

How Will Globalization Impact South Asia's Economic Recovery?

July 27, 2009 - Many economists are beginning to see signs of an end to the global economic crisis; talk has turned now to how long the recovery will take. But there is another concern about how this crisis may have reshaped the global economy and how it may have changed globalization in ways that will hinder recovery in many countries. **World Bank Economic Advisor for the South Asia Region, Ejaz Ghani** addresses some of the emerging questions about what the global economy might look like for this region.

According to **Ghani**, globalization has accelerated growth in South Asia and contributed to poverty reduction over the last three decades. But the current global crisis may potentially change globalization itself, as developed countries adjust to global imbalances that contributed to the crisis. *"The three aspects of globalization - capital flows, trade flows, and economic management - may not be the same in the future,"* said **Ghani**. *"Some Finance Ministers are concerned whether changes in globalization will help or hinder the pace of economic recovery."*

So, how will these changes in globalization impact South Asia's recovery?

Ghani said South Asia's recovery will be determined by a number of factors, including the three aspects of globalization: Capital flows, trade flows, and economic management

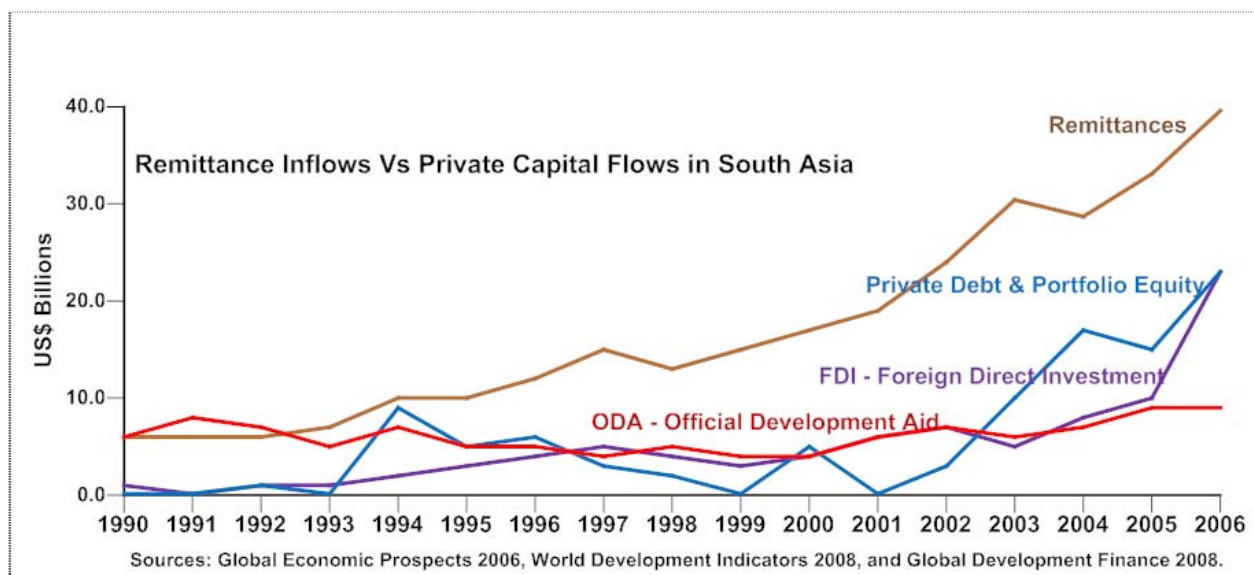
Capital Flows

Foreign capital inflows—remittances, international syndicated bank lending, private capital investments, and bond issues—to South Asia had surged in recent years, but collapsed in the aftermath of the crisis. *"With the ongoing global financial restructuring, it will take time for private foreign capital flows to recover,"* said **Ghani**. *"Even then the capital flows will be less accessible in a new risk-averse environment, and the cost of capital will be higher. This will slow the economic recovery."*

Ghani believes, however, that South Asia, even with lower capital flows, will suffer less compared to other regions because of its particular features.

First, South Asia's investments are largely driven by domestic savings. A high level of domestic saving enables a country to cope better with reduced capital inflows. Most South Asian countries have a large and significant positive savings rate compared to other developing countries.

Second, South Asia is unique in attracting capital flows that are less volatile. The region relies more on remittances inflows than for example portfolio flows and bank loans. *"Remittance inflows in South Asia are more stable and persistent compared to portfolio flows,"* said **Ghani**. There are both benefits and risks associated with global financial integration. Benefits include access to capital, technology transfer, knowledge, and risk sharing. The risks are that countries will be exposed to the problems and volatilities of developed economies. *"Given the high domestic savings and less dependence on volatile capital inflows, South Asia is likely to bounce back faster,"* added **Ghani**.

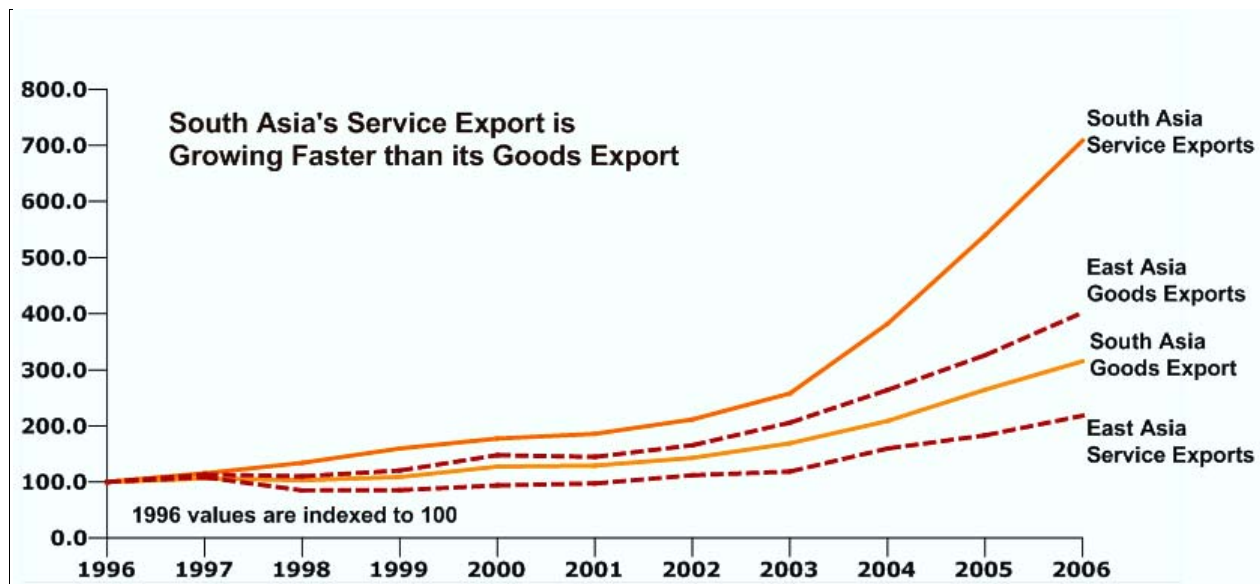


Trade

South Asia's foreign trade has grown considerably over the last decade, which has contributed to rapid growth. Many countries in crisis have accelerated their recovery with the help of expanding exports. The recovery of East Asian countries following the crisis in the 1990s was achieved by exporting to developed countries. *"Given that the current crisis is synchronized and global in nature, there is less room for an export led recovery,"* said **Ghani**.

Global discussion is now focused on how reduced trade will limit the pace of recovery in developing countries. Other roles performed by trade in promoting growth in developing countries have been overlooked. These include knowledge spillover and externalities generated by trade that are vital to growth. The current global crisis has not reduced the stock of knowledge available in developed countries, which developing countries can use to benefit.

He said unlike East Asia, South Asia's economy is largely service driven. Service exports are less volatile compared to goods exports. Globalization of services is still at an early stage. South Asia's service export has experienced faster growth compared to its goods exports. It is even faster than East Asia's goods growth rate. A service-led export growth strategy will likely enable South Asia to recover quicker and sustain high growth over the medium term. But not all countries will benefit as there is tremendous diversity within South Asia. Countries need to focus on their competitive advantages, he said.



Fiscal Stimulus

The speed of recovery will also be determined by the scope and implementation of fiscal policies. “*South Asia is vulnerable in this area,*” said **Ghani**. “*South Asia, unlike East Asia, suffers from high ratios of public debt to GDP. This limits the scope for a large scale fiscal stimulus.*”

South Asia is the largest net importer of commodities (food, metal, and oil) in relation to GDP. The sharp decline in commodity prices, especially oil could reduce large commodity-related subsidies. Such savings could be used to finance discretionary fiscal stimulus. “*South Asia spends too little on education, health, roads, power, and water compared to the rest of the world,*” said **Ghani**. “*Increased and better expenditure with a greater focus on improved outcomes in social and physical infrastructure, and safety nets will speed up the recovery consistent with long-term growth.*”

Will the changes in globalization accelerate or restrain recovery?

Recovery will depend on the composition of capital flows, trade, and economic management. “*New trends in globalization will create new challenges but will also provide new opportunities,*” said **Ghani**. “*Increased trade from globalization of services and increasing South-South trade will provide new opportunities for South Asia.*”

There are substantial opportunities for developing countries to catch-up with developed countries, he said. South Asia will continue to benefit from its demographic dividend and productivity growth will remain on an upward trajectory. As South Asia undergoes structural transformation from agriculture to manufacturing and service sectors, the region will be well positioned to bounce back with global economic recovery.