri urban-slum divide). These gaps in growth seem to be widening over time resulting in high incidence of poverty and income inequality across South Asia.

South Asia has resiliently grown in the past decade fueled by a large working age population, growing capacity of productive endowments, a large Diaspora and an overall increasing integration with rest of the world. The four key trends that may sustain these positive developments include a substantial share of youth in the population structure of South Asia, fast urbanization in turn making agglomeration possible, a rising share of services in the gross domestic product, and transformation of agriculture.

Thus South Asia is unique in a sense that on one hand services contribute a major share to its GDP growth and on the other hand agriculture sector is still the largest employer, absorbing maximum labour force. While strong economic growth kept South Asia insulated, to a certain extent, from global fiscal crisis; strong agro-base minimized the impacts of global food prices shocks in South Asian countries during 2008-09.

Growth in services sector can provide jobs to skilled, educated, and trained workforce. With a growing working age, urbanized and agglomerated population (Table 1) the key challenges for South Asian countries will involve provision of education, health and jobs in order to ensure respectable livelihoods. Furthermore if migration from rural to urban is being fueled by rising opportunities in the latter, then one would have to adopt two

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<sup>1</sup> *Disclaimer: This paper was prepared by Abid Q. Suleri, Vaqar Ahmed, Muhammed Zeshan, and Samavia Batool of the Sustainable Development Policy Institute (SDPI), Islamabad, Pakistan, for the 6th South Asia Economic Summit. The research contained herein, including data, analysis, and/or policy recommendations are those of the author/s and the IPS bears no responsibility for them. Any queries/clarifications/errors/omissions can be directed to [vaqar@sdpi.org](mailto:vaqar@sdpi.org).*

pronged strategy. On one hand, valuing rural space and sustainable resource and leveraging potential of sustainable livelihoods; nurturing socio-cultural co-existence; and enhancing productive potential, and on the other hand working on an infrastructure that connects people and places, providing an enabling environment for work and residence. Both social sector and infrastructure provisions will indeed require enhanced domestic resource mobilization.

Table 1: Population, Urbanization and Agglomeration in South Asia (2012)

| Country     | Population ages 15-64 (% of total) | Population ages 0-14 (% of total) | Urban population (% of total) | Population in urban agglomerations of more than 1 million (% of total population) |
|-------------|------------------------------------|-----------------------------------|-------------------------------|---|
| Afghanistan | 50.3                               | 47.4                              | 23.9                          | 10.7  |
| Bhutan      | 66.8                               | 28.5                              | 36.3                          | -   |
| Bangladesh  | 64.7                               | 30.6                              | 28.9                          | 14.9  |
| Nepal       | 59.4                               | 35.6                              | 17.3                          | -   |
| Pakistan    | 61.3                               | 34.3                              | 36.5                          | 19.2  |
| India       | 65.4                               | 29.4                              | 31.7                          | 12.7  |
| Sri Lanka   | 66.6                               | 25.2                              | 15.2                          | -   |
| Maldives    | 66.0                               | 29.0                              | 42.2                          | -   |

Source: World Development Indicators 2013

The growth experience in South Asia has not been inclusive or participatory (Stalon 2013, Suleri, 2006a). The region like many other competing regions has also not regarded the basic norms of sustainable development in turn increasing the vulnerability originating from un-sustainable production and consumption patterns. The various forms of inequalities still existing hinder the equitable access to even the basic necessities of life. The inequalities are not limited to income or consumption patterns but also include continued inequalities of various sorts faced by women, marginalized groups and minorities. The demand-side accountability still remains weak given the low levels of literacy particularly in rural areas. This has resulted in weak service delivery in most social sectors as well as rent-seeking in the productive areas that have state footprint.

This paper aims to explore that despite expansion in gross domestic product in South Asia intra-country socio-economic disparities continue to exist. We will specifically look into opposite behaviours of macro-level economic and micro-level welfare indicators. We also explore if evidence from new economic geography (Krugman 1991) can provide answers for minimizing intra-country (and intra-region) disparities. Particularly important here is the role of trade, urbanization, agrarian transformation, integrated supply chains in the region, and reforming in-country institutional structures.

This paper also looks into the development financing challenges of reducing meso and micro-level disparities within South Asian countries. An argument is made that besides

strengthening sustainable livelihoods (growth) through new economic geography, concerted efforts are required to reform taxation structures that can mobilize fair revenue collection, and finally strengthen the social safety nets to take care of the excluded segments of the society and explore the regional financing vehicles including the SAARC Development Fund.

In this paper we resorted to results from already available literature on South Asia which focuses on intra-country growth-related disparities. We supplement our analysis with literature from new economic geography and an econometric exercise that aims to look at the potential of South Asian growth and integration for reducing poverty and inequality.

On top of it, we also looked at the key mega trends observed across South Asia including individual empowerment, rise of middle class and urbanization, diffusion of power, evolving cultural trends, agrarian transformation and climate change (Suleri, 2013a). These trends can turn into a boon or bane depending upon relevant influencing factors (termed as game changers in this paper).

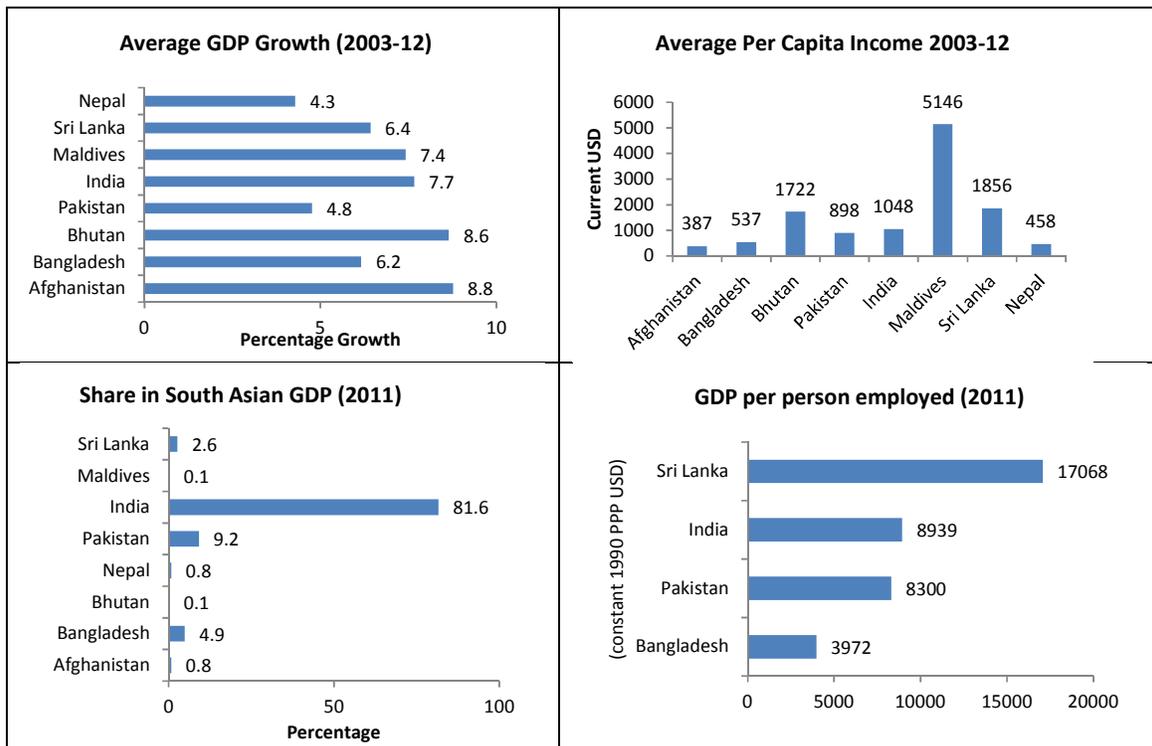
The growth experience across South Asia is discussed in detail in the next section. This is followed by a discussion on intra-country disparities in sources of economic growth including human and physical capital. In section 4 a discussion based on the new economic geography literature exhibits how economic growth coupled with increased regional integration may provide an answer to enhancing welfare. This linkage can be further strengthened through the forces of agglomeration which take place in cities and integrated supply chains. Finally we look at the future development options possible for South Asia including a discussion on MDGs achievement and the financing mechanisms available to South Asian countries for addressing intra-country growth disparities.

## **Growth Experience in South Asia**

### **Expanding Productive Capacities**

The past few years have seen South Asian countries expanding their productive capacities to new frontiers. Some of the fastest GDP growth rates were seen in these economies (in the past 10 years) with Afghanistan and Bhutan growing above 8.5 percent average, India and Maldives remained above 7 percent, Bangladesh and Sri Lanka's real GDP growth rates ranged between 6.2 – 6.4 on average, whereas Nepal and Pakistan remained above 4 percent average (Box 1).

## Box 1: Growth and Productivity in South Asia



Source: World Development Indicators 2013

The population growth in the South Asian region was cited as a critical factor in keeping the per capita incomes of these economies low at least in the past decades (Nafziger 2006). India despite being termed as world's largest economy exhibited an average per capita income of slightly over USD 1000 across 2003-12. As explained in the introduction section, the pace of population growth in many of the region's economies outpaced the resource availability with the government to spending on public goods ultimately resulting in deprivation of various forms. Having said this, the share of Indian economy in South Asia remains dominant. In 2011 this share stood at around 82 percent followed by Pakistan at 9.2 percent. For these two economies and others to become globally competitive players the stock of GDP is far less important than the level of productivity in the economy. A large labour force is still rendering a GDP per person employed, lower than the average of middle income countries. Box 1 indicates these numbers for select South Asian economies for which the data is available.

### Constraints on Inclusive Growth

While a lot has been written about the various constraints faced by the South Asian countries on the economic front, there seems to be a consensus on two issues (Ahmed et al. 2010, Ahmed et al. 2011). First the fiscal discipline continues to be compromised and second the quality of public institutions responsible for the government's economic management has shown slow improvement. So in essence while there remains a resource

constraint to meet development priorities of South Asian countries, a clear dearth of capacity to manage existing resources is also evident (GoP 2011). The combination of the above mentioned factors leads to a weak linkage between growth, employment and poverty alleviation thus constraining the inclusive growth.

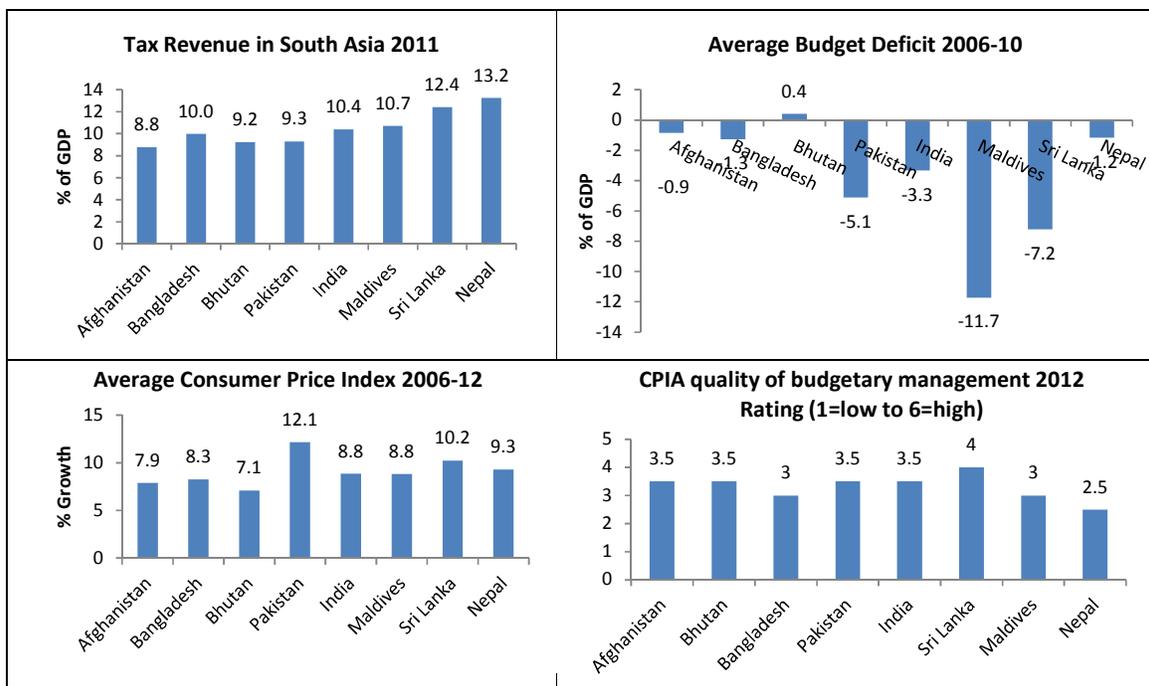
### Macroeconomic Governance

One of the reasons for low spending on Millennium Development Goals (MDGs) and related targets is the low levels of government revenues. In fact South Asia exhibits some of the lowest levels of tax to GDP ratios across the globe (Box 2). The taxation structure is complex and suffers with leakages owing to intervention by public officials. Tax administrative reform measures have been on-going in most South Asian economies, however the desired increase in revenues as a result of such measures has yet to be witnessed (Ahmed et al. 2011).

The expenditure side of the budgets in this region represents overspending in turn resulting in budget deficits. The average budget balances between 2006-10 indicate that only Bhutan exhibited minor surplus. Some of the high budget deficits in the region were seen in case of Maldives, Sri Lanka, Pakistan and India. These budget deficits and the manner in which they were financed have been partly responsible for the growth in consumer prices, constraining purchasing power and keeping poverty rates stubbornly high. The average growth in consumer price index between 2006-12 remained positive and was in double digits in case of Pakistan and Sri Lanka.

The management of available stock and flow of resources with the governments in South Asia requires substantial improvement. The World Bank's Country Policy and Institutional Assessment (CPIA) quality of budgetary and financial management rating measures the extent to which one observes discipline in budgetary priorities, controls, reporting accuracy and audit procedures. This rating for South Asian countries is given in Box 2 which indicates a mediocre level of discipline where there is space of improvement. Bangladesh, Nepal and Maldives are on the lower side within South Asia in terms of this rating.

Box 2: Taxes, Deficits and Inflation in South Asia



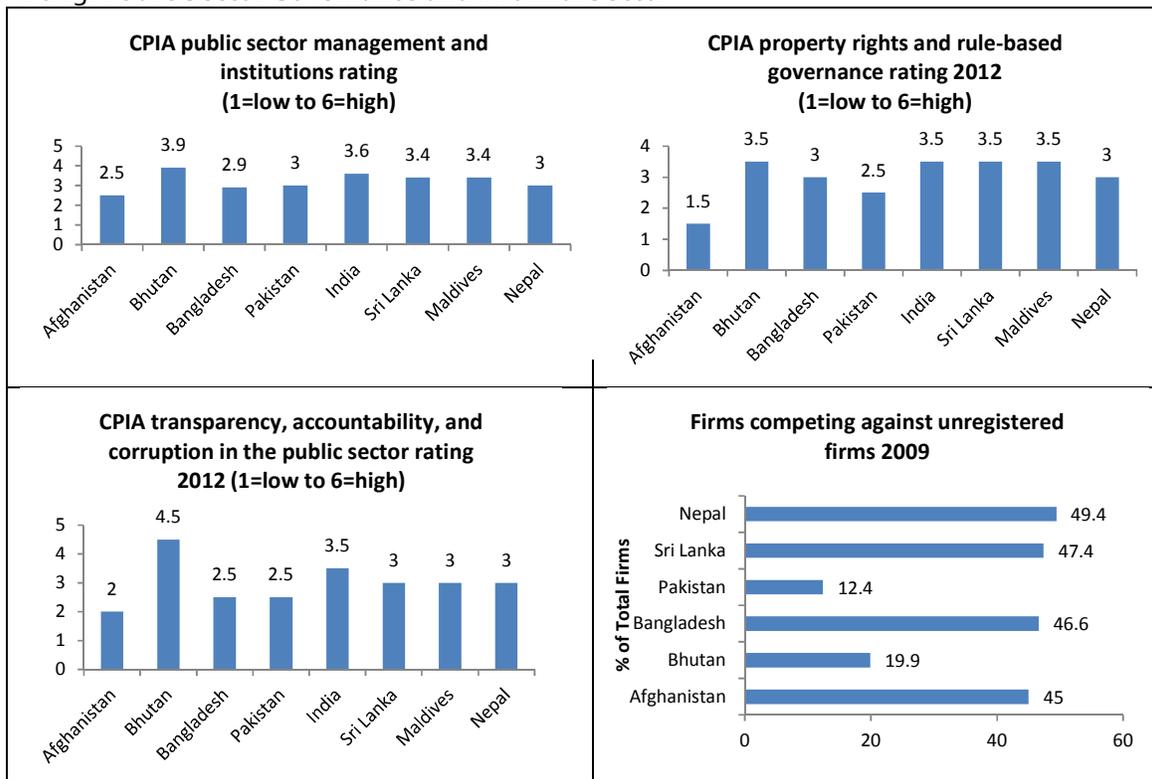
Source: World Development Indicators 2013

### Quality of Public Institutions

While revenue mobilization and overall budgetary management is the responsibility of economic managers at finance and planning departments, the efficiency with which the money is absorbed heavily depends on the quality of public institutions and human resources capacities within those institutions responsible for spending of resources, providing an enabling environment for equal opportunities to all, competition, and ensuring transparency in policy and practice. It is argued that poorly resourced and weak public institutions produce public policies heavily in favour of those 'who have' over those 'who do not have'. This in turn makes the rich even richer and turning the poor further poor (Suleri, 2006a).

We further argue that in “shining South Asia” and “suffering South Asia” –where public institutions are weak, policies are tailored on a quick-fix approach, and an ongoing tension between “haves” and “have not” prevails. The property rights, a pre-requisite of free market economies do not get enough respect. Formal economic sector is another victim of these institutional and policy deficiencies, thus there are high number of firms operating in the informal sector (undocumented economy) in every South Asian country. Such a phenomenon not only gives rise to disincentives for formal sector firms and loss of important revenue for the government, but also to usurpation of rights of employees working in formal sector. The CPIA ranking indicates a wide margin of improvement that can be brought about in this area (Box 3). This phenomenon is however inevitable given the high levels of corruption endorsed by the poor performance exhibited under transparency, accountability and corruption rating in Box 3.

### Box 3: Public Sector Governance and Informal Sector



Source: World Development Indicators 2013

### Poor Linkages between growth and poverty alleviation<sup>2</sup>

The assumption by policy makers that achieving growth may produce some losers in society in the short run, but in the long run growth would automatically alleviate poverty, is the major constraint on inclusive growth (Suleri, 2006a).

Suleri (2006a) argues that (in case of India and Pakistan) "Our service delivery system favours the rich, our infrastructure is developed to cater to the needs of the already privileged, our lending institutes lend money to those who can prove that they are not in need of money, our taxation system offers tax holidays to big investors, big loans worth millions of rupees can be written off with a little push of the political pen but defaulters of small loans are sent behind bars. Even our educational and health systems (the backbones of any living society) also favor those who can afford to pay". He further argues that the notion of pro-poor development needs to be revisited, as the growth will remain pro-poor as long as it is at least of some benefit to the poor.

Quoting UNDP (2005), "...if one dollar is poured in Brazil, then according to the existing wealth distribution pattern, only 15 cents would reach the poor whereas 85 cents would go

<sup>2</sup> This section is derived from Dr. Abid Suleri's article, "Ranks of the rich, files of the poor", published in The News in March 2006. The article is accessible at <http://www.cuts-citee.org/articlesmar06.htm>

to the rich and this would still be a pro-poor intervention", he argued that to make growth really inclusive for the poor, it has to be relative – that is, it has to be positively biased towards the poor and the marginalised (Suleri, 2006a), which unfortunately could never be the case for South Asia.

Though there are many initiatives focusing on inclusive growth, lack of policy cohesiveness is neutralizing almost all of them. The weak institutional arrangement and poor macroeconomic governance, lack of coordination (among institutions, among institutions and target population, and among target population themselves) is a major factor affecting policy cohesiveness. As a result, many of these initiatives have turned into standalone activities which do not bring any real change. But there is much more to these policies than just the lack of coordination and cohesiveness. For instance, absence of democratic participation by all stakeholders including the targeted sections of population, non-consultative and non-transparent policy formulation mechanism, and a predilection for quick fixes in most of the developing countries are some of the other factors -- which not only widen the gap between various inclusive growth initiatives, but also favour the rich and the well off over the poor and the marginalized thus leading to economic disparities.

### **Disparities in Access to Sources of Growth**

The discussion in previous section builds a strong case that in order to achieve inclusive growth one needs to have two parallel strategies, one that would take care of the growth per se, and the other that would simultaneously take care of distributing the benefits of growth in a manner that also favours the excluded segments of society. The latter also demands that the sources of economic growth are equitably accessed by the society. Quality of human capital and level of physical capital available for growth are the major sources of economic growth. We briefly discuss the state of these two factors in South Asia.

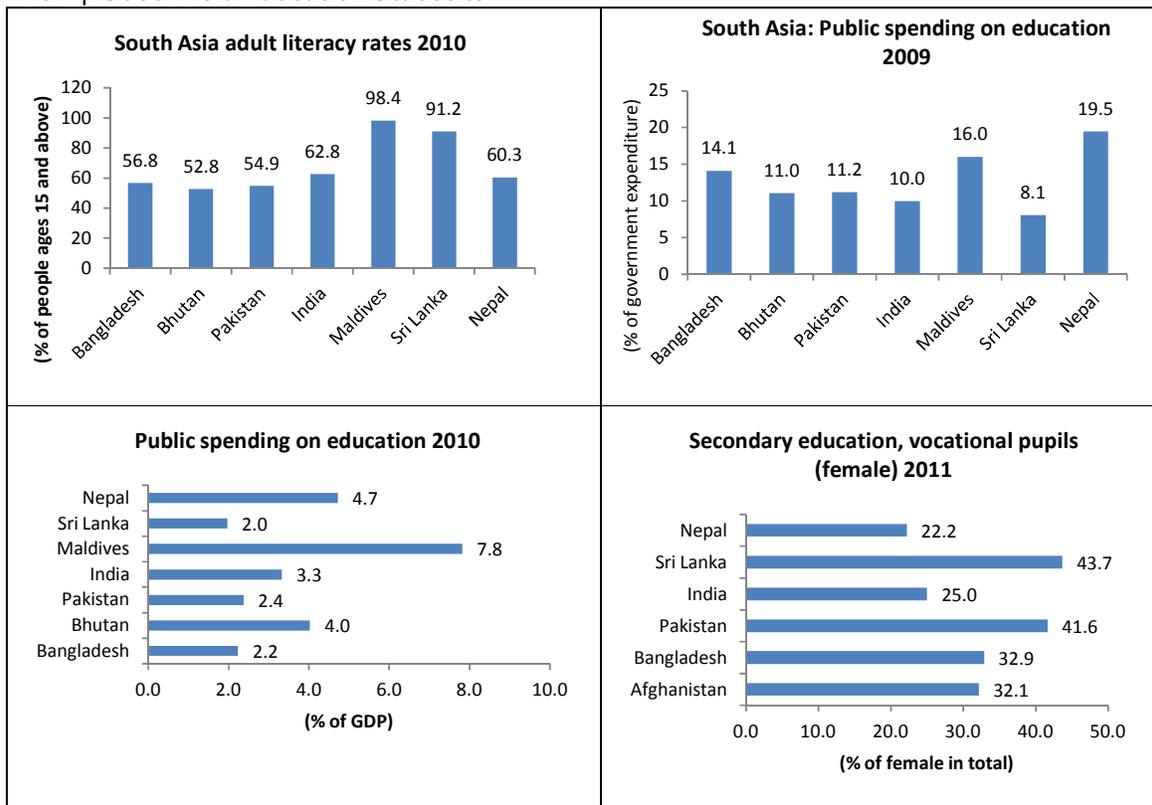
### **Human Capital**

The availability and quality of human capital available in the economy greatly depends upon the kind of provisions made towards education, health and human resource development (HRD). South Asia is home to a large and uneducated labour force. This fact is endorsed by the low levels of adult literacy rates. Except for respectable rates in Sri Lanka and Maldives the other economies in the region have adult literacy rates<sup>3</sup> ranging between 52-63 percent (Box 4). Within the national budgets we observe that Maldives attaches the most priority to education in the region by spending 7.8 percent of its GDP on education in 2010. Whereas Bangladesh and Pakistan despite having some of the lowest literacy rates in the region spent under 2.5 percent of their GDP on education in the same year. While vocational education has been greatly promoted across South Asian countries in order to orient labour force with skills-based and demand-driven knowledge, however we observe gender disparities even in access and take-up of this medium. For example in India and Nepal only 25 and 22 percent of vocational school pupil are female.

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<sup>3</sup> Here we are not judging by the official definition of literate person which in certain instances means someone who can write his/her name in national language and can put his/her signatures.

#### Box 4: South Asia Education Statistics

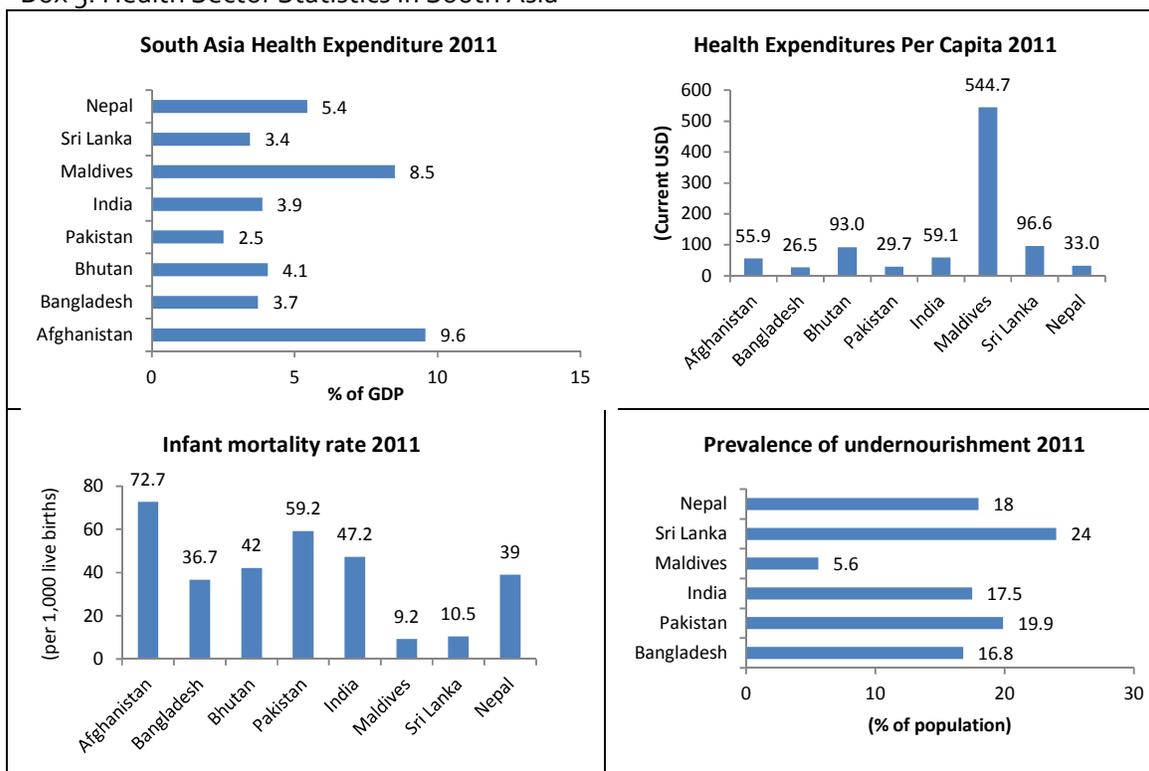


Source: World Development Indicators 2013

Thus the society in each South Asian country may be divided by literacy levels. Those who get a chance to go to school, college, and for higher education versus those who do not have access to education. Barring few exceptions, this would in turn establish who would survive in service oriented economies which rely on skilled and educated service providers (see Ghani 2010).

From education we move to health sector where South Asia clearly spends one of the lowest per capita levels on the health of its citizens. The per capita health expenditure for 2011 was under USD 30 in case of Bangladesh and Pakistan (Box 5). The highest per capita health expenditure in South Asia in 2011 was seen in Maldives at USD 544.7. The actual outcomes data on health indicates that there is still a long way to go before health related MDGs can be achieved in this region. For example there still exist high infant mortality rates in case of Afghanistan, India and Pakistan. Similarly the food security related hazards also pose future health risks. We see that the percentage of undernourished population in case of Bangladesh, Nepal, India, Pakistan and Sri Lanka, is above 15 percent. There is increased evidence in South Asia that it is the female member of the household that has a higher probability of remaining undernourished (Hatlebakk 2012). We understand from literature that malnourishment in the early childhood has irreversible negative effects on child's IQ level. In simple words it means that people who do not have access to adequate health services would lose out when it comes to access to sources of growth.

## Box 5: Health Sector Statistics in South Asia



Source: World Development Indicators 2013

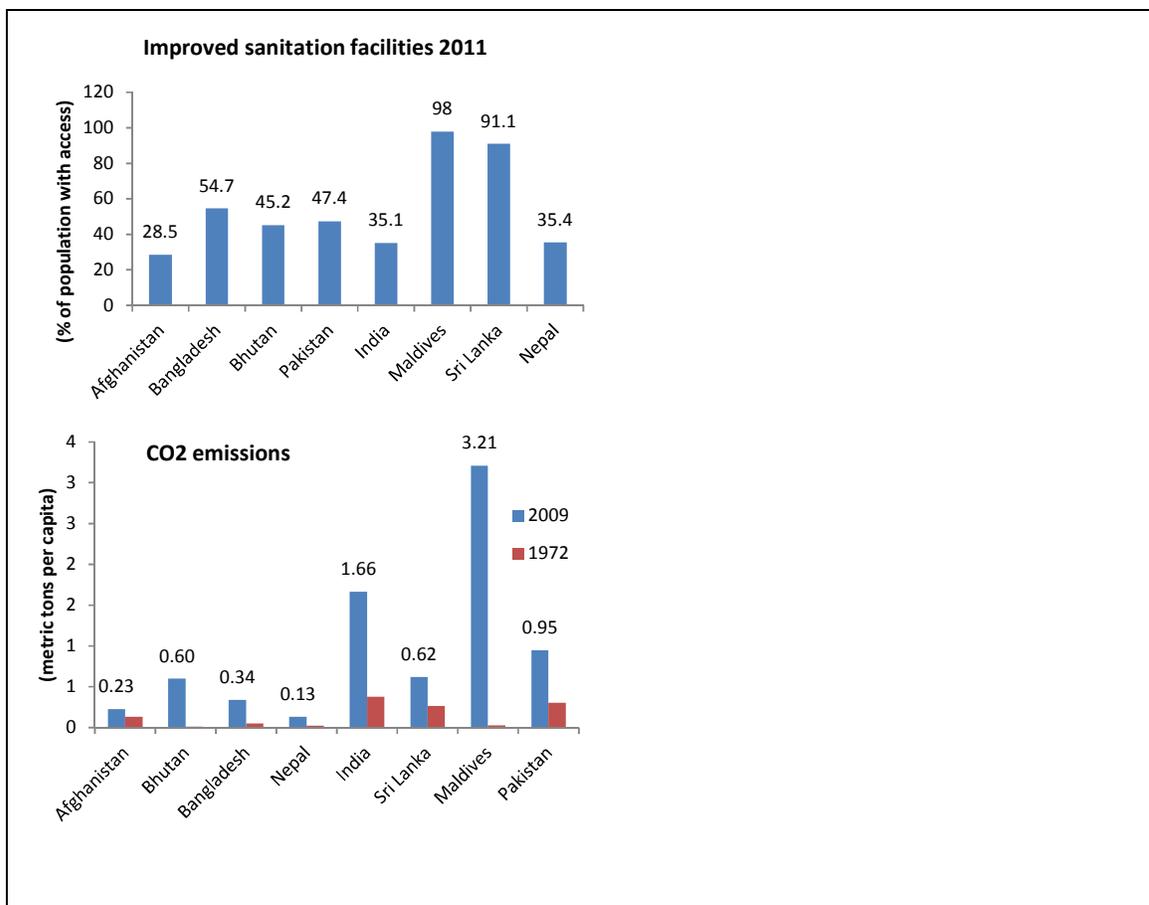
### Challenges of urbanization

One should also bear in mind that investments in health and education by themselves will not ensure a society safe from future risks. The increased urban settlements (particularly peri-urban areas) have implied lack of proper sanitation and increased incidence of hazardous carbon. Over 60 percent of population in Afghanistan, India and Nepal did not have access to improved sanitation facilities in 2011 (Box 6).

There is a clear increase in CO<sub>2</sub> emissions in the South Asian region over the past few decades. Box 6 indicates that the highest increase in emissions between 1972 – 2009 is seen for India and Maldives. However other South Asian countries are not far behind. The production structures which contribute to such high levels of emissions certainly cannot help towards the goals of sustainable development. There are now instances of climate change-led migration across South Asia. This again has a negative effect on equitable access to sources of production

### Box 6: Challenges associated with urbanization





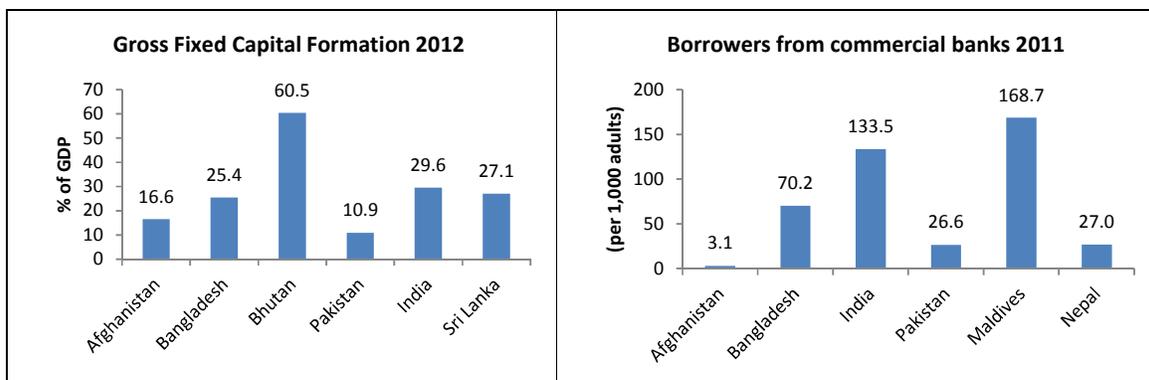
Source: World Development Indicators 2013

The above mentioned is a classical chicken-egg situation. The unprecedented economic growth in South Asian countries does not help in strengthening its human capital, as this growth does not get translated into improved public services i.e., education, health, and sanitation. Deprived of these basic services, majority of South Asians in each country cannot have access to sources of production and hence remain trapped in poverty. This vicious cycle is an important factor behind intra country disparities.

### Capital Accumulation

There has been extensive debates if the growth in South Asia was consumption-led in the past decade. While this seems merely a national income accounting argument whereby consumption and investment shares in GDP are analyzed separately, however the fact remains that growth in this regions have been (in case of most economies) associated with higher levels of capital formation. Except for Afghanistan and Pakistan, the South Asian economies have exhibited above 20 percent gross fixed capital formation to GDP ratio in 2012 (Box 7). There is now vast facilitation in terms of financial services as increased number of people are now accessing the formal banking sector for ensuring their working capital needs.

Box 7: Investment Dynamics



Source: World Development Indicators 2013

In order to fulfil its budgetary deficits, most of the South Asian governments rely heavily on domestic borrowing thus crowding out the private sector. We have discussed the importance of macro-economic governance in the beginning of this paper. Lack of fiscal discipline by state leads to a situation where state has monopoly on domestic borrowing and restricts the access to capital for all other players. Going forward it is now becoming increasingly important that governments in South Asia assume a policy and compliance role and exit the market for private sector competition (GoP 2011).

South Asia is an energy thirsty region and as a case study we picked up energy sector and in Table 2 details on investment undertaken in energy sector with private participation in 2012 are provided. Apart from India all other countries show a dismally low level of private participation in a sector that is certainly important for growth in other productive avenues. Partly this is due to refusal of South Asian governments to deregulate energy sector. For capital accumulation to increase large scale and longer term investments will be desired. Such investments however require a competitive and level playing field, certainty of contract enforcement and timely dispute settlement mechanisms (Hussain and Ahmed 2012).

Table 2: Investment in energy with private participation 2012

| Country    | current US\$ Billion |
|------------|----------------------|
| Bhutan     | 0.2                  |
| Bangladesh | 0.3                  |
| India      | 18.2                 |
| Pakistan   | 0.7                  |
| Sri Lanka  | 0.5                  |
| Nepal      | 0.03                 |

Source: World Development Indicators 2013

The entrepreneurship milieu is not much encouraging if one looks at the new business density across South Asia measured by new registrations of businesses per 1000 people (Table 3). There may be several reasons for this however two are worthy of being highlighted in the context of our overall analysis. A large informal sector discourages people to enter formal market where transactions costs of complying with rules can make

them uncompetitive vis-à-vis the formal sector. Second the formal markets are closed for the smaller segments of entrepreneurs. By 'closed' we imply that the costs of entry and exit are abnormally high for an aspirant entrepreneur to pursue (see Orso 2009).

Table 3: New business density 2011<sup>4</sup>

| Country     | New registrations per 1,000 people |
|-------------|------------------------------------|
| Afghanistan | 0.12                               |
| Bhutan      | 0.06                               |
| Bangladesh  | 0.10                               |
| India       | 0.09                               |
| Pakistan    | 0.03                               |
| Maldives    | 3.10                               |
| Sri Lanka   | 0.58                               |

Source: World Development Indicators 2013

In countries like South Asia with low investment in human capital development, low capital accumulation, and monopolized access to capital, one of the major determinants of access to sources of production is access to natural resources; especially access to land. Despite the fact that feudal patterns of landholding are gradually phasing out in most parts of South Asia, one still finds that land ownership is highly skewed.

India has the highest number of tenants and landless labourers in South Asia. Incidentally the highest number of poverty related suicides also prevails in rural India. We will discuss the factual details about land inequality latter in this paper however we recognize here that the skewed ownership of land not only deprives the majority of rural workforce in South Asian countries to access the sources of production, but also forces them to migrate to urban areas for a better future. The aftermaths of this unplanned urbanization can be seen in terms of growing number of peri-urban neighbourhoods and slums in all major cities of South Asia.

This dichotomy of development can only be removed through meaningful land reforms and creating opportunities for landless rural workforce to access natural resources of production. At a more macroeconomic level the concentrated land holdings and cartelized supply chains in agriculture sector are also contributing towards food price inflation in South Asia (Ahmed and Jansen 2010).

### Is Welfare Improving?

In Table 4 we observe the relatively higher levels of growth seen recently in South Asia vis-à-vis some other regions. However as we observe in preceding sections, they are two interesting phenomenon. In the case of some countries, one observes improving social sector numbers (particularly education and health) coming out during phases of declining

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<sup>4</sup> new registrations per 1,000 people ages 15-64

long run economic growth. In case of others, there are greater investment commitments towards social sector priorities however declining absorption of already disbursed budgets.

**Table 4: Annual Per Capita Growth Rates**

| Region                                      | 1970s | 1980s | 1990s | 2000s |
|---|-------|-------|-------|-------|
| South Asia                                  | 0.55  | 3.23  | 3.33  | 4.96  |
| East Asia & Pacific                         | 5.03  | 5.97  | 6.82  | 8.00  |
| Middle East & North Africa                  | 3.46  | -0.67 | 2.01  | 2.40  |
| Sub-Saharan Africa                          | 1.26  | -0.73 | -0.67 | 2.00  |
| Latin America & Caribbean                   | 3.19  | -0.24 | 1.15  | 1.85  |
| Europe & Central Asia                       | -     | -     | -2.60 | 4.89  |
| World                                       | 2.09  | 1.37  | 1.25  | 1.34  |
| <i>Source: World Development Indicators</i> |       |       |       |       |

If one splits the analysis by urban and rural setting, there are rising per capita incomes in rural areas amid lack of access to basic services.<sup>5</sup> Similarly there is lack of capacity to organize resources (e.g. see ODI 2005) and assets which ultimately prevents growth from translating into empowerment. In the urban setting and due to faster growth in cities there are higher rates of internal migration across South Asia (Rajan 2012). However the potential of domestic commerce, which is the first resort for poor migrants dwellers in slums and peri-urban areas, is being stifled due to fragmented urban zoning leading to malfunction of municipal authorities (GoP 2011).

Stalon (2012) summarizes the above mentioned disconnect with 3 key results from South Asian growth experience. First the growth has accelerated since 1970s. Second income inequality has increased over time and third, despite high growth, there has been a slowdown in poverty reduction. In case of the third result the author explains that economic growth has not been inclusive due to: a) changing sectoral pattern of growth, b) impact of employment growth on poverty has been limited due to low labour productivity growth and c) low levels of public spending on social sectors.

The above mentioned discussion on macro and meso level economic indicators can also be supplemented with data on poverty profile in South Asian region. The situation is particularly grave if one considers poverty headcount ratio at USD 2/day (Table 5). With this definition Afghanistan, India, Pakistan and Nepal have alarmingly high levels of poverty. This clearly indicates that the growth process has been uneven and while many in South Asia might have crossed the poverty line during the past decade, a lot more still needs to be accomplished. The policy makers also need to understand that while growth may be a necessary condition for poverty reduction, it is in no manner a sufficient condition (Basu and Mallick 2007).

Table 5: South Asia Poverty Profile

<sup>5</sup> The non-farm incomes in rural areas have seen strong growth. See Binswanger-Mkhize (2012).

| Country     | Poverty headcount ratio at \$1.25 a day (PPP) (% of population) | Poverty headcount ratio at \$2 a day (PPP) (% of population) |
|-------------|---|--|
| Afghanistan | -   | -  |
| Bangladesh  | 43.3  | 76.5   |
| Bhutan      | 10.2  | 29.8   |
| Pakistan    | 21  | 60.2   |
| India       | 32.7  | 68.8   |
| Maldives    | 1.48  | 12.2   |
| Sri Lanka   | 4.11  | 23.9   |
| Nepal       | 24.8  | 57.3   |

Note: Latest available figures after 2004

Source: World Development Indicators 2013

The inequality milieu is far more concerning as the countries in South Asia have GINI index above 30. Most of the economies are not very far from each other implying that the variance in inequality across the region is very less. This clearly indicates towards the weak policies in the region towards redistribution of wealth and resources. The data is endorsed by statistics on the income share held by lowest 10 percent in South Asia. This is relatively higher for Pakistan at 4.4 percent and low for Maldives and Bhutan at 2.7 and 2.8 percent respectively.

Table 6: South Asia Inequality Profile

|             | GINI index | Income share held by highest 10% | Income share held by lowest 10% |
|-------------|------------|----------------------------------|---------------------------------|
| Afghanistan | 27.82      | 23.21                            | 4.08                            |
| Bhutan      | 38.06      | 29.36                            | 2.8                             |
| Bangladesh  | 32.12      | 27.03                            | 3.9                             |
| Pakistan    | 30.02      | 26.05                            | 4.36                            |
| India       | 33.9       | 28.79                            | 3.69                            |
| Sri Lanka   | 36.4       | 30.03                            | 3.39                            |
| Maldives    | 37.37      | 28.03                            | 2.71                            |
| Nepal       | 32.82      | 26.52                            | 3.63                            |

Note: Latest possible figures after 2004

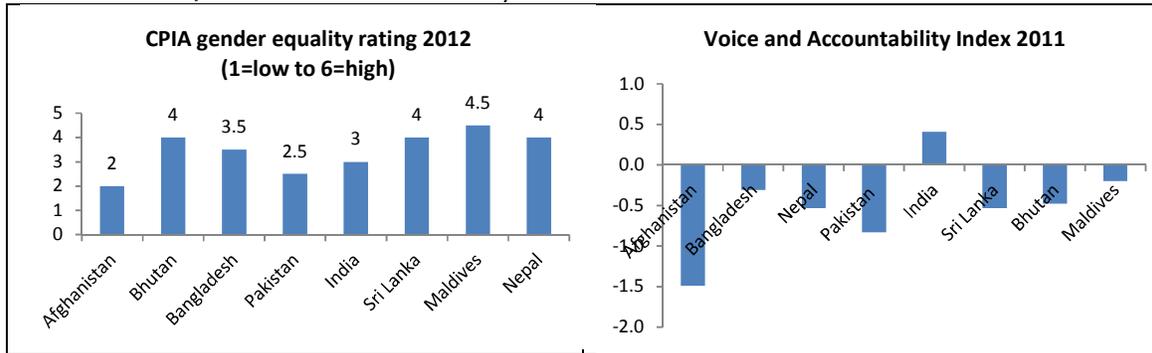
Source: World Development Indicators 2013

Let us now take a broader view of welfare in terms of not just poverty and inequality, but also gender equality, voice and accountability. South Asia has come a long way in refining its understanding about the new and more productive roles of women in the society. However, the data shows that a lot more needs to be done before gender equality can be established in practice. Box 8 indicates that none of the South Asian countries are on the higher gender equality rating according to the World Bank's CPIA methodology. Bhutan, Maldives, Sri Lanka and Nepal have a relatively higher rating than Afghanistan, Bangladesh, India and Pakistan.

The drive to provide women their true place in the society is very closely linked with the

ability to raise voice on critical issues, deepen outreach and having both demand and supply side accountability mechanisms. The voice and accountability index of the World Governance Indicators for 2011 exhibits that voice and accountability mechanisms for the citizens are weak in South Asia. Due to a relatively more vibrant civil society this index is on a positive ranking for India while all other countries are in negative.

Box 8: Gender, Voice and Accountability<sup>6</sup>



Note: Estimates for voice and accountability index range from -2.5 (weak) to 2.5 (strong) performance.

Source: World Governance Indicators 2013

As mentioned in previous section, access to land is quite skewed in South Asia. The land inequality in South Asia remains stubborn and there are a large number of small land holders cultivating small pieces of land. This implies that vast South Asian population for which pattern of land holding determines empowerment through assets and activities remain underempowered. The size of average operational land holding is 0.5 hectares in Bangladesh, 0.8 in Nepal and Sri Lanka, 1.4 in India and 3.0 in Pakistan. In India there are 81 percent farms that have land holding under 2 hectares having a share in total cultivated area of 44 percent (NCEUS 2008, Thapa 2009).

For growth to translate into human welfare, it is necessary that macroeconomic policies are accompanied by complementary and compensatory microeconomic policies with a view to introduce and strengthen social safety nets. This will create resilience among growth's assumed losers who are often left to fend for themselves (Suleri, 2006a).

### Growth, Welfare and New Economic Geography

Although the true potential of regional trade within South Asia has been studied in several past studies. However, we propose here that trade may be an important instrument for addressing intra-country disparity in South Asia. In this section we start by discussing the usual role of exchange (trade) between people and places and introduce two concepts from

<sup>6</sup> Voice and accountability index from World Governance Indicators follows methodology in Kaufmann et. al.

new economic geography i.e. role of cities as engines of growth and integrated supply chains. South Asia is home to several services-led economies (Ghani 2010). Services and their value addition are compounded as agglomeration increases, after all services can only be exchanged when people-to-people interaction multiplies (Kolk 2010). This act of exchange is facilitated by modern cities.

The new economic geography explains how infrastructure-related improvements can promote total factor productivity which can in turn boost domestic economic growth, trade and competitiveness. There are two channels that allow this to happen. The first is that economies of scale emerge as a result of better availability of growth and trade facilitation. Second agglomeration economies also set in spatial clusters. Apart from these two literature also suggests the occurrence of innovation-induced effects.

Linking the above mentioned with South Asia's logistics performance (Table 7, one observes low levels of ranking in terms of competence and quality of logistics services, quality of trade and transport-related infrastructure and efficiency of customs clearance processes. This is indicative of how much South Asia is in fact losing in economic terms due to its own inability to reform sectors, necessary for benefiting from location, transportation and distribution economies of scale.

Table 7: South Asia Logistics Performance Indices 2012 (1=low to 5=high)

|             | Efficiency of customs clearance process | Quality of trade and transport-related infrastructure | Competence and quality of logistics services |
|-------------|---|---|--|
| Afghanistan | 2.33                                    | 2.0   | 2.16   |
| Bhutan      | 2.29                                    | 2.3   | 2.42   |
| Bangladesh  | 2.33                                    | 2.49  | 2.44   |
| India       | 2.77                                    | 2.87  | 3.14   |
| Pakistan    | 2.85                                    | 2.69  | 2.77   |
| Maldives    | 2.24                                    | 2.47  | 2.68   |
| Sri Lanka   | 2.58                                    | 2.5   | 2.8  |
| Nepal       | 2.20                                    | 1.87  | 2.12   |

Source: World Development Indicators 2013

### Modeling regional growth and welfare

In order to demonstrate how geography can help poverty we see in this section the poverty and inequality impacts of growth in South Asia. Williamson (1965) developed the theory of a negative correlation between regional inequality and economic growth. This relation has been summarized in Equation (1) where  $r$  stands for regional inequality and  $Y$  stands for GDP per capita.

$$r = \vartheta(Y), \quad \vartheta_Y < 0 \quad (1)$$

This relation depicts a long-term process, consistent with neoclassical view, that reducing

macroeconomic disparities are associated with higher economic growth. It presumes that regional disparities in developed countries diminish due to many factors such as representative political power, technological spillovers, transport infrastructure (Friedmann, 1969).

However, Berry (1988) claims that change in regional inequalities depends on macroeconomic cycles. It links high economic growth rates with rising inequalities, the so called spatially cumulative growth (Thisse, 2000). Economic processes are associated with increasing spatial inequality as more developed regions have comparative advantage during economic booms. Following Petrakos et al., (2005), the present study constructs a model of regional inequality, economic development and regional integration which is as follows:

$$r_{it} = f(g_{it}, y_{it}, s_{it}), \quad f_g > 0, \quad f_y < 0, \quad f_s > 0 \quad (2)$$

$$i = 1, \dots, N \quad (\text{countries})$$

$$t = 1, \dots, T \quad (\text{time})$$

Where  $r$  indicates the level of inequality in each country over  $t$  time,  $g$  stands for growth rate of national gross domestic product (GDP),  $y$  stands for national GDP per capita, and finally  $s$  stands for trade integration of a country. This model presumes that inequality is pro-cyclical, and a higher national GDP growth rate will increase regional inequality. Especially, during the earlier stages of development, from short-term to medium-term, the development process might promote inequality.

The present model introduces a longer-term development process which is represented by  $y$ , this variable has an inverse causal link with the regional inequality ( $f_y < 0$ ). Finally, it presumes that developed regions will benefit more from greater regional spread and trade in the short-run, but spatial inequalities tend to decrease in the longer-run over the time. Literature argues that less developed countries might be under pressure because of rising regional competition (Padoa-Schioppa, 1987). However, discussion on this topic is limited and need extensive research. The next section provides details of the variables and the data sources used in our estimation.

## Model and Data

The present study analyzes the impact of short-term and longer-term economic growth and regional integration (measured through trade) on poverty and inequality in SAARC countries. To achieve this end, it employs 4 variables:  $r_{it}$  is GDP per capita's coefficient of variation (population-weighted) for each country used as dependent variable (in case of impact on poverty we used,  $p_{it}$ , headcount ratio as dependent);  $g_{it}$ ,  $y_{it}$ , and  $s_{it}$  are independent variables indicating GDP growth rate (which is an indicator of short-term development), GDP per capita (which is an indicator of longer-term development), and

trade integration.<sup>7</sup> It assumes that a higher ratio of intra-SAARC trade represents a higher level of integration between SAACR member countries. This may be represented as follows:

$$s_{it} = (X_{it}^{SAARC} + M_{it}^{SAARC} / X_{it} + M_{it})$$

And also

$$r_{it} = \sqrt{\sum [(x_{ijt} - \bar{x}_{it})^2 * (p_{ijt} / p_{it})]} / \bar{x}_{it}$$

The present study employs three models for empirical analysis of SAARC countries; Seemingly Unrelated Regression Equations (SURE), Fixed-effects and Random-effect models. SURE provides better results than the individual country case study as it simultaneously estimates the parameters of all the countries. The specification details regarding a standard SURE model may be seen in (Kubacek 2013).

The Fixed-effects model presumes that cross country differences among the panel countries might create biasness in estimates (Ai *et al.*, 2013). Hence for unbiased estimates, one should control such differences. However, this method does not take into consideration the time invariant characteristics within the model as they are unique for each country in the cross sectional panel which are not supposed to be correlated. The specification of standard fixed and random-effects model may be seen in Barr *et al.*, (2013).

### Model Results – Impact on Poverty

Our results support the neoclassical hypothesis which maintains the view that economic growth reduces the poverty in SAARC countries (see SURE model in Panel A of Table 9). We use Poverty Headcount Ratio at USD 2 a day, as our dependent variable. Within the region, the short-term development such as growth in real GDP and long-term development such as rising per capita income (in size terms measured in USD) both significantly reduce the poverty.

To be more specific, Nepal experiences the highest reduction in poverty followed by Bangladesh and Sri Lanka whereas India and Pakistan both experienced the least decline in poverty. Further, the short-term real GDP growth rate helps in reducing poverty but its impact is weaker. The reason for this weaker impact is the short-term adjustment mechanism taking place during the process of growth when reallocation of resources occurs. However, this impact is more visible after the completion of this transition period when the markets clear. Finally, regional trade among the SAARC countries also helps in reducing this regional poverty. Our results indicate that India has

<sup>7</sup> Source: World Development Indicators 2013

been the largest beneficiary in terms of poverty reduction from regional trade followed by Pakistan, Sri Lanka, Nepal and Bangladesh.

**Table 9 Impact of Growth and Trade on Poverty**

Dependent Variable: Poverty Headcount Ratio at USD 2 a day

Panel: A Seemingly unrelated regression model

| Variables | Sri Lanka  |          |          |          |         |
|-----------|------------|----------|----------|----------|---------|
|           | Bangladesh | India    | Nepal    | Pakistan | Lanka   |
| gdp_pc    | -0.026***  | -0.01*** | -0.04*** | 0.01     | 0.02*** |
| gdp_gr    | -0.035     | 0.02     | -0.03    | -0.06    | -0.08*  |
| S         | -0.12      | 11.94*** | -0.14*** | -2.81*** | 0.30*** |
| Constant  | 96.74***   | 64.38*** | 104.54** | 97.33*** | 56.00** |
| R-sq      | 0.7317     | 0.9422   | 0.8866   | 0.8565   | 0.8931  |
| chi2      | 76.58      | 563.97   | 259.48   | 181.88   | 256.01  |

| Panel: B    | Fixed-effects model | Random-effects model |
|-------------|---------------------|----------------------|
| gdp_pc      | -0.01***            | -0.03***             |
| gdp_gr      | -0.10*              | -0.01                |
| S           | -0.27***            | -0.07**              |
| Constant    | 86.51***            | 90.80***             |
| F/Wald test | 120.74              | 179.64               |

\*\*\*, \*\* and \* indicate 1%, 5% and 10% level of significance respectively.

The findings of SURE model are consistent with our Fixed-effects and Random-effects models which we have estimated for the panel of SAARC countries (see Panel-B of Table 9). These models, Fixed-effects and Random-effects, exhibit that GDP growth rate and GDP per capita both reduce the poverty in this region significantly. Further, the regional connectivity through trade also has significant impact on poverty reduction in SAARC countries. In contrast to the SURE model which portrays weaker poverty reduction

associated with real GDP growth, the Fixed-effects model indicates that real GDP growth significantly reduces poverty.

### Impacts on Inequality

The present study also examines the impact of short-term to long-term economic growth, and regional trade on the inequality in SAARC countries. Our results indicate that long-term economic development measured by higher GDP per capita has significant impact on regional inequality. It is evident that all the SAARC countries experience reduced income inequalities after the improvement in GDP per capita. Further it is encouraging to see that short-term economic development measured by real GDP growth has also contributed to reduce inequality in SAARC countries especially in Bhutan, Maldives, and Pakistan. It can be suggested that both long and short-term growth factors reinforce each other towards equitable growth (see Panel A of Table 10).

Finally, the regional trade integration has produced mixed results for SAARC countries. For a few countries like Afghanistan, India, Nepal and Pakistan; regional trade integration has positive impact on inequality while for the rest, it has negative impact on inequality. However, given the fact that regional trade within the SAARC countries is not very liberalized, these results are not much discouraging.

**Table 10 Impact of Growth and Trade on Inequality**

Panel: A- Seemingly unrelated regression  
Dependent Variable: Inequality

|          | Afghanistan        | Bangladesh          | Bhutan           | India        | Maldives             | Nepal               | Pakistan            | Sri Lanka   |
|----------|--------------------|---------------------|------------------|--------------|----------------------|---------------------|---------------------|-------------|
| gdp_pc   | -<br>0.0001**<br>* | -<br>0.00004*<br>** | -<br>0.000003*** | -<br>0.0001* | -<br>0.000002*<br>** | -<br>0.00002**<br>* | -<br>0.00004*<br>** | -0.00002*** |
| gdp_gr   | 0.0003**<br>*      | 0.00001             | 0.000006***      | 0.00002      | -1.33E-06            | 0.00000             | -0.00002            | 0.0000      |
| S        | 0.0004**<br>*      | -0.00010            | 0.0000022**<br>* | .021***      | -0.000001*           | 0.00002**<br>*      | 0.0013***           | -0.00007    |
| Constant | 0.120***           | 0.3060**<br>*       | 0.020***         | .84***       | .014***              | 0.12***             | 0.303***            | 0.12***     |
| R-sq     | 0.8689             | 0.9317              | 0.9468           | 0.9963       | 0.9977               | 0.7769              | 0.6794              | 0.9737      |
| chi2     | 441.47             | 660.92              | 718.87           | 11019.5<br>9 | 15989.57             | 197.35              | 175.32              | 1600.86     |

Panel: B –Fixed-effects Model and Random-effects Model

|          | Fixed-effects | Random-effects |
|----------|---------------|----------------|
| gdp_pc   | -0.000009***  | -0.000009***   |
| gdp_gr   | -0.0002**     | -0.0002**      |
| S        | 0.00          | 0.00           |
| Constant | 0.22***       | 0.22**         |
| F/Wald   | 12.10         | 36.50          |

\*\*\*, \*\* and \* indicate 1%, 5% and 10% level of significance respectively.

The Fixed-effects and Random-effects both strongly support that inequality reduces during long-term rising GDP per capita and also by the short-term higher real GDP growth.

On the other hand, the (low levels of) regional trade among the SAARC countries is not impacting the regional inequality. These models are more robust than the SURE model as they use a larger degrees of freedom.

## **What next for South Asia?**

### **Mega Trends**

There are three key development challenges facing South Asia at this point. First how to make macroeconomic developments more relevant at micro levels and eliminate the disconnect between growth and welfare. Second is the laggard achievement towards MDGs and reconfiguring the pro-poor reforms post-2015. Third how to innovatively finance the rising cost of future development priorities. We tried to address some of these challenges in our previous sections, but before summing up our arguments it would be pertinent to discuss political economy context of past and future of South Asia too.

We argued in the introduction section that there are several evolving mega trends in South Asia that could either become a boon or bane depending upon how game changers impact them. Some of these mega trends can be highlighted at this stage.

First we see increased examples of individual empowerment across South Asia. The decreasing number of people below the poverty line, rising middle class, access to information and cellular technology and an independent media in most South Asian countries has contributed towards empowering an ever large number of people. This trend has been strengthened by pro-people legislation such as right to information laws in Bangladesh, India and Pakistan. Such laws have increased transparency across public sector governance. There have been instant impacts of increased empowerment that have resulted in Nepal's anti-monarch movement, Pakistan's independence of judiciary movement led by vast number of lawyers, and India's Anna Hazarey movement against corruption.

Second, demography and urbanization will have a greater interface in determining development outcomes. Today South Asia's dominant youth population has greater choices in terms of mobility for education, jobs and related opportunities. This has translated in an increased internal migration from rural to urban areas as well as rising number of younger people leaving for other parts of the world. The former has implied greater diffusion of knowledge where family relatives in rural and urban areas interact, the latter has been a sources of increased remittances from abroad in turn supporting balance of payments and also technology and ideas transfer from advanced countries (Ahmed et al. 2011).

Third, there are new power centres emerging with in most South Asian countries. In Bangladesh this has taken the form of civil society led social enterprises such as Grameen and BRAC influencing lives of vast numbers of people. In Pakistan military's hold is now fast getting replaced by parliament, superior judiciary, provincial governments and corporate owned media. In India the free market and growth led prosperity has implied a greater role

of large businesses in the development process. There is also an increased power with State governments. Some rebel movements like the one in northeast have challenged centre's monopoly. In Nepal the weakening of Kathmandu-based parties signifies the diffusion of power.

Fourth, there are evolving cultural trends that cannot go unnoticed. An improved per capita income across the region, better literacy rates, access to information and technology have implied an expansion in tastes and preferences of South Asian consumers. While these have implied a rising appetite for consumer imports, some sophistication is also seen in export of South Asian soft products. Today Bollywood movies, yoga, cuisines, Ayurveda, Khadi clothing, hand-stitched sports equipment, vintage leather and information technology are some examples of how South Asia is starting to impact global consumer preferences.

Finally the region is witnessing an agrarian transformation and adverse impacts of climate change. There is increased evidence that peri-urbanization is eroding cultivable land, there are decreasing returns for farmers (due to distortive structure of agricultural subsidies) and a declining share of agriculture in overall GDP. The climate change threat further exacerbates the food insecurity already seen across South Asia.

We should also discuss briefly here the game changers that can impact our mega trends mentioned above positively or negatively. First is the failure of South Asian governments to invest in human capital. The public spending towards education and health (discussed above) remains dismally low. There are increased instances of documented exclusion and marginalization when it comes to distributive justice. Such marginalization in perceptions or reality then transforms into passive and later active (and sometimes armed) movement.

Second there is weak redressal of natural and human made disasters. Kumar and Parikh (2001) show that even after accounting for farm level adaptation, a 2 °C rise in mean temperature and a 7 % increase in mean precipitation will reduce net revenues by 8.4% in India. For Pakistan, wheat yields are predicted to decline by 6-9 % in sub-humid, semi-arid, and arid areas with 1°C increase in temperature (Sultana and Ali 2006). For Sri Lanka, Wijeratne (1996) shows that an increase in the frequency of droughts and extreme rainfall events could result in a decline in tea yield, which would be the greatest in regions below 600 meters. Karim, Hussain and Ahmad (1996) project a net negative effect on the yields of rice, the staple food of the population in Bangladesh.

The 6F challenges (food, fuel, fiscal, frontiers, functional democracy, and fragility of climate challenges) if responded by inappropriate policies and practices lead to wrong prioritization of resources by state and the result is individual insecurities. Individual insecurities, when get any collective identity –be it ethnic, national, sectarian, creed or provincial– lead to class conflict and erode the whole societal fabric (Suleri 2010), thus turning the mega trends negative.

Third, Attempts to realize openness and transparency in isolation from democracy, or rather at the expense of democracy, may let the dark forces of dictatorship emerge all over the region. Even in India some analysts like former editor of the Times of India, Mr. Padgaonkar (2013) in his blogs has talked about the rise of middle class fascism on the twin

issues of corruption and transparency which may succeed in toppling the Indian democracy which so far has proved only guarantee for the country's continued survival. The January 2013 long march of Islamic cleric Tahir-ul-Qadri in Pakistan for transparency in electoral system especially accountability of candidates before the Pakistan's general elections had created serious doubts that elections might get postponed (AFP 2013). The thirst for openness and transparency is a major game changer which may change the direction of mega trends.

Fourth, the positive impacts of the absence of violent conflicts on mega trends are as obvious as are the negative effects of their presence and need no explanation. Countries like Afghanistan and Pakistan which face continuous threats from external and internal militants is also a big issue for the region. The above mentioned mega trends if influenced positively by the game changers would determine to a large extent on how to reduce the intra country disparities in South Asia. The future of equitable development in South Asian countries depends on how appropriately they capitalise upon some of the mega trends and how they can manoeuvre the game changers in their favour.

#### **MDGs: Issues for the Future**

A lot has been written about the various MDGs and how the achievement across the development world remains mixed. For us the fundamental question is the inherent contradiction in MDG framework, for instance, MDG1 i.e., poverty reduction and MDG7 i.e., environmental conservation may contradict each other if a holistic approach is not applied to work on MDGs (Ahmed and Suleri, forthcoming). The lack of local ownership of MDG agenda is also visible in most of the development plans and initiatives in South Asia (Ahmed and Suleri, forthcoming). In cases where top leadership lacked interest in overall coordination, one also observes lack of supply-side accountability.

The deadline to achieve MDGs is fast approaching and having realised that most of the developing countries have already missed the train, now the focus of discussion is development beyond MDGs. However, any new initiative towards this direction is again bound to fail if an attempt is not made to rectify some of the mistakes that the region collectively and the countries at individual level have been making so far (Ahmed 2013).

As mentioned in the previous section, some of the game changers did not work well to capitalize on emerging trends across South Asian countries and it negatively affected their pursuit to attain MDGs. Due to a disconnect between economic growth and citizen welfare, the spending on formation of human capital remained low; natural calamities, very often got turned into human disasters due to flawed policy responses (either due to weak public institutions, poor capacity among implementers, or budgetary constraints); the trust deficit between donor/lender states and South Asian recipient states and between the state and citizens due to the reports of lack of transparency and openness in various development initiatives, affected the capacity of South Asian governments to deliver on MDGs; and finally violent conflicts and militancy partly triggered due to the perception of individual insecurities and started as struggle between "have" and "have not" (Suleri, 2013) have

made achievement of MDGs an uphill task for South Asian countries. It goes without saying that until existing game changers in South Asia are not made people centric, the chances of succeeding in any post MDG agenda would remain slim.

The future potential and challenges facing MDGs or post MDG agenda in South Asia include the election cycles in at least 3 economies including India and Pakistan<sup>8</sup> which may imply policy shifts. There is also increased frequency of climate change led and human made disasters. Even in 2013 Bangladesh, India and Pakistan have seen large scale flooding and the subsequent loss of human life and assets. The volatility in global commodity prices and South Asia's increased integration with the global economy has implied a higher vulnerability of agriculture and manufacturing sectors. Most of these economies have an oil-based energy mix and oil import has occupied a heavy share in the balance of payments. Any increase in oil prices (and related raw material) has implied a slowdown in domestic production activity. Finally we observe the increased instances of militancy across South Asia. As a result most countries in the region had to divert scarce budgetary resources towards maintenance of internal and external security.

Across the region there also remains a need to evaluate the past programs and projects aimed towards achieving MDGs. The current evaluations have not been termed comprehensive across literature (Nayyar 2012). Once recent studies are in place, lessons learnt can then feed in to future strategies. Furthermore there are examples of large scale social safety nets that have helped in reducing incidence of poverty in South Asia, however the impact of such programs on MDGs is still awaiting research. The examples of such social safety programs include: Benazir Income Support Program in Pakistan and Indian National Rural Employment Guarantee.

Going forward the governments in South Asian region will also have to account for the spoilers in the MDGs progress. In the short term we should be mindful of food security and malnutrition issues facing this region. Strictly in economic terms these will result in a less than desired quality of future labour force. In the medium term and as the youth bulge in South Asian enters the working age group there is a need for national strategies for youth engagement. In several countries of this region the youth still remains distant from the development objectives at the local and national levels. Finally in the longer term, climate change and its resultant hazards need to be understood in location-specific and regional contexts. There is weak coordination among SAARC countries towards actionable adaptation measures across the region.

### Understanding New Triggers for Change

We would like to argue in favour of 3 possible triggers that can enhance the effectiveness of development spending in the region and optimize results in the context of MDGs. First, the need to realize the importance of local knowledge and build social capital around this knowledge base (Malecki 1998). This can readily help in bridging the trust deficit between

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<sup>8</sup> In Pakistan the new government has assumed office in June 2013.

public sector and local communities and thereby making the latter a partner in effective development. Second trigger could be the spread of social accountability tools which can strengthen local level demand-side accountability, enabling the communities to demand better service delivery in social sectors (WB 2013). The last trigger worthy of further research is social innovations. Experience across the developing world tells us that pro-poor and informal innovations have greater diffusion at local levels, in turn increasing productivity of poorest of the poor (Westley and Antadze 2010).

### Positioning South Asia in a New Development Agenda

Joseph Stiglitz (2013), in his recent work, “the price of inequality: how today’s divided society endangers our future”, writes and we quote,

*“The political and economic reform agenda (...) assumes that while market forces play some role in the creation of our current level of inequality, market forces are ultimately shaped by politics. We can reshape these market forces in ways that promote more equality. We can make markets work, or at least work better. The Great Recession did not create the country’s inequality, but it made it much worse (...), and it further limited a large segment of the population’s access to opportunity. With the right policies, (...) we can make things better. It is not a matter of eliminating inequality or creating full equality of opportunity. It’s just a matter of reducing the level of inequality and increasing the extent of equality of opportunity.”*

Stiglitz’s work is based around increased inequalities and lack of opportunities in the United States, but his remarks can be very well applied to the developing world and South Asian countries. We basically need to work on political processes across South Asia if a dent in poverty and inequality has to be created. We also understand from the past and current literature that post-2015 development agenda will require developing countries to build effective partnerships with developed world (towards technology, knowledge networks, technical assistance etc.) at the same time strengthening South-South linkages in trade and investment (Kelegama 2013). However in order to benefit from both these opportunities, countries in South Asia will have to step up their efforts towards domestic resource mobilization and that necessitates reduction in intra country disparity. Already one sees that in several South Asian economies share of foreign aid in the GDP is on the decline. This further increases the importance of tapping in domestic resources including tax revenues.

If one looks at the key challenges facing the taxation regimes in South Asia we see that direct taxation mechanisms are inelastic with a narrow tax base, and substantially high administrative costs. Therefore in most cases these taxes are easy to evade (Bird *et al.*, 2005; Avi-Yonah *et al.*, 2006). The indirect taxes again have a narrow base along with complex rate structure and a high compliance costs (Ahmed *et al.* 2011). To make matters worse the political representatives instead of taking bolder measures towards tax reforms have increasingly started to rely on non-tax revenues which are politically less damaging. Non-tax revenues have also been found to have a negative long run relationship with tax to GDP ratio.

Can there be a regional and collective effort towards reducing various forms of intra-

country welfare disparities. In this regard the South Asian economies need to be more visionary regarding the expansion of SAARC Development Fund (SDF) with a view to overcome some of the bottle necks for equitable access to resources of production. SDF has three main Windows including Social, Economic and Infrastructure. The Social Window has started operation and projects are being implemented in SAARC countries. There is now a need to open economic and infrastructure windows for scaling up SDF for accelerating growth and Infrastructure development in South Asia.

SDF also needs to coordinate its fund receipts, allocation and disbursement efforts with national planning and development departments. Currently the national representatives in SDF only belong to the Finance Departments of Central Government. This can allow for greater room towards innovation for development finance. Sobhan (2013) has argued that in several developing countries domestic savings, foreign direct investment and remittances from abroad have exceeded official development assistance. Therefore the innovation and additionality in development finance should be configured to focus towards more effectively using growing external surpluses in particularly remittances from abroad.

A regional solution to this region's poverty can be more sustainable if a shared vision for accessing SDF is established across South Asia. Ghani, et al. (2013) suggest that in order to reduce growth disparities in South Asian region, fiscal transfers should be made to the lagging regions because these regions spend less on social service and have low tax-to-GDP ratio. Furthermore, acceleration of the privatization of Public sector enterprises (PSEs) and then diverting the revenue from the sales to the development of the lagging regions may help. Resources can be diverted from the subsidy-oriented programs to provision of education, health, infrastructure etc. in low income regions.

Palanivel and Unal (2010) also advocate similar pro-poor policies for addressing the rising inequality in South Asia. As poor consume more public goods than the rich, social spending would break the poverty trap by providing job opportunities, education and health services. Social spending not only reduces the incidence of poverty but also provides social and physical infrastructure for growth (Narayan, 2008). In South Asian region, a substantial amount of working population is also poor, thus Felipe and Hassan(2006) also recommend to provide quality jobs to address the issue of 'working poor' in the country. Kabir (2013) also support the idea of 'protecting workers' rather than 'protecting jobs' with a special focus on the youth for creating a long term impact on growth. In order to ensure that the social spending is protected across South Asia, SDF may be empowered to play the role of a whistle-blower. In such a role it will be able to strengthen its oversight over national economic policies and advice accordingly. Given its leverage through various funding windows SDF can link the future releases with present reforms and their success.

Prabir (2009) observes that the land-locked states (Nepal, Bangladesh, India's northern-eastern states) have a higher concentration of poor as compared to the coastal states in South Asia. Trade restrictions arising out of high transportation cost, border delays etc. impede the trade-led industrialization and widen the income gap. Kelegama and Abayasekara (2012) view regional economic integration as a step towards balanced regional development. They argue that by becoming a part of the connected regional markets, lagging regions may be able to overcome macroeconomic imbalances and thus

suggest removing barriers to trade, allowing free labor movement, developing crisis-sustaining financial markets and most importantly coordinating fiscal policies. Moreover, Agarwala (2013) also view the connectivity of the cities as a tool for shared growth among the regional economies. Expanding the industrial base to lagging cities and overcoming commuting hindrances may help countries to sustain its GDP growth.

We understand that in order to make the regional solution towards reduction in poverty and inequality a success, overall responsibility lies with the national governments for fulfilling their responsibility towards the regional integration agenda, and also the SAARC Secretariat to provide a visionary leadership and reforms coordination role. The civil society organizations (CSOs) and think tanks continue to provide analytical support and they will also have to innovate their role depending upon the fast changing political economy of South Asian region. There are new tools at hand to create demand for national and regional solution to welfare disparities. CSOs need to form partnerships and take advantage of a deregulated media in most parts of South Asia. The large presence of youth on the social media is another trigger for bridging the information gap. It is this bottom-up approach to outreach that if augmented with the already underway top-down efforts (for creating change at the government and SAARC levels) can bring sustainable improvement in the lives of future generations.

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