South Asia in the New World Order

The role of regional cooperation

Shahid Javed Burki

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South Asia in the New World Order

Rapid changes have taken place in the structure of the global economy, and this book looks at how South Asia can take advantage of these changes. The author argues that the developing global economy will be more complex than originally thought, that instead of a bipolar model with two countries, the United States and China, at the centre, it will be multipolar with eight centres of economic activity, including India.

The book goes on to suggest that in the context of such a model, there should be regional cooperation between India and its immediate neighbouring countries for South Asia to advance as an economic region. It argues that South Asia will need to look at its history, and that changes in attitudes, particularly in India and Pakistan, are necessary. The possible benefits to the region, in terms of increases in the rates of economic growth if the regional approach is adopted, are discussed. The book presents a useful contribution to studies in South Asia, as well as Asian Economics.

Shahid Javed Burki is a professional economist. He was previously Finance Minister of Pakistan and Vice President of the World Bank.

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The book is dedicated to my grand children,
Shaafi, Leila and Nafees

"Only the young can live in the future,
and only the old can live in the past"
Will Durant, *The Story of Philosophy*

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January, 2011
Shahid Javed Burki
Potomac, Md., USA.

1 Prologue

I will begin this work – a book spread over eight chapters, including the Prologue – with a short biographical note. It is appropriate to say a few words about my academic background and work experience before launching a study that draws upon several disciplines. This will explain why in this work I have focused so much attention on the importance of history for understanding why people and nations behave in certain ways. Beliefs take a long time to form but once they are learned and get embedded in cultures and social norms it takes equally long to shake them. By beliefs I don't mean religious affiliations. My concern is with all beliefs, economic, political and social. Under the British, mainland South Asia acquired a certain amount of homogeneity. Although it retained many religions, languages and cultures it was given one political system and essentially one economy. This is why certain modern historians – Niall Ferguson among them[1] – credit the almost two century-long stay in this part of the world by the British with a number of achievements. One of them is "nation building". However, the nation the British built succumbed to fissiparous tendencies, the strongest of which was Muslim nationalism as promoted by Mohammad Ali Jinnah, Pakistan's founding father. Jinnah was able to successfully argue for his "two nations theory" – the notion that India was inhabited by not one but two nations, one Hindu and the other Muslim – on the basis of which he achieved the partition of British India into two states. India and Pakistan were thus born in August 1947. A quarter century later Pakistan split into two parts, the present day Pakistan and Bangladesh. The break-up of Pakistan showed that ethnicity could melt the glue of religion as the basis of nationhood.

Today South Asia is a highly fractured society in part because of the way the area's troubled history has hardened some of the attitudes the various peoples of the area have developed towards one another. It is my contention in this work that unless the peoples of South Asia begin to look at each other differently, they will not attain for themselves a position that could be theirs in a rapidly changing global economy and the political structure that supports it. To understand today's South Asia, therefore, requires some acquaintance, however passing, with a number of disciplines including anthropology, economics, history, political science and sociology.

This is why a brief reference to how I was trained and the influences under which I have operated during my professional life are relevant. I have been persuaded to use several disciplines to view the positions of nations at certain periods in their histories and how they have evolved over time. During my academic life, which took me deep into many disciplines, I learnt to view the world not from the perspective of one discipline but from that of several that overlapped at the margin – from the perspective of economics, history, economic history and political science. During my formative years I was deeply influenced by three teachers – Sir Roy Harrod, Alexander Gerschenkron and Samuel P. Huntington.

I started my academic life in physics and mathematics, but switched to economics when I went to the University of Oxford as a Rhodes Scholar. By then I had already joined the Civil Service of Pakistan (CSP), a powerful component of Pakistan's governing structure in the first quarter century of the country's existence as an independent state.[2] Given that my future was now in government service and in the part of the government that had begun to deal with the development of a backward economy, I was advised by Sir Roy Harrod to switch to economics. Sir Roy, who was once a close associate of John Maynard Keynes and was also his biographer[3], was an influential economist at Oxford. His advice mattered. He had made a contribution to growth economics by developing what came to be known as the Harrod-Domar model. This model in turn popularized the notion of the Incremental Capital Ratio (ICOR) – the proportion of gross domestic product (GDP) that needed to be invested in order to produce a one-per cent increase in national output. In other words economic growth was the result not only of capital accumulation but also of the efficiency with which it was used. After graduating from Oxford in 1963 I went back to Pakistan and to the CSP and spent almost four years working as a sub-divisional administrator, as the administrator of a large American-funded rural development program, and as the administrator of foreign-assisted aid programs in West Pakistan. In these varied jobs I recognized how wise Sir Roy had been in advising me to leave physics for economics.

In 1967 I left Pakistan for Harvard University for advanced studies in economics. At Harvard, while studying economic history – a requirement for a Ph.D. in economics, I became a close associate of Alexander Gerschenkron, the dean of economic historians in the United States. Gerschenkron was pleased with the way I was applying his thesis on economic backwardness[4] to the development of Pakistan, in particular to the development of the Punjab. He invited me, along with six other students, to attend the Economics History workshop, where I wrote two long papers tracing the interest the British administration had shown in developing the Punjab and upper Sindh as the granaries for the food deficit provinces in the north-eastern parts of their Indian empire.

From Harvard I went to the World Bank in 1974, entering the institution as a senior economist in a department headed by Mahbubul Haq, the Pakistani economist who had become a close adviser of Robert McNamara, the institution's president. Haq had convinced McNamara that economic growth alone would not help the poor in the developing world. The state would need to intervene directly to aid the economically and socially disadvantaged. The World Bank should be prepared to help those countries that were prepared to develop programs and projects that aided the poor. I worked with Robert McNamara as the Secretary of the Policy Review Committee that he chaired. The committee was responsible for reviewing, approving and enforcing the policies the institution pursued in different parts of the world. Much of the policy work at that time was concerned with reaching the poor.[5]

After spending several years in the economic policy wing of the Bank, I was assigned to lead the World Bank's operations in China (later also in Mongolia) from 1987 and 1994. It was during this period that China laid the basis for achieving spectacular growth in its economy in the 1990s and beyond. The World Bank was closely associated with this process, bringing the knowledge of modern economic processes and practices to the senior leadership that only knew Soviet Union-style central planning. It was also in that period that China dealt with what it still calls the Tiananmen Square incident but the West refers to as the Tiananmen Square massacre – an operation by the Chinese army to clear the famous public square of tens of thousands of students and workers who had held the senior leadership virtual hostages in their Zhongnanhai compound. Hundreds of people were killed, which led to the imposition of sanctions by the G7, the group of the world's richest states. The sanctions included constraints on the flow of finance to the country. The World Bank was supposed to follow, but I demurred on the grounds that as a development institution it must not be motivated by political considerations. The Tiananmen Square incident lent support to the view advanced by Samuel Huntington that rapid economic development not supported by political institution building can lead to chaos.[6]

From my position in China, I went on to lead the World Bank's program in all of Latin America. I was the World Bank's Vice President in charge of Latin America and the Caribbean from 1994 to 1999, a period during which a number of countries in the region faced economic crises. Some of these were the consequence of the policies adopted by them. This was the time when a group of economists working in various institutions located in Washington had advanced a view that supported economic openness and a limited role for the state in economic management as the best way of promoting the development of what were now being called "emerging economies". This would lead to their faster integration into the global economic system. This point of view came to be known as "The Washington Consensus"[7]. Some of the advocated policies contributed to a series of economic and financial crises in several Latin American countries, which I had to manage for the World Bank. In an important book Joseph Stiglitz, who worked at the Bank as the institution's Chief Economist while I was in charge of Latin America, laid the blame on the Consensus for many of the problems that the Latin Americans had to deal with in the 1990s at a heavy cost to their economies.[8]

This brief biographical sketch, I think, will help readers to understand the approach I have taken in this work. This work brings together several strands of thinking in dealing with the current situation in South Asia – in particular the mainland of South Asia – which has yet to develop a regional identity as against strong national interests. I argue that that approach will hurt the region since it will miss the opportunity to carve out a place for itself within the rapidly changing global economic trading system. Why it has been difficult for the South Asian countries to act that way is largely down to their difficult collective history. There are lessons to be learnt from other regions. Will the South Asians be able to bring about change on their own or will they need some catalyst from outside the region?

I set out eight themes in Chapter Two and weave them together to provide the analytical underpinning of this work. I suggest that to understand what and where South Asia is today, we must first look at its formative phase, a period of about a decade, when the British Raj in India ended and was being replaced by two self-governing new states, India and Pakistan. This settling-in period led to long-standing rivalry between the two states. While the rest of Asia was becoming a part of the "rise of the rest", South Asia remained absorbed in its own quarrels. I then discuss three developments that are reshaping the global economy – profound demographic changes, globalization and a redefined role of the state. I begin to develop one of the main messages of the book – the role India could play in shaping South Asia's economic future. However, if for political reasons India could (or would not) perform this role, the region may seek the involvement of another state as a catalyst. I conclude the chapter on a more hopeful note by suggesting that a number of recent – mostly positive – developments may have set the stage for South Asia to occupy the space it deserves in the new global economic order.

Chapter Three looks at the way the global economy is being reshaped, mostly because of the severe recession that began in the United States in

August 2008 and lasted for more than a year. While this was the longest-lasting economic downturn in recent history, it is not the only reason why the global economy has gone through a massive structural change over the last couple of decades. The change started with the beginning of the process generally referred to as "globalization". The deep recession in 2008–09 raised a number of questions about the viability of capitalism as the way of managing national and global economies. I will suggest in this chapter that what the world really needs are not changes in the basic foundations of capitalism, but in their interpretation. This was the case, in particular, in defining the role of the modern state: in what way should the state work to oversee the national economy and in what ways should the states across the world come together to oversee the rapidly changing global economy?

After emerging as the world's largest economy in the 20th century and its leader in the second half of the century, the United States has begun to lose ground to some of the emerging economies. Most of these are in Asia. This process will continue for a number of structural reasons including some extraordinary demographic changes, a subject to which I keep returning in the book. The role of demographic change in economic progress has been largely ignored in economic writings. Partly as a result of demographic developments, we are now witnessing the emergence of a multi-polar world. Will India, with the world's second largest population, be one of the poles in this world or will it need to work with the countries of South Asia to play this role? What will the "post-America" world look like? These questions are also raised in Chapter Three and I will attempt to provide some answers to them.

One reason South Asia has not been able to evolve as a region is that history weighs heavily on the countries in the area. There has been a great deal of intra-regional strife. However, history also has played a role in developing a South Asian narrative that encompasses a number of areas of human endeavour, including culture, sports, politics and economics. How can the positive aspects of South Asian historical experience be used to mould a better future for the countries in the region? How can the negative aspects – especially inter-state conflicts that have been such a prominent feature of the recent history of South Asia – be overcome? What role can formal institutional arrangements for regional integration play in this context? I will attempt some answers to these questions in Chapter Four.

Could South Asia perhaps be in the process of turning the corner? This is the subject of Chapter Five. Some recent developments in the region – three elections in Bangladesh, Pakistan and India, respectively, all held within the space of 16 months, and the decision by the policymakers in Sri Lanka and Pakistan to deal with insurgencies (in the case of Sri Lanka based on ethnicity, in the case of Pakistan based on religious fundamentalism) – may have created an environment in which the countries can create a better future for themselves. While it is not easy to impose one particular narrative on the way 1.5 billion people have expressed themselves by taking the journey to the polling stations in three countries, the elections were good indications of the main priorities of the people in the region. It is clear that the people are interested in seeing the governments work towards improving their welfare rather than spending the resources of the state on imposing certain religious beliefs. That said, there are powerful minorities that believe otherwise. In Pakistan, in particular, Islamist extremism has gained strength to the point that it has begun to challenge the state. I will briefly trace the history of extremism in the country and spend some space on analysing how the rise of *jihadism* has interfered with the country's economic, political and social development. What happens to the war between the Pakistani state and the extremists will have consequences not only for Pakistan, but for all of South Asia. It could also deeply impact what the political scientist Samuel Huntington called the "clash of civilizations".[9]

One of the assumptions about the shape of the global economy was that individual countries would be able to work with one another without too many constraints on various kinds of contacts among them. That was the meaning of "globalization". That did not happen. Over the last two-to-three decades a multi-layered world has emerged in which regional associations have begun to lend mass to the smaller economies so that they can deal more effectively with those that have a greater weight in the global economic system. This is the subject of Chapter Six. South Asia is one of the few regions in the world where regionalism has not worked. It has at best made a weak attempt at regional integration. The reason why the South Asians have made little advance in this area is their failure to submerge national in favour of regional interests. Some institutions exist, including the South Asia Free Trade Area (SAFTA) which was formally launched on 1 July 2006, six months late because of the failure of Pakistan to ratify in time the treaty aimed at establishing this trading community. For SAFTA to succeed, both India and Pakistan will need to take an active interest in advancing the concept of free trade in the region. It is interesting – and disappointing – that the trade policy for 2009–12 issued by Islamabad in July 2009 makes no reference to SAFTA.

South Asia has two options: it could pursue narrow national interests or it could work as a region with the countries in the area prepared to step forward and devise ways of working as a cohesive and well-integrated region. In Chapter Seven I will suggest why South Asia could do so much better by adopting a regional approach, and become a part of the multi-layered world that is coming into being. Every world region has its peculiarities. Among the different parts of the emerging world there are some similarities among the various regions, but many differences. These need to be kept in view by the states in the region as they design their future. South Asia is much more densely populated than all other parts of the emerging world; population can be an asset or a burden depending upon public policy choices. This is another place in the book where I will explicitly include demography in my analysis. South Asia's colonial experience has left the countries with a good working knowledge of English, which is the language of the "flat world" that has emerged because of globalization.[10] Its location on the fringes of the world that has large hydro-carbon resources has created opportunities for an increasingly energy-short world. Global warming has created problems for the region, the scope of which differs from other parts of the world. What should be the locus of decision-making given these positive and negative endowments? Should the countries act together or separately?

The final chapter of the book – Chapter Eight – will present an assessment on the possible impact on the rates of growth of South Asia if it were to act as a region rather than a collection of countries that happen to occupy the same geographic space. Given the situation of South Asia today, what does the future look like? Economists like to develop scenarios to supply answers to questions such as these. What could we posit for South Asia, say, in the next 10 to 15 years? I will construct a series of scenarios for this purpose. In these I will begin with the assumption that inter-state conflict will continue to define the South Asian landscape. If that turns out to be the case what will the region look like? On the other hand, if the South Asians can get to work together, what kind of future could they produce for themselves by, say, the year 2025? That is the third scenario. In between these two is the scenario according to which the countries in the region begin to take advantage of the rapidly changing economic position of East Asia, including China, in the global economy but are still not able to work together. This way individual South Asian countries become the partners of "emerging Asia".

The main point of this exercise is to demonstrate why regional cooperation could define a new role for South Asia in the emerging global order. To take advantage of the opportunities that are being created is, therefore, a major challenge for the leaders of South Asia. If they can overcome their prejudices and cast off the heavy burdens that history has left on their shoulders they will be able to ensure a better life for their billion-and-a-half people. If they fail they will only prolong the misery in which more than one-half of this large population lives.

2 Challenges and opportunities

Introduction

While India is rising – its gross domestic product (GDP) increased at close to 9 per cent a year before the world went into the Great Recession of 2008–09, slowed down a bit because of the global recession, and has picked up again with Finance Minister Pranab Mukherjee promising in his 2010–11 budget speech a 10 per cent increase each year in GDP to be achieved in a couple of years – it will find it difficult to achieve the economic superpower status to which it aspires. This is at least for two reasons. First, it has not found a way to have the prosperity achieved by one-quarter of the population reach the remaining three-quarters. As Joseph Stiglitz writes in his most recent book on globalization, India is indeed shining "on the lives of some 250 million people [but] for the other 800 million people of India, the economy has not shone brightly at all".[1]

The other reason why India has been held back from achieving its ambition is that it is an island of relative stability in a highly restive part of the world. There is an on-going conflict in Pakistan involving the rise of Islamist extremists who are challenging the writ of the state. Thousands of people have perished in the conflict to which there is no end in sight. This conflict has been seen by some – including the United States Secretary of State Hillary Clinton – as posing an existential threat for the country. The militants and terrorists operating from within Pakistan are not only endangering the survival of the Pakistani state; they have also extended their operations beyond the country's borders. In November 2007 10 members of the group *Lashkar-e-Taiba* held Mumbai hostage for three days and killed almost 200 people. In May 2010 an American citizen of Pakistani descent attempted to set off a car bomb in New York City's Times Square.

The future of Afghanistan, not strictly an Indian neighbour, remains highly uncertain in view, particularly if the United States' declared intention to withdraw its troops from that country beginning in July 2011 comes to pass. Nepal, to India's immediate north, remains unsettled and in great turmoil. The powerful Maoist movement that earlier showed some willingness to work with the established groups to stabilize the country called a strike in April 2010 that paralyzed Kathmandu, the country's capital. Although the strike was called off, uncertainty remains. As Manjushree Thape, a Nepalese, wrote in an article published in May 2010, "we Nepalese are still baffled about how to be part of the modern world […] For this we are still, seemingly forever, waiting".[2] Bangladesh, to the east, is still struggling to stand on its own feet although it has made some progress since the return of democratic rule in January 2008. It now has the second highest rate of GDP growth on the South Asian mainland after India. Then there is Sri Lanka, to the south, not strictly a part of the South Asian mainland, but the narrow body of water that separates it from India is not wide enough to prevent it from casting a shadow on its neighbour. Although the military was able to put down the long-enduring Tamil insurgency in early 2010, discontent among the members of this large minority remains. That the Tamils are a large community in India's south complicates matters. What complicates them further is the country's drift towards authoritarian rule. It is only the little kingdom of Bhutan, where the monarch has willingly surrendered most of his royal powers, that is the most stable country on India's borders.

Even India has had to deal with armed rebels in its midst whose ranks are being swollen by the discontent occasioned by growing inequality. Known as Naxalite-Maoists, the challenge they pose to the Indian state was first thrown in the eastern village of Naxalbari. The areas in which insurgents draw their support from Dalits (formerly known as "untouchables") and Adivasis are sometimes referred to as the Red Corridor. In 2006 Prime Minister Manmohan Singh called the group's activities "the single biggest challenge ever faced by our country".[3] Two years later the prime minister said the country was "losing the battle against Maoist rebels".[4]

India has enough military strength to first contain and then overcome the challenges it faces at home. Its leadership recognizes that the high rate of economic growth that it has demonstrated the ability to achieve will not trickle down fast enough to handle growing discontent inside its borders and among its people. The government is committed to helping the lagging rural sector; worried enough about creating new jobs for new entrants to the work force, it has created an employment guarantee scheme for rural areas. It is the external challenges emanating from its immediate neighbourhood that need to receive the attention of the policymakers in New Delhi.

What, then, are the options available to India, by far the largest country in South Asia by the size of its population and the size of its economy, to achieve the status of an economic superpower? This question has several answers. The most obvious one is to work to bring stability to its neighbourhood. It should not be tempted to go it alone, since it will be continuously distracted by instability and uncertainty all around its borders; but to deal with the neighbours, India will need to cast off some of the old approaches and work towards a new strategy aimed at producing a working economic entity in South Asia to which it and its many neighbours are fully committed. A move in that direction is not taking place. The most important initiative in this respect is the South Asian Association for Regional Cooperation (SAARC), created a quarter century ago. As shown by the Bhutan summit of April 2010, there was much greater attention given to the meeting between the prime ministers of India and Pakistan on the sidelines of the summit than to the work of the summit itself.

How can South Asia become a functioning regional entity able to carve out a place for itself in the rapidly changing structure of the global economy and the political system that is being developed to support it? This is the question to which I attempt some answers in this book. However, before laying out a plan of action that the South Asian countries could follow, it would be appropriate to provide a context within which such a plan could work. We will explore briefly in this chapter, and in some detail in the chapters that follow, a number of themes that will inform this analysis.

To begin with we should examine the formative phase of the region that has come to be called South Asia. The shape it has taken dates back to 1947 when the British, having stayed in the subcontinent for almost two centuries, went back to their island, leaving their former colony in a state of considerable turmoil. Some of it has persisted to this day, particularly along the entire periphery of India, the largest and most organized country to emerge from colonial rule. Could this have been avoided had the British left in less haste and taken more time to depart? Could they have prevented the mass transfer of population that followed their departure when 14 million people crossed the newly drawn border between the northern part of India and the western part of the new and manufactured state of Pakistan? These are just two of the many "What if…?" questions that are tempting to ask but hard to answer.[5] We must deal with the present, no matter how it was shaped.

South Asia's future will be determined not only by the way the eight countries that make up the region – Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka – manage their affairs and relate to one another; it will also be affected by the enormously significant changes occurring in the global economic system. Asia is now engaged in the game of catching up – a process described at some length by economic historians such as Alexander Gerschenkron and Angus Madison. The former studied it in the context of Europe and the latter applied it to rest of the world. The process essentially describes how the countries (or the regions) that have been left behind catch up with the leader or leaders. The state has an important role to play in this endeavour. The catch-up game that is currently underway will most definitely result in the centre of gravity of the global economy shifting towards the Pacific from the Atlantic. Will the shift also bring in the countries on the rim of the Indian Ocean and those that are further inland to be in the front row of the global economy? This will be determined entirely by the choices made by those responsible for making public policy.[6]

South Asia could become part of the "catching up" Asia if its policy-makers work with one abundant resource – a large and young population. With the adoption of the right set of policies this population could become an asset. This has happened in some parts of India and Bangladesh, but in different ways. The Indians trained a segment of their population to become the world leaders in information technology. The Bangladeshis allowed their women to work in the ready-made garment industry. If this is not done, the large South Asian populations could become large economic and social burdens, as is happening in Afghanistan and Pakistan. If these two countries are not able to sort themselves out, they will not only unravel themselves but also become great burdens for the rest of South Asia.

It is not only demography that will help define South Asia's future, but also the way it reacts to the process of globalization – taking advantage of its positive aspects while protecting itself against some of its negative attributes. The world has already done a lot of learning by first enthusiastically embracing globalization – particularly shoving back the state on the economic stage and giving the vacated space to the private sector – and then becoming more cautious about fully imbibing it. An important part of the strategy for the future must be the role assigned to the state. For some four decades after achieving independence the South Asian countries allowed the public sector to lead the economy. In India, starting with the period of Jawaharlal Nehru, the country's first prime minister, the state was put at the "commanding heights" of the economy. It remained there until the mid-1980s. Then initially slowly and subsequently much more rapidly, the state's role was circumscribed while that of the private sector was expanded. This is likely to continue, as even the West has recognized that free and unconstrained capitalism can do a great deal of damage. This is one of the lessons of the Great Recession of 2008–09.

The other aspect of globalization concerned economic openness. Asia, including its southern part, did not go as far as the countries of Latin America and Eastern Europe in fully opening their economies to the outside world. Import tariffs were lowered but some restrictions remained on non-essential imports. Foreign capital inflows were encouraged but the flow of hot money was generally not permitted. In many respects South Asia was even more conservative than the countries in the eastern part of the continent about opening its economies. This caution paid off when the world went under in the Great Recession.

South Asia: The formative phase

Even a cursory view of any South Asian country leaves one impressed with the region's diversity. This is particularly the case for three countries in the region – India, Pakistan and Sri Lanka. Bangladesh, Bhutan and Nepal are culturally, ethnically and religiously more homogeneous. The British rulers were also impressed with the diversity encompassed by South Asia. Sir John Strachey, who spent many years in British India and went on to become a member of the Governor-General's Council, wrote a book about the latest British colonial acquisition. Strachey's book became a primer for all those from his country who wished to learn about their Indian empire. India, he wrote, was merely a label of convenience, "a name we give to a great region including a multitude of different countries". India, in other words, was a vast geographical place masquerading as a country. "Scotland is more like Spain than Bengal is like the Punjab", said Strachey. "It is conceivable that national sympathies may arise in particular Indian countries [but] that they should ever extend to India generally, that men of Punjab, the north-western provinces and Madras should ever feel that they belong to the Indian nation, is impossible. You might with as much reason and probability look forward to a time when a single nation will have taken the place of the various nations of Europe".[7]

Strachey was, of course, both right and wrong. There were many differences in the land the British ruled formally for 90 years, from 1857[8] to 1947,[9] which led to its division into three states after they went home.[10] Some of the Muslim majority areas were taken out to form the independent Muslim state of Pakistan. The "idea of Pakistan" was conceived by Muhammad Ali Jinnah, the father of the country, who proclaimed, to the dismay of the Hindu-dominated All India National Congress (AINC), that British India did not have one Indian nation but two separate ones, one Hindu and the other Muslim. Each needed a state of its own in which they could have their different cultural and social norms projected onto the political system they would eventually evolve for themselves. After a lot of hesitation, both the British and the AINC accepted Jinnah's "two nations" theory and agreed to the creation of a separate homeland for the Muslims of British India.[11] However, Pakistan came divided in two parts: its eastern and western wings were separated by a thousand miles of Indian territory. The two Pakistani wings remained together in an uneasy alliance for a quarter century but went their separate ways in 1971 after a bloody war in which India sent its army to aid the *Mukti Bahini*, the Bengali Liberation Army.[12] Religion, the people of East and West Pakistan discovered, was not a strong enough glue to keep them together within the boundaries of one state with two very different people. However, I will argue in this work that while religion may be a weak glue, shared economic interests can be much stronger. This is where Strachey went wrong in his prognosis of the probability of a European union. A single European union was in place a hundred or so years after Strachey published his book. The same may happen one day for the states of South Asia.

India, minus Bangladesh and Pakistan, has survived as a nation state, making real what Sunil Khilnani, the Indian political historian, calls the "idea of India". He attributes it to Jawaharlal Nehru, the first prime minister of the country. According to this, very diverse people could live together as long as they were allowed space within one political system. The "period of Indian history since 1947", writes Khilnani, "might be seen as the adventure of a political idea: democracy. In this context, India can be considered the third moment in the great democratic experiment launched at the end of the eighteenth century by the American and French revolutions." Each of these endeavours "released immense energies; each raised towering expectations". The Indian experiment "may well turn out to be the most significant of them all, partly because of its sheer human scale, and partly because of its location, a substantial head of effervescent liberty on the Asian continent".[13] The elections held in April–May 2009, a subject I will touch upon in greater detail in a later chapter of the book, have lent some substance to the argument advanced by Khilnani.

While the idea of India has survived, the "idea of Pakistan" is still being tested, as is the "idea of Bangladesh". The idea of Bangladesh put out by Sheikh Mujibur Rehman, the father of the nation, was much narrower than the other two ideas. According to this, a large ethnic group, with its own language and culture, needed its own political space. The question I will pose in this work is whether these "ideas" of nationhood can be brought together in some sort of "idea of South Asia" based on economics as the main driving force. Without regional cooperation the countries of the region will not be able to take advantage of the opportunities being created in the rapidly evolving global economic and political systems.

Six decades after South Asia achieved independence from the two century-long rule by the British, the structure of its economy looks very different from the time the colonial rule ended. This may not have been the case if the British had lingered longer since that would have diverted the energies of the people in the fight for independence. Whether the economic shape of the South Asian mainland would have been different had it not been partitioned first into two states and ultimately into three is a hard question to answer. However, the fact that soon after the British left, there was conflict between the two successor states – India and Pakistan – no doubt had a significant impact on both the structure as well as the rate of their growth. This was the case, in particular, for the region's smaller countries such as Pakistan and Bangladesh. As we will discuss later in the book, trade played a significant role in changing the character of the various South Asian economies. Had the trading relations between India and Pakistan not collapsed suddenly in the late 1940s, the Pakistani economy would have progressed in a different way. Its industry as well as its agriculture would certainly have developed differently. Both sectors would have been linked much more closely with the Indian markets than was the case. This is one of the intriguing "What if…?" questions of South Asian history.

Table 2.1, below, presents some data on the structure of the various South Asian economies. India, with 80.6 per cent of the region's combined GDP is by far the largest economy. Its share is larger than its proportion of the region's total population which, as shown in Table 2.2, is 75.2 per cent. This means that the income per head of the population in India is much higher than the average for the rest of Asia. India has had a marginally better record of developing its vast human resource but the differences are not very significant from other countries. In recent years income distribution has worsened as the rate of growth has picked up. This has begun to worry several analysts. In a report sponsored by the Asian Development Bank and presented at the meeting of the Emerging Markets Forum held in Mumbai in June 2009, it was revealed that a handful of families controlled as much as 80 per cent of the capital of the firms listed on the Mumbai exchange.[14] A similar revelation in 1969 in the case of Pakistan by the Chief Economist of the Planning Commission led to the demise of the military government that had taken pride in its economic performance. India's political structure is much more robust and less likely to crumble under the weight of such revelations, but that it is happening should be a cause for worry.

The rise of "the rest"[15]

As already discussed in the introductory part of this chapter, a number of unifying themes are presented in this book. These will look at the past and present developments in the subcontinent by placing the region in the global context. As has been pointed out and elaborated in a number of recent academic, policy and journalistic works, the shape of the global economic and social systems, and the international political order are changing rapidly. Why this is happening has been extensively discussed from several

Table 2.1 Key economic indicators of South Asian economies

Indicators	*Afghanistan*	*Bangladesh*	*Bhutan*	*India*	*Maldives*	*Nepal*	*Pakistan*	*Sri Lanka*
GDP (millions 1990 US$)	9,358	67,876	1,305	1,141,346	1,055	11,815	163,290	32,387
GDP (millions current US$)	NA	6,841	1,096	1,176,891	1,055	10,315	142,893	32,346
GDP growth (annual %)	12.4	6.5	22.4	8.7	7.7	2.5	6.0	6.8
GDP growth (annual %)	NA	6.4	19.0	9.0	7.0	3.0	6.0	7.0
GDP per capita (current US$)	302	431	1,668	1,046	3,456	367	879	1,616
Gross savings (% of GDP)	NA	34.6	72.0	38.6	NA	29.0	25.0	23.0
Gross domestic savings (% of GDP)	NA	17.5	60.0	35.6	NA	10.0	16.0	17.0
Foreign direct investment, net inflows (BoP, current US$)	NA	653	78	22,950	15	5.74	533	603
Foreign direct investment, net inflows (% of GDP)	NA	0.95	7.0	1.95	1.0	NA	4.0	2.0
Current account balance (% of GDP)	NA	0	NA	−3.2	NA	NA	−15.1	−3.1
External debt stocks (% of GNI)	17.8	30.0	69.0	18.9	56.0	35.0	28.0	44.0
International reserves (end of year; US$ millions)	3,228	5,789	764	256,419	241	1,499	8,903	2,300
Fiscal balance (% of GDP)	NA	−3.3	−0.8	−3.1	−7.9	−2.0	−4.0	−6.9

Source: World Development Indicators; The World Bank, Economist Intelligence Unit, Statistical Yearbook for Asia and the Pacific 2008; The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP).

Table 2.2 Key social indicators of South Asian economies

Indicators	*Afghanistan*	*Bangladesh*	*Bhutan*	*India*	*Maldives*	*Nepal*	*Pakistan*	*Sri Lanka*
HDI Index	NA	147	131	132	99	145	139	104
Population, total (millions)	28.2	161.3	0.7	1,186.2	0.3	NA	167.0	19.4
Population growth (annual %)	1.7	1.3	1.9	1.4	2.0	2.1	1.8	0.6
Urban population (% of total population)	21.0	25.5	31.0	29.2	35.0	16.2	35.0	15.1
Life expectancy at birth, total (years)	NA	64	66	65	68	64	65	72
Infant mortality rate (per 1,000 live births)	NA	52	63	57	26	46	78	11
Poverty headcount ratio at 1.25 a day (PPP) (% of population)	NA	50	NA	42	NA	68	23	14
Asian poverty line, US$1.35 per day (2005 PPP), magnitude (millions)	NA	89.3	0.2	740.4	NA	15.8	51.7	3.5
Percentage of population living below Asian poverty line, consumption PPP (2005 PPP)	NA	55.7	35.9	65.3	NA	59.9	32.7	18.4
Gini Index	NA	31.0	46.8	36.8	NA	47.3	31.2	41.1
Literacy rate, adult total (% of people aged 15 and above)	NA	53	53	66	97	57	54	91
Combined gross enrolment ratio in education	NA	56.0	52.1	61.0	71.3	60.8	39.3	68.7
Total net enrolment ratio in primary education (%)	NA	92.1	79.9	94.2	98.1	80.1	65.6	96.7
Pupil-teacher ratio in primary education	NA	51.0	38.0	40.0	16.4	40.0	39.0	23.5
Health expenditure, total (% of GDP), 2006	9.2	3.2	4.0	3.6	8.0	5.0	2.0	4.0
Health expenditure per capita (current US$)	NA	12	49	29	245	17	16	62

Source: World Development Indicators; The World Bank, Key Indicators for Asia and the Pacific; The Asian Development Bank, Statistical Yearbook for Asia and the Pacific 2008; The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP).

different perspectives. It would be useful to recall some of the explanations that have been provided.

The most popular of these is the notion that, for a variety of reasons, today's developed countries are losing their dynamism and the future will most certainly see significant erosion in their economic power. In an influential book, Fareed Zakaria calls the current period "the post-American world", which will see the economic rise of what he labels "the rest". He calls it the third tectonic movement in the history of the globe – at any rate the part of the history dominated by *Homo sapiens*. The first was the rise of the West that began in the 15th century and accelerated dramatically in the late 18th century. The second was the rise of the United States in the closing years of the 19th century and continued throughout the 20th century. "We are now living through the third great power shift of the modern era. It could be called the 'rise of the rest'. Over the past few decades, countries all over the world have been experiencing the rates of economic growth that were once unthinkable. While there have been booms and busts, the overall trend has been unambiguously upward. This growth has been most visible in Asia but is no longer confined to it." Zakaria quotes Antoine van Agtmael, the fund manager who coined the term "emerging markets", to suggest that the 25 multinational companies that will be the world's leading firms in the next few decades will include several from the emerging world. "His list includes four companies each from Brazil, Mexico, South Korea, and Taiwan; three from India; and one each from Argentina, Chile, Malaysia, and South Africa".[16]

A somewhat similar argument has been advanced by Singapore's Kishore Mahbubani in *The New Asian Hemisphere*. There is an edge to his argument in the sense that he does not believe that the West is comfortable with the idea of an emerging Asia. He maintains that Asia's rise is irresistible, hence the subtitle of his book, and the West should accommodate itself to that development. "We are therefore moving towards a real crisis in the management of our world order unless the West changes course", he wrote. "Too many western minds are looking at dangers; fewer looking at opportunities […] the Asian march to modernity represents a new opportunity both for the West and the world. If the West could learn to work with, rather than against this march it can help make the twenty-first century one of the happiest centuries of human history."[17]

Antoine von Agtmael's list of the future great global companies is a good indication of the fact that South Asia is losing out to other emerging economies in creating a space for itself in the tectonic shift in the structure of the global economy. Why has that happened and what could change the trend are questions that will be addressed in this work. Real value could be added to this discourse by examining the place South Asia currently has in the changing global environment and the public policy choices that could improve the situation for the region. However, we will first look at the changes that are taking place in the structure of the global economy, in the international political order, in the way people are now governed, and in the way the people from various parts of the world relate to one another.

Demography is destiny

Changes in the global economic and political systems are happening fast. Many of them are driven by demography, the development of the internet and the adoption of a new model of economic growth by countries that were part of the entity once called the "Third World". Even today, after much work by demographers, economists, political scientists and sociologists, we do not fully understand how the change in the rates of population growth and in the sizes of country populations affect economic development and growth. Is a continuous growth in population that results in the doubling of the number of people living in a given area every quarter century or so good or bad for the area's economy? International opinion a couple of decades ago was focused on the problems such unrelenting increase in population creates. The conventional wisdom then was that the world was heading towards a Malthusian disaster. However, not everybody agreed. The two bestselling books of those times, the Club of Rome's *Limits to Growth* and Lester Brown's *Seeds of Change*, looked at the problem of population growth and the availability of food from two very different perspectives.

The first book argued that a continuous high rate of population growth, combined with some increase in income per head of the global population, were together creating a demand for non-renewable resources that would, in the not too distant future, result in their exhaustion. There were two public policy implications of this conclusion – one explicit and the other implicit. The first suggestion was that the international community should work urgently to reduce the rate of population growth, particularly in the developing world. A United Nations population conference was convened to underscore the need for action. The other conclusion – the implicit, since it would not have been politically correct to espouse it – was that much of the world's population should not aspire to achieve the economic and social standards that were common in rich countries. The globe simply did not have the resources to make it possible for so many people to live in the way the Europeans, North Americans and Japanese did.[18]

Brown and several other analysts did not buy into this gloomy outlook. In his widely read book, Brown reached the opposite conclusion and argued that most problems of scarcity in the past had been resolved by technology.

There was no reason why the future should be any different. Price increases brought on by scarcity encouraged innovation. The "green revolution" in several populous South Asian countries in the late 1960s and the early 1970s had resulted in quantum jumps in land and labour productivity. Significantly more quantities of food were produced from the same amount of land and by the application of the same quantity of labour than before. High yielding varieties of seeds developed in research institutions in Mexico (for wheat) and the Philippines (for rice) had spared a number of countries from Malthusian famines.[19] The optimists did not think that the green revolution was a "once in history" kind of event. It would be repeated again and again every time the increase in population produced food scarcity and put pressure on prices. Genetic engineering increasing yields and "designer" crops can be seen as continuing the trend that began with the green revolution.

Given the experience with demographic change and its consequences for various parts of the global economy of the last quarter century, some of the earlier conclusions do not seem all that obvious. In the last 25 years, we have seen a significant decline in the average rate of human fertility. That has occurred all across the globe. There are a number of consequences of this development not foreseen in the 1970s when there was such a great deal of talk about the "population bomb" ticking in the globe, ready to explode. One of these is that in a number of European countries and in Japan populations have begun to decline in size. Russia has the worst case of population collapse in Europe, but in its case, mortality increases related to alcohol abuse have added to fertility declines to bring about a rapid and continuing reduction in the size of the population. This raises an important question. Can declining national populations with a constantly increasing proportion of older people who need to be supported by a continuously declining share of the young remain economically viable and socially dynamic? The answer is no, unless these countries allow large-scale migrations from the more populous countries in the world. This was the approach adopted by the United States in the pre-9/11 era, while Western Europe, fearful of the cultural impact of an increasing proportion of immigrants in their populations, followed a much more constrained approach. In Europe there is a particular fear associated with the increase in the proportion of Muslims in their population. This fear has earned a name of its own: *Islamophobia*.

The second consequence of the change in fertility was that of "demographic inertia." This means that even if the rates of fertility have begun to decline in the developing world – as they have in all Asian countries – because of the high birth rates in the past, the proportion of the young in the population would continue to increase for a few more decades. This has created a window of opportunity for a number of populous countries in South Asia. This is the case, in particular, for India, Pakistan and Bangladesh, all of which have a long tradition of international migration. Moving out of crowded places has always provided a relief – this was the case in the pre-9/11 world. Populations with a high proportion of young – Pakistan, for instance, had a median age of 18.2 years in the early 2000s – can become an economic asset or a burden depending upon the public policy choices made by the state in the past. Countries such as India and the Philippines have used their young populations to provide high economic returns by participating in the process that *The New York Times* columnist, Thomas Friedman, has called the "flattening" of the world. According to him, "a combination of technological, market and geopolitical events at the end of the twentieth century has leveled the global economic playing field in a way that has enabled more people than ever, from more places than ever, to take part in the global economy and, in the best of cases, to enter the middle class".[20] Friedman's description applied to some parts of India but not to other South Asian countries. Not all populous countries have benefited. Some, like Pakistan, by seriously under-investing in human resource development, created an environment that invited a segment of the youth to join the forces of extremism and become *jihadists*. As a consequence, by the summer of 2009, when the Pakistani state decided finally to move against the forces of extremism, the country was beginning to be called the most dangerous place on earth.

Globalization and South Asia's response

The internet, a remarkable communication technology developed over the last three decades, had its origins in the United States. It has transformed the global economy by making it possible to transfer information instantly. Among the many consequences of this development, one of the more important was that workers did not have to be located in one place. Work could be disbursed wherever human talent and physical resources were available. This introduced the concept of "outsourcing" and created an entirely new process of production. National firms became global firms and nationalism began to give way slowly to "globalism". Studying this process of change became the central focus of the analytical work done at the United Nations Industrial Development Organization (UNIDO). Based in Vienna, Austria, UNIDO began publishing a series of annual reports titled *Industrial Development Reports*. The series started in 2002 and dealt with a number of issues relating to the changing structure of the global industrial economy.[21] Several reports focused on the growth of multinational corporations as the catalyst of change in which large firms were no longer constrained in their actions by the policies of the states in which their headquarters were located. Instead, they had taken their operations worldwide, locating production facilities according to their reading of comparative advantages.[22] Asia – particularly in the continent's eastern part – was a major beneficiary of this change in the business practices of the multinational corporations.

There is now a consensus emerging among economists and political scientists that one of the important aspects of change in the global political order is the gradual withdrawal of the nation-state from governance. The nation-state is being squeezed from both sides. The space in which it currently operates is being gradually taken over by multilateral systems and the systems of local government. Multilateralism is taking several forms. It is taking the form of the surrender of some sovereign rights to such multilateral organizations as the United Nations Security Council and the World Trade Organization (WTO) – under the 1995 Treaty of Marrakesh that had the WTO supplant the General Agreement on Tariffs and Trade. Under Chapter 7 of the United Nations Charter, the Security Council can authorize military action against errant states. The WTO acts as a court when individual states litigate against one another.

However, for the purpose of this study, it is the regional cooperation for trade and economic development that holds special appeal. The European Union (EU) is the most successful organization in this context. From humble beginnings as an organization set up to coordinate European trade in coal and steel, it has evolved into a supra-state institution. The attempt to write a European constitution, having started in the early 2000s, is currently suspended, but at some point in the not too distant future it will resume and provide the members of the EU with a governing document that will take away some powers from the member states and locate them in a central place, presumably in Brussels, the current headquarter of the EU. The area of international trade has already been surrendered by the European nation-states to the European Commission. Next it may be the making of foreign policy.

The other encroachment on state power is coming from the opposite end. According to the World Bank in the above cited report, "a state that ignores the needs of large sections of the population in setting and implementing policy is not a capable state. And even with the best will in the world, [the] government is unlikely to meet collective needs efficiently if it does not know what many of these needs are. Reinvigorating public institutions must, then, begin by bringing the government closer to the people. That means bringing popular voice into policymaking – opening up ways for individual users, private sector organisations and other groups in civil society to have their say. In the right setting it can also mean greater decentralisation of government power and resources".[23]

In the 1997 *World Development Report*, analysts at the World Bank suggested that the changes in the system of global production were also producing changes in the global political order. Two developments were taking place simultaneously. One was to turn a number of areas of policy-making into international institutions. The other was to devolve more financial power and political authority to governments at the sub-national levels.[24] This trend was visible in both the developed and developing countries. It was in some cases the result of the support given by the political elite, and in others, by developments at the grassroots level. Mahatama Gandhi, the spiritual leader of the Indian independence movement, had always espoused building the country's social and economic development by focusing on the villages. He called the villages the "little republics". Even though the Indian Constitution created a highly centralized state, decentralization to the local level has been practised more vigorously than in other South Asian countries. In Bangladesh, the move towards greater decentralization started soon after the country gained independence in December 1971. Non-governmental organizations such as Grameen Bank centred their activities in the villages. The 2001 Local Bodies Ordinance, promulgated by the military government led by General Pervez Musharraf in Pakistan, had support provided by the leadership while the gradual transfer of power in India from the central government to governments at the state level, providing an example of both the inclination of some of the leaders as well as movements at the grassroots level.

The changes discussed above have been provoked by a number of developments, some of which happened because of the way economies and societies have always evolved in human history. The process generally referred to as "globalization" is one such determinant of change. Some have been the consequence of human action – especially action by world leaders. One example of this is the way the United States Administration under President George W. Bush, the country's 43rd president, fought what he called the "global war on terror".[25]

Public policy looked at from this perspective takes two forms. It focuses on the strategic interests of the countries that make up a region. For a region the recent history of which has been dominated by intense rivalry among different states, a country-centred strategic approach could be seen as a zero-sum game. One country's gain would be another country's loss. This was the case in Europe before the Second World War and has been the case in South Asia since it achieved independence from colonial rule in the late 1940s. Each capital in such regions will seek to improve its position with respect to all others in the neighbourhood. The other context in which regional policy could be formed is regional. The assumption in this case would be that each capital will place the interest of the region ahead of its own in the belief that the outcome will be a plus-sum game. Economists have a term for this kind of approach – Pareto optimality – when a given solution brings benefit to all participants in the transaction. Nobody suffers. If this approach were to be applied to the making of public policy in South Asia, what the various governments would be pursuing would be very different from the way national policies are currently shaped and the ends to which they are directed. For a very long time – in fact, since the time the area now called South Asia acquired its present political shape – the countries in the region have largely focused on internal issues. This way of looking at their situation produced tensions with the neighbours. If they looked beyond their borders, they did it to protect themselves from sometimes real and, at other times, perceived security threats.

The current debate on what approach Pakistan should follow in dealing with the scourge of Islamist extremism is a good illustration of this conundrum for at least two, if not three (if we also count Afghanistan as part of the region) South Asian countries. As the group that calls itself *Tehrik-e-Taliban in Pakistan* expanded its physical presence beyond the traditionally troubled tribal belt in the country's north-west, the question was raised whether Islamabad, in particular its military leadership, was prepared to use power to beat back this serious threat to national security. In the spring of 2009, when the snows melted in the mountains that form the border between Afghanistan and Pakistan and the passes through which people moved cleared, this conflict escalated. The question arose as to how much of its enormous fire power the Pakistani military was prepared to use to stem this tide. The military initially acted with restraint, a posture that was interpreted in several different ways. The Americans, in particular General David Petraeus, the man most closely associated with the development of the conceptual underpinning and implementation of the American surge in Iraq, was one leader who was convinced that the military leadership and a segment of the political elite were still not convinced that the Taliban were Pakistan's real enemies; the military believed that the real enemy was in the east – India. According to this it was right for Pakistan to focus its military strategy toward minimizing the threat India posed to its security. The army had to be trained, equipped and motivated to deter India. The Taliban were essentially a side show.

There was some truth in this interpretation of the Pakistani military's world view,[26] a point that I will develop in a later chapter. However, the Pakistani leaders – not just the military leaders but some thinking people in the political field and some influential civil society organizations as well – had a more nuanced view of the situation. They saw the Taliban onslaught as a consequence of a dynamic that had been in place for decades, if not for centuries. The Taliban (literally 'the students', but in effect those who were educated in the seminaries that were set up in the refugee camps that accommodated, at one point, 3.5 million people displaced by the Soviet invasion of Afghanistan in 1979 and the country's subsequent decade-long occupation[27]) were the product of the fiercely independent Pushtun culture which fought against all foreign threats. The Pushtuns were not prepared to accept the occupation of the areas in which they lived by the use of military force by a foreign power. For several decades, they resisted the gradual advance of the British into their territory until the British decided to divide the Pushtun tribes by drawing the Durand Line in 1893,[28] which effectively became the border between Afghanistan and British India, and later between Afghanistan and Pakistan. The Pushtuns were also not keen on seeing their own culture being encroached upon by foreign influences. In looking at such perceived threats, they did not differentiate between the American forces, the forces under the command of the North Atlantic Treaty Organization (NATO) and what they saw as the Punjabi-dominated Pakistani army. How should an approach that satisfied the aspirations of the various people involved in this growing conflict be developed? To use a popular American phrase, the situation demanded thinking outside the box.

Taking the regional approach would be one element of such thought. A bit of this was done by President Barack Obama's Administration in the context of its extensive review of the United States policy towards Afghanistan. Instead of looking only at Afghanistan, the new policymakers in Washington decided to focus on what they called the "AfPak" problem. The reason behind the enlargement of the geographical scope of the new approach was a simple one. The almost evenly split Pushtun population, estimated at some 40 million people between Afghanistan and Pakistan, meant that the two countries had to develop similar approaches to addressing the grievances and aspirations of this ethnic group. This was especially the case since, after having failed spectacularly to bring the Pushtuns under their control in the 19th century, the British, by drawing the Durand Line in 1893, had divided them in two – the Afghanistan and Indian groups. In 1947 Pakistan inherited the Indian Pushtun group. However, the Pushtuns did not wish to be divided. Kabul did not accept the Durand Line or the incorporation of the Pushtuns living in the areas south of the Hindu Kush mountains into the new state of Pakistan. Afghanistan was the only country that opposed the entry of Pakistan into the United Nations when the latter presented its credentials for admission in 1949.

One could go on analysing the Pushtun problem but it is strictly not germane to the argument being presented here. The argument is to push for regionalism as a way of dealing with some of the more intractable problems that South Asia faces today. This applies not just to the Taliban problem, but also to the problem of Kashmir,[29] to the way the long-enduring Sri Lankan problem moved towards its climax in May 2009, and towards the difficult relations between Bangladesh and India.

To take one more example of how a problem that was generated and developed in one country can spill over into another is to look at how the Tamil rebellion in Sri Lanka reached a bloody conclusion. According to one report, about 100,000 Sri Lankan Tamils left their homes and took refuge in India, using the "last spit of the coast in Mullaitivu District on the north-eastern corner of the Island" as the spring board for making their escape.[30] The question was raised whether India would remain neutral to the way the conflict had approached its denouement? It was, after all, the arrival of reportedly millions of East Pakistani refugees into Bengal and Assam that prompted the country to intervene in Pakistan's 1971 civil war and the creation of Bangladesh as a separate state. In the concluding phase of the Indian elections of 2009, several Tamil leaders advocated the use of Indian force to protect the Tamil community in Sri Lanka. Using India's readiness to insert itself in Pakistan's civil war in 1971, J. Jayalalitha, the Tamil Nadu opposition leader, "argued that India should send troops to the island to establish an independent state for the Tamils, if they are not granted some autonomy by the majority Sinhalese".[31] It did not happen and the Liberation Tigers of Tamil Eelam (LTTE) was roundly defeated by the Sri Lankan army. However, the Tamil issue was kept alive by the Tamil diaspora in many parts of the world.

There are, in other words, several episodes in South Asia's recent history in which individual states have worked against each other in pursuit of national interests, rather than with one another in pursuit of regional goals. One recurrent theme in this work is to suggest that South Asia will only be able to take advantage of the opportunities that have been created by the changes in the global economic system and the evolution of the international political order if the countries in the region act together rather than against one another. The Obama Administration's initial take on the rise of the Taliban in Pakistan and Afghanistan was to draw India formally into its search for a solution. India resisted and Washington changed the terms of reference for Richard C. Holbrooke, the special envoy to the region. An opportunity for using a regional approach was thus lost.

Many of South Asia's security problems, therefore, need a regional context to be successfully addressed. Is that possible given how long hostilities have existed among the countries of the region and how fixed some of the country positions have become over the last many decades? What could be the catalyst to move the countries away from pursuing narrowly defined national interests and towards pursuing a path that allows some give and take? How could the perception that the interaction among the countries of South Asia is essentially a zero-sum game be changed into one that sees Pareto optimal solutions? This could happen if two countries in the region – India and Pakistan – brought about a fundamental change in their thinking about each other and the region to which they belong. However, the conclusion in this work is that India will have to take the lead.

The need for India's leadership

Only India, being the region's largest country by far (accounting for 74.5 per cent of the population) and its largest economy, and the only South Asian state to have won the epithet of a near superpower (as the only G-20 member from the region), can play the leadership role in the region. The problem is that the country is at the centre of many of the political disputes that have made it so difficult for the states of the region to work together. Kashmir is one such dispute, but not the only one. There is a deep suspicion among the Sinhalese of Sri Lanka, who constitute that country's majority, that if not India then at least the state of Tamil Nadu supported the Tamils during their decades-long defiance of central authority. The opposite impression also prevails. It was a young Tamil woman, a suicide bomber, who assassinated Rajiv Gandhi while he was campaigning to be prime minister in the 1991 elections.

India, having midwifed the birth of Bangladesh in 1971 by supporting its civil war against West Pakistan, could have expected to be on easy terms with the new country and its new leaders. That was not to be the case. Although the Awami League, the party of the martyred Sheikh Mujibur Rehman who spearheaded the movement for the independence of Bangladesh, has relatively decent relations with India, it has not concluded a natural gas deal with its neighbour. Bangladesh has vast surpluses of natural gas while India has serious deficits. A pipeline between the two countries would benefit both. It would be a Pareto optimal solution. Although the deal has been attempted several times, it has not been consummated due to intense suspicion on both sides. India has not been able to secure transit rights through Bangladesh to its states in the north-east. There was some advance in Bangladeshi-Indian relations in early 2010 following the visit to New Delhi by the Bangladeshi Prime Minister Hosina Wajed. India committed a line of credit of US$ 1 billion to Bangladesh, while the two sides signed a number of agreements as confidence-building measures.[32]

Nepal, on India's northern border, is the world's only other Hindu-majority country. In fact, the proportion of Hindus in its population is far greater than in India. It, too, has resources in surplus that India badly needs. Its fast-running rivers carrying huge amounts of water along steep slopes could be harnessed for generating power. However, these deals have been difficult to negotiate. Furthermore, the Nepalese authorities claim that they face all kinds of non-tariff barriers in their trade with India. Sometimes their exports are sent to distant laboratories for testing before certificates of acceptance are issued. Similar complaints are heard in Dhaka and Colombo.

I heard several of these in 2004–05 when I led a team of regional economists that worked on a United States Agency for International Development (USAID)-sponsored study on the possible contributions that the South Asia Free Trade Area (SAFTA) agreement, which is still in development, could make to the region.[33] In a meeting with Prime Minister Manmohan Singh in New Delhi in December 2004 to discuss the study, he asked if I could perhaps tell him how countries in the subcontinent felt about India. I had just concluded a visit to all the countries neighbouring India. My answer surprised him. I told him that while all countries were suspicious of New Delhi, one felt warmly towards it, was prepared to forget the past and look at the future through a different prism, and was anxious to develop strong economic and cultural relations with its neighbour: that was Pakistan. Islamabad was well disposed towards improving relations with India, in part because the businesses and traders had not encountered the enormous bureaucratic hurdles that had affected the outlook of other regional exporters to India. There was not much formal trade between the two countries. Intra-regional trade, in other words, had done more to sour relations among the region's states than improve them.

Pakistan's encounter with Islamist extremism in the early 2000s persuaded several influential people within its policymaking circles, as well as among the numerous civil society organizations that had begun to play an important role in the country's political life, to look to India as a balancing influence. The will seems to be there on the Pakistani side, but India, understandably troubled and irked by a series of terrorist attacks carried out by Pakistan- based groups, remains highly suspicious of Pakistan and its intentions. In a series of conversations with then-President Musharraf and current President Asif Ali Zardari, I got the same response to my suggestion that Islamabad should try hard to develop better relations with India. Both said that they had reached out to India but New Delhi had failed to reciprocate. If it is beyond the two countries to sort out their differences themselves, is it possible for some foreign mediator to intermediate and prepare the ground? To Indian ears, this suggestion would sound preposterous. However, that is not what history tells us.

On at least four different occasions, New Delhi was prepared to allow outsiders to help them reach an understanding with Pakistan on exceptionally contentious issues. It happened in 1949, when the United Nations Security Council ordered a ceasefire between the Indian and Pakistani forces over what had become the disputed state of Kashmir. It happened again in 1960, when the World Bank became involved in the settlement of the division of the waters of the Indus River system. It was at the prodding of the World Bank that President Ayub Khan of Pakistan and Prime Minister Jawaharlal Nehru of India signed the Indus Water Treaty in 1960 at a ceremony in Karachi, then the capital of Pakistan. The Indus Treaty has survived a least two wars between India and Pakistan, and several near-wars. The World Bank still remains engaged as an arbiter when there is a dispute concerning the use of water.

The third instance of foreign assistance came in the fall of 1965, when the two countries had fought an inconclusive war, once again over Kashmir. This time it was Russia that offered its good offices. Its Prime Minister, Alexis Kosygin, hosted Prime Minister Lal Bahadur Shashtri of India and President Ayub Khan of Pakistan at the city of Tashkent, which resulted in the signing of a treaty. The fourth time was in 1999. This time it was the Americans who became involved when, over the 4 July weekend in 1999, President Bill Clinton hosted Prime Minister Nawaz Sharif of Pakistan in an effort to de-escalate the Kargil conflict.[34] This time no treaty was signed, but America was able to push back the two sides from the brink of war. Given this history, India should be able to set aside its reservations. The decisive victory in the elections of April–May 2009 of the Congress Party led by Dr Singh offers an opportunity that India could exploit. However, if foreign help is to be sought, who could provide it?

Pakistan also needs a significant reorientation in its approach towards India. It needs to recognize the importance of working within a regional economic framework to deal with some of the structural problems the country currently faces. Its policy towards India for many decades was that of a competitor rather than a collaborator. In the first quarter century after independence India was caught in what its own economists called the "Hindu rate of growth"[35] (about 3.0 to 3.5 per cent a year growth in GDP, not much more than the rate of population increase), while Pakistan was averaging a growth rate of 5.0 to 5.5 per cent a year. It appeared to the Pakistani leadership groups that not only was the "idea of Pakistan" working, but that the model of growth the country had adopted was also producing better results than the Indian approach to economic development. A number of foreign analysts agreed. Several books were published by the members of the Harvard Development Advisory Service detailing and applauding the approach adopted by the country.[36] In that period Pakistan was able to close the economic gap between itself and India in terms of the income per head of the population. Briefly its per capita income in purchasing parity terms overtook that of India. However, the Pakistani circumstances changed quickly. Why that happened will be analysed in greater detail in a later chapter.

Now Pakistan is South Asia's sick man. Its political system is less well-developed than that of most of its neighbours; its economy marches to the brink of bankruptcy and disaster every few years, only to be saved by foreign helping hands; and its very existence is threatened by an Islamist insurgency that is pursuing its own and not national interests. In this situation, the country has to recognize that its survival as a nation-state as well as its economic and social future lie in pursuing an entirely different set of objectives and strategies. An integral part of this has to be close and cooperative economic relations with India, the country with which it has had several long-running disputes.

It would help Pakistan if those who lead it, including the military that has played such an important part in its politics and its economic life, recognize that the country should assign a high priority to developing a framework within which relations with India could be recast. This could be done in the context of a regional arrangement that initially seeks cooperation in economic matters, to be expanded later to include other areas. The experience from other parts of the world shows that smaller countries benefit from regional associations centred around an anchor economy. For South Asia, India is such an economy. This works not only for the developing world, but also for the world's developed regions. Mexico has derived enormous benefits from the North America Free Trade Area (NAFTA), much more than the arrangement's largest and richest member, the United States. Mercosur, a trading arrangement centred around Brazil, has benefited smaller countries such as Paraguay and Uruguay. Even Argentina, after initial hesitation, warmed to the idea of Mercosur. Such an arrangement already exists in the form of SAFTA, which was launched in 2006. However, SAFTA has made little progress in bringing together the countries of the region. How it could be strengthened is an important part of this work.

Possible catalysts for bringing peace to South Asia

Given South Asia's troubled history, it may be exceedingly difficult for India to take the lead in developing a regional outlook to replace the country-centric approach in place today, and re-position the region firmly in the changing global system. Some of the smaller countries in the area may not be very willing to have India play the leadership role in organizing South Asia. As the political theorist Hedley Bull wrote several decades ago, "the deepest fears of the smaller units in the global system are their larger neighbours".[37] If India is unable to provide the lead, this role could, in theory, be played by a country that has a strong strategic interest in the region and is in favour of having a regional approach to guide its relations with the rest of the world. Four countries could possibly be cast in that role:

the United States, China, Russia or Saudi Arabia. Their intervention may be welcomed by the smaller countries, but would not be acceptable to India. The reasons for India's unwillingness to countenance the presence of any of these players on the South Asian stage are based in its belief that the region is its "sphere of influence". While New Delhi does not yet feel that it has the political, economic and military strength to project a Monroe Doctrine of its own concerning South Asia, I believe, it thinks that an outside catalyst would only reduce its growing stature. For different reasons, the four countries mentioned above could play a role without containing Indian ambitions in the region.

Even after the fundamental transformation of United States-Indian relations during President Bush's second term (2005–09), when Washington and New Delhi signed a pact that allowed India a near-formal position in the restricted club of nuclear nations, the Indians are not willing to play second fiddle to the United States in South Asia. As Gideon Rachman of the *Financial Times* wrote in an article published after the 2009 Indian election results were announced, "India is a major power with its own interests and its own distinct take on the world. It will not fall automatically in line with Western policy".[38] This became abundantly clear when India emphatically opposed the Obama Administration's attempt to involve the United States in an attempt to resolve the long-running Kashmir issue. Washington believed that it was necessary to make progress on Kashmir as a part of its strategy to deal with Islamist extremism in the border areas between Afghanistan and Pakistan. While the Indian stance resulted in changing the official position of the Obama Administration, it was clear that the American president had not totally changed his position. In an interview with Anwar Iqbal, the Washington-based correspondent of *Dawn*, Pakistan's largest English-language newspaper, Obama once again emphasized the importance of coming to an agreement on the Kashmir issue, while avoiding spelling out the role his country could play. "India is a great friend of the United States and Pakistan is a great friend of the United States and it always grieves us to see friends fighting", he told Iqbal. "And we can't dictate [to] Pakistan or India how they should resolve their differences, but we know that both countries would prosper if those differences were resolved. And I believe there are opportunities, maybe not starting with Kashmir but starting with other issues, that Pakistan and India can be in a dialogue together and over time reduce tensions and find areas of common interest. And we want to be helpful in that process, but I don't think it is appropriate for us to be mediators in the process".[39] Working behind the scenes, Washington exerted considerable pressure on New Delhi to begin negotiations with its neighbour, which were suspended following the attack on Mumbai in November 2007. The attack was carried out by 10 gunmen who came by boat and managed to penetrate the security defences and held the city hostage for three days. They attacked several targets and killed 167 people before all but one of the assailants were gunned down. Blaming Pakistan's *Lashkar-e-Taiba* for the attack, India suspended the "composite dialogue" in which the two countries had been engaged for a number of years. It was under American pressure that New Delhi agreed to resume formal contacts with Pakistan in early 2010, when the foreign secretaries of the two countries met in New Delhi for "talks about talks". In April, on the sidelines of the SAARC summit in Bhutan, the prime ministers of India and Pakistan agreed to begin formal discussions again.

China would be an even greater problem since its rapid economic and ilitary rise in the last quarter century poses a challenge for India to which it still does not know how to respond. Admitting China as an arbiter in South Asian affairs would present a challenge for India that it would find hard to stomach. After the spectacular growth of the Indian economy in 2003–08, when the growth rate in its GDP averaged close to 9 per cent a year, the country considers itself on par with China. It may be a competitor but certainly not a collaborator in South Asian affairs. There are many influential voices in India, including those belonging to India but operating from outside Indian borders, who believe that the Indian model of development, which is based on democratic decision-making, is far superior to that of China. The Chinese political system will find it difficult to absorb the strong internal dissensions like those that almost tore the country apart at the time of the Tiananmen crisis of June 1989. This view is powerfully articulated by the Nobel Prize-winning economist of Indian origin, Amartya Sen.[40]

The much-weakened Russia once had strong interests in South Asia for more than a century. It played the "Great Game" with Britain as the two European imperial powers were competing for influence in the Asian mainland. The British departure from the area eased the pressure on Russia, which had by then transformed itself into the Soviet Union. The pressure was eased but Moscow did not lose interest in the area. Aggressively pursued by Jawaharlal Nehru, India's first prime minister (in that position for 17 uninterrupted years, 1947–64), the Soviet Union first served as a model of economic growth that the first generation of India leaders, Nehru in particular, found very attractive to follow. Moscow was also a counterpoint to the growing influence of Washington after the Second World War. Although Franklin Roosevelt, the American President, was very supportive of the Indian independence movement, Nehru kept his distance from the United States. Temperamentally, Nehru was not an aligner. His role as one of the leaders of the Non-Aligned Movement (NAM) served his purpose well and he ended up becoming a bit of a thorn in the American side. Although the "if you are not with us, then you are against us" approach to foreign policy was to be articulated clearly as America's strategy by President Bush in 2001, following the 9/11 terrorist attacks on the United States, even in the early post-Second World War period, Washington did not look kindly on those who did not align themselves closely with its world view. The containment of the Soviet Union and halting of the spread of communism was an important part of the American world view in that era. Nehru's India did not share that outlook. The Soviet Union took advantage of the Indian position and saw the NAM as a movement for a loose association with Moscow. India was to become a strong associate of the Soviet Union right up to the point of its dissolution in 1991. Pakistan, on the other hand, went in the opposite direction and became closely aligned with the United States to the point of joining two Washington-led pacts,[41] the South East Asia Treaty Organization and the Central Treaty Organization.[42] Because of this history, Russia, the successor state of the Soviet Union, is not seen as a neutral player in South Asia. It is unlikely that it could serve as the catalyst for bringing about a change in the South Asian mindset.

Saudi Arabia is the fourth country on the list of possible catalysts. It has many interests in the region. South Asia has the world's largest Muslim population, estimated at about 475 million out of a total of between 1.4 to 1.6 billion people of Islamic faith. The Saudi Arabian monarch, currently King Abdullah, counts the "keeper of Mecca and Medina", Islam's two holiest sites, in his official title. However, given that the rise of Islamist extremism is one of the most serious problems faced by the South Asian subcontinent at this time, Saudi Arabia could not possibly be the catalyst for change. It does, however, have some other credentials as well. It is now home to millions of South Asian workers who supply a number of essential services to the Kingdom's citizens in addition to working in its factories, transport system and on the thousands of construction sites. The workers send tens of billions of dollars as remittances to the various South Asian countries. The Kingdom is also an important source of oil for South Asia, sometimes provided on concessional terms. This has especially been the case for Pakistan. At the "Friends of Pakistan" meeting held in Tokyo on 7 April 2009, where the cash-strapped country secured pledges amounting to more than US$5 billion, Saudi Arabia was one of the half dozen important donors.

There was considerable warming of relations between Saudi Arabia and India following the visit to the Kingdom by Indian Prime Minister Manmohan Singh. The two countries signed the "Riyadh Declaration – A new era of Strategic Partnership", covering economic, security, defence, technological and political areas, as well as ways to combat terrorism. This followed the Delhi Declaration signed when King Abdullah visited

India in January 2006 as the chief guest at Republic Day celebrations in New Delhi.[43] Indian relations with Pakistan figured in both meetings. Prime Minister Singh declared in Riyadh that “India desired greater ties with Pakistan which has close ties with Saudi Arabia but Islamabad would have to stop fostering anti-India terrorism”. This swing in India-Saudi relations puts the latter country in a better position to play the role of a quiet mediator than is the case with other possible contenders for this role.

The conclusion I would draw from this analysis is that in creating a working economic and political region, South Asians will have to find the leaders from within their own system. This is precisely what happened in the case of some of the other successful regional enterprises. The EU owes its present structure and strength to a few visionary leaders from France and Germany who, after seeing their countries at war for decades, if not for centuries, decided that regional integration was the only way forward. Beginning hesitantly, they have been able to create by far the most successful politico-economic region in modern history. The evolution of the EU has pushed back crude nationalism, and as it advances, the nation-state will slowly retreat in importance. The South Asian region needs to go in the same direction. It is still looking for a leader – or leaders – who will take it there.

South Asia may be getting ready: A realignment of the stars

The alignment of stars may have changed in South Asia in the two-year period between February 2008 and April 2010. There is some hope that the countries in the region may have withdrawn from the move towards the accommodation of religion in politics and arrested the drift towards regionalism in the area’s larger countries. These changes provide some hope that the South Asian countries may begin the work towards greater economic integration. This began more than a decade ago when General Zia ur Rehman, then president of Bangladesh, persuaded the other countries of the area to begin the process of regional cooperation. In 1986 seven South Asian countries – Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka – came together to form SAARC. SAARC was a modest start, but with ambitious goals. It was agreed that the countries would begin work on creating a free trade area in the region and eventually a mechanism for resolving economic and political disputes among the countries of the area. Kathmandu was selected for SAARC’s headquarters. The leaders also agreed to hold a summit every year, rotating the location among the member countries. However, for 18 years no significant progress was made, largely (but not entirely) because of the continuing hostility between India and Pakistan. In 1999 Pakistan's army launched an operation in the Kargil area in northern Kashmir which almost led to a war between India and Pakistan. It took active intervention by President Clinton to diffuse the situation. The American president invited Sharif, Pakistan's prime minister, to confer with him on 4 July 1999.[44] There was another near-war in 2001–02, following the terrorist attack on the Indian parliament in December 2001. This was linked to *Lashkar-e-Taiba*, an extremist group based in Pakistan. For several months the troops from the two sides were massed on the borders; about a million men faced each other and war seemed imminent. It took strong pressure from the United States and Britain to prevent war between the two nations. As already discussed above, terrorism once again set back relations between the two countries following the Mumbai attack.

The process of healing in South Asia may have begun in 2008–09 with a number of positive developments in the countries of the region. The stage may then have been set for addressing their long-enduring differences. The beginning of real change in South Asia can be dated to 18 February 2008, when Pakistan held elections and began the process of transferring power from the military to the elected representatives of the people. Such transfers had happened before, as in 1971 when the military surrendered power to Zulfikar Ali Bhutto whose Pakistan People's Party had won a decisive victory in West Pakistan in the elections held a year earlier. However, Bhutto was overthrown by the military in July 1977, which went on to govern until August 1988 when General Zia ul-Haq, its commander, was killed in an air crash. Eleven years of civilian rule followed but the military retained its influence. It was behind the four dismissals of elected prime ministers during this period. The military returned to power in October 1999 and stayed in place for nearly nine years. It was only after President Musharraf resigned from office in August 2008 that civilian rule returned.

Four factors indicate that the change this time around may prove to be more durable. The first is the maturation of the political parties, which seem prepared to resolve their many differences without calling upon the army to intervene. It was these invitations in the past that created a space that the military was happy to occupy. Second, after a remarkable campaign that lasted for more than a year and half, Pakistan seems to be on the way to evolving a system of independent judiciary which may no longer be prepared to countenance military interventions on the basis of the "doctrine of necessity." According to this doctrine, it was not prudent for the judiciary to intervene and reverse a political order which may not have been established in a strictly constitutional manner. The third development is the rise of an aggressively independent media that has shown impressive resilience even when faced with serious executive pressure. The fourth factor, of course, is the strength of civil society. This was instrumental in restoring the judges of the Supreme Court and the Provincial High Courts who were summarily removed by President Musharraf in the twilight period of his nearly nine years of rule. The military has been traditionally hostile to the idea of a close relationship between India and Pakistan. Its seeming withdrawal from the political scene may create an environment in which détente could take place.

Another important change has also occurred in Pakistan. In early May 2009 the political leadership of Pakistan ordered the military to root out Islamist extremists from the country's northern areas, in particular from the "settled" districts of the North-Western Frontier Province (NWFP). The administrative division of Malakand in the east of the NWFP was being overrun by a group that had aligned itself with the *Tehrik-e-Taliban in Pakistan*. Using the district of Swat as the base, they had begun to fanout to other areas of Malakand. In Swat, the NWFP government had agreed to the militants' demand to reintroduce the *Sharia* system of justice.This agreement was seen as a licence by the militants to extend their influence to other parts of the NWFP and eventually they hoped to take over Punjab, Pakistan's most populous and richest province. In a detailed five-hour briefing given on 15 May 2009 to the political leaders representing all the parties, General Ashfaq Pervez Kayani, Chief of Army Staff, expressed confidence that the army's mission would be completed not in "months but in weeks," after which the police would be called in to maintain law and order.[45] This turned out to be a fairly accurate assessment of the situation.

This development has brought relief not only to a large middle class in Pakistan that is mostly secular in outlook, but it has also brought hope to the Indians who had suffered many acts of terrorism inspired by the militants trained by religious groups operating from Pakistani territory. Developing a force of *jihadists* was once a part of the strategy pursued by the military in Pakistan. It was also supported by the United States in the 1980s, when it needed exceptionally committed foot soldiers to fight the Soviet Union's occupation of Afghanistan. That such an approach would have unanticipated consequences such as the spread of the militants' ideology in Pakistan was not realized at that time.

There were positive moves in some other South Asian countries that may also change the political environment in the region and set the stage for the development of a regional outlook. The military in Bangladesh, having briefly intervened in the political life of that country, went back to the barracks after supervising another general election that brought the Awami League back to power in Dhaka. The Awami League, headed by

Sheikh Hasina Wazed, the daughter of the country's founding father, has a more secular outlook when compared with some of the other large parties in the country. It is also in favour of close relations with India. The King of Nepal was persuaded to surrender power to an elected parliament. In May 2009 the Sri Lankan army declared victory over the Tamil Tigers and appeared to have ended the 25-year civil war in the country.

This period of positive change in South Asia continued with the return of the Congress Party of India in the elections held in April and May 2009, and the reappointment of Manmohan Singh as prime minister on 22 May 2009. The Congress Party was expected to win but the scale of its triumph caught most observers and political analysts by surprise. What was particularly significant was the reversal of fortunes of the religious parties that had campaigned aggressively for the creation of a distinct Hindu entity in India. According to one newspaper analyst, "what the elections have shown is that Congress is still the only major party that plays to India's core instincts, complete with all its warts". The opposition was not helped by the anti-Muslim rhetoric of Varun Gandhi, Rahul Gandhi's estranged cousin. The latter is likely to be the country's prime minister in a couple of years. The Congress's win indicated that "India's majority Hindus tend to be deeply religious but blend their religiosity with a fundamental tolerance".[46] About a year later, on 19 April 2010, President Asif Ali Zardari signed the 18th amendment to the Constitution, which returned executive authority to the prime minster and his accountability to parliament. A fully democratic government may be more inclined to make peace with India than the =ne dominated by or under the influence of thee military.

In the absence of survey data that would assess the sentiments in the various countries in the region about their attitudes towards one another, we can only speculate about the direction in which South Asia may go in the years and decades to come. All the events discussed above may possibly have created an environment in the region that lends some dynamism to the process of regional integration, which has at best made hesitant progress for more than a decade. If that were to happen, South Asia might be getting ready to participate in the global economic system that offers it opportunities which it has not fully exploited.

The themes briefly discussed here will be woven together to tell the story of South Asia from the time it attained its current political shape to the present, and where it may go in the future. The last will depend upon what kind of public policies are adopted by the countries in the region. There is an emerging consensus among the analysts from several disciplines which suggests that the American domination of the global system will end in the near future, if that has not happened already.[47] The "rest" are rising. Demography, an often-ignored determinant of change, favours South Asia, as does its location close to areas that have surpluses of energy and adjacent to East Asia, currently the most dominant player among the "rest". The progress towards this post-American era would have been less chaotic had it not been interrupted by the great financial and economic crisis that started in 2007 and seemed to have peaked in the summer of 2009. One consequence of this crisis is the redefinition of the role of the state, an area in which the countries of South Asia have taken the lead. However, South Asia's future depends on its ability to resolve differences that persist among the countries of the region. The most significant of these is the dispute between India and Pakistan, which has a long history and has cost both countries blood, tears, money and a series of lost opportunities. What complicates this relationship is the fact that both countries have large arsenals of nuclear weapons. As Richard Cohen, an American columnist, put it in a contribution to *The Washington Post*, the "two countries have what it takes to blow each other to kingdom come. They also have the reason. They hate each other".[48] However, hate is not a permanent feature of relations among nations. The Europeans have demonstrated this vividly. India and Pakistan also have the reason to work together: without a workable South Asian economic region, the countries will lose out in a rapidly changing global economy. There are immense opportunities available, but they will only come South Asia's way if the states in the region place economic benefits above national politics. They must understand that relations among nations are a plus-sum and not a zero-sum game. They should search for Pareto optimality in their relations.

3 Reshaping the global economy

The dawn of the Asian century?

Introduction

The years 2007–10 were bad for the world economy; they were even worse for the Western financial system. However, the changes they brought led to a great deal of speculation about the future shape of the global economic system and also how Asia might influence the shape of things to come. Was the Great Recession of 2008–09 a mere interruption in the process of global economic change that began a decade and a half ago when, with the process of globalization exerting its force, the system of production and the structure of international trade began to change? These changes propelled some large emerging markets, most of them in Asia, to the centre of the global economic stage. Or are we seeing, as some analysts have maintained, a change that will inevitably result in directing the global economy in the direction it was taking before the current crisis began to take its toll? Some analysts have said that the "rise of the rest" – Fareed Zakaria's phrase[1] – will bring about a fundamental restructuring of the global economy. Some argue that the rise of the rest may be a temporary phase in the evolution of the global economy.[2] We will suggest in this book that what we are witnessing is a durable change as Asia – not just East Asia but some other parts of the continent as well – catches up with the more advanced countries.

There are good reasons to believe that the process that began a decade and a half ago will continue to alter decisively the global economic landscape. This change is occurring not just because of globalization, which is usually defined as the relatively free flow of capital, trade and information, but also because of an extraordinary demographic transformation. With so much adjustment still to take place, it may seem premature to ask, as we do here, what the future of emerging markets will look like. The crisis of 2008–09 notwithstanding, it appears that we are witnessing another epoch of major realignments in the world's major economies. If that happens, it will be in keeping with the previous patterns in economic history. As on previous occasions, we will see the emergence of new economic powers. The world will have several poles of economic activity, some of them most certainly in Asia. However, in order to think about the future we need to comprehend the past.

Previous "catch-up" periods

Some economic historians have identified "catch-up" periods in the world economy when some of the national economies that had lagged behind joined the leader, and sometimes even overtook it. In the 18th century France caught up with Britain, the country that had launched the Industrial Revolution. A quarter century later Germany joined the two leading economies of Europe and became one of them. Alexander Gerschenkron, a distinguished economic historian, explored the rise of some of the European nations following Britain's Industrial Revolution. According to him, whereas Britain's ascent on the ladder of economic power was largely the consequence of private initiative and enterprise, the state, such as it was, helped France and Germany to catch up.[3]

In the late 19th century it was the United States' turn to catch up. It not only joined Europe's leading economies but, by the start of the First World War, it had overtaken most European economies in terms of the size of its economy and income per head of its population. The 20th century saw more catch-up periods. After the Second World War, which saw the defeat and devastation of Germany and Japan, the Americans helped the vanquished "axis powers" to recover. It did this by launching the Marshall Plan in Europe, an unusual response by the victor towards the countries it had defeated. It took an even more active position in Japan, helping it to acquire some of the institutions it needed to modernize and thus join the ranks of the more advanced nations. Not only did Japan recover, it joined the leading world economies in terms of the structure of its economy and income per capita of its population. The pace and style of Japanese economic development caught the eyes of many academics, including Ezra Vogel, the sociologist at Harvard University who wrote a bestselling book titled *Japan as Number One*.[4] He was so impressed with the dynamism of the Japanese economy that he thought it could overtake the United States within the foreseeable future. Had that happened, it would have been a spectacular case of catch-up. Japan, with only one-half of the United States' population, would have had to double its income per head to overtake America.

The next phase of closing the gap took place in the 20-year period between 1975 and 1995, when a number of East Asian economies – the World Bank called them the "miracle economies" in a celebrated study of East Asia[5] – achieved rates of economic growth that were without precedent in economic history. Within these two decades, four East Asian states – South

Korea, Taiwan, Hong Kong and Singapore – saw a remarkable transformation of their economies. Although they did not approach the income levels of Japan and the Western economies, they became industrial powerhouses. Even though there was a brief interruption in their progress by what came to be called the Asian Financial Crisis of 1996–97, they resumed economic development at about the same pace as in the pre-crisis period.

Before the start of the global economic crisis in the fall of 2007, there was much speculation that a new group of catch-up economies had appeared on the global economic scene.[6] Brazil, Russia, India and China got their own term: the BRIC countries. They were likely to become major economic players. Given the large sizes of their populations, some analysts believed that the centre of global economic activity would move to these countries. There was also a consensus emerging in academic circles that we were witnessing another significant change in the structure of the global economy; that "decoupling" was occurring in the global economy and the BRICs, along with some other large emerging economies, would no longer be affected by the cycles to which the more developed economies were subjected. That was not to be so. In fact, some of the emerging economies were more affected by the crisis than countries in the developed parts of the world. Excluding China and India, the gross domestic product (GDP) of emerging Asia fell by an annualized rate of 15 per cent in the last quarter of 2008. In the first quarter of 2009 Singapore's GDP declined by an annualized rate of 20 per cent. In other words, the smaller, more export-driven economies were more affected than those that depended much more on internal demand as the engine of growth. Asia's two largest economies, China and India, continued to achieve positive rates of growth even during the first few months of the crisis. India was never very dependent on exports to the developed world, and while China was more exposed, when measured on a value-added basis, its exports to the United States accounted for less than five per cent of its GDP. It certainly helped that among all the countries, China planned to spend a much larger proportion – an estimated five per cent – of its total output than any other country on stimulating its economy and helping it to recover from the Great Recession. The United States' effort was estimated at only two per cent of its GDP.

The conclusion that could be drawn from the way the various components of the global economy performed in the early 2000s was that the large Asian economies would, in spite of the setback in their rates of growth in 2008–09, continue to catch up, in terms of the size of their GDP, with the more developed economies. What is even more significant is that the model of economic management they have pursued won a number of new admirers, who began to question the wisdom embedded in unconstrained capitalism. This is likely to lead to a redefinition of the role of the state in economic management. The new global economy will be structurally different from the one that was shaped in the half century between the end of the Second World War and the beginning of the sharp economic downturn in 2008.

The crisis that began in the United States in the summer of 2007 reached other shores – it did not spare the BRICs or other parts of the globe. "The impact of the crisis will be particularly hard on emerging countries: the number of people in extreme poverty will rise, the size of the new middle class will fall and governments of some indebted emerging countries will surely default", wrote Martin Wolf, chief economics commentator of the *Financial Times*, for a special issue of the newspaper dedicated to a discussion of the future of capitalism. "Confidence in local and global elites, in the market and even in the possibility of material progress will weaken, with devastating social and political consequences. Helping emerging economies through a crisis for which most have no responsibility whatsoever is a necessity."[7]

As already indicated, it is hard to accept this grim conclusion. Some countries in the emerging world were, no doubt, hurt and many of them needed the assistance of the international community. Several, however, emerged stronger from this experience and continued to participate in the reshaping of the global economic structure. Among them was most certainly China but also possibly India. In other words, Asia will soon have at least one or perhaps two economies that will be at the centre of the new global economic system. The centre of gravity of the global economy may shift from the mid-Atlantic to the mid-Pacific. To make this point it might be useful to briefly visit the changes that have occurred in economic thought in the last few decades, especially after the conclusion of the Second World War.

Changes in the structure of the global economy, 1945–2007

The last half century divides itself neatly into two periods – neat in the sense of the attention given by policy-makers the world over to certain ideologies concerning economic management. Several influential world leaders did not see the Second World War as a triumph of the United States and its allies in Western Europe and the Pacific; they saw it as the victory of socialism and statism over the market place. The remarkable economic growth of the Soviet Union and the growth of its military might were seen as a vindication of the way it had managed its affairs, in particular its economy. The admirers of the Soviet Union were not confined to the leaders of what came to be called the Third World – leaders such as Jawaharlal Nehru of India, Gamal Nasser of Egypt, Julius Nyrere of Tanzania, Kwame Nkrumah of Ghana and Soekarno of Indonesia. Even in victorious Britain the voters sent Winston Churchill and his Conservative Party home in favour of the Labour Party and its leader, Clement Attlee. The model these leaders favoured was that of the mixed economy. In John Maynard Keynes they had their own philosopher for this approach. The man who gave the clearest substance to this line of thought in the Third World was India's Nehru, under whom the state was placed at the "commanding heights" of the economy.

Under Nehru, India's first prime minister, who served 17 uninterrupted years in that position, the country adopted Soviet-style central planning but with some significant differences. The Soviets had totally eliminated the private sector, placing practically all economic activities in the hands of the government. On the other hand, India under Nehru did not disturb private ownership. That happened later when Indira Gandhi, his daughter, nationalized privately owned banks in 1969. Nehru encouraged large investments by the state in industry. He also ordered his successive administrations to build an elaborate system of licensing that put the private sector under strict government – hence bureaucratic – control. India gradually gave more autonomy to the state governments. Such a development was not envisaged by Nehru and other fathers of the Indian Constitution who gave the new state an enormous amount of authority over the federating units. The Soviets, on the other hand, particularly under Joseph Stalin, used force – often brutal force – to concentrate power and authority in the hands of Moscow.

The state also played a prominent role in transforming the miracle economies of East Asia. The region had a remarkable record of high and sustained economic growth. From 1965 to 1995 the 23 economies of East Asia grew faster than all other regions of the world. Most of this achievement was attributable to seemingly miraculous growth of the eight economies studied by the World Bank for the preparation of the *Miracle Economies* report.[8] In most of these economies the government intervened – systematically and through multiple channels – to foster development and, in some cases, encourage the development of specific industries. Policy interventions took many forms. Policies to bolster savings, build strong financial markets and promote investment with equity, including keeping deposit rates low and maintaining ceilings on borrowing rates and retained earnings, establishing and financially supporting government banks and sharing information widely between selected industries, protecting import substitutes, supporting declining industries, and establishing firm- and industry-specific export targets. The state also ensured reasonably equitable distribution of incremental income. The East Asian economies were the only ones that avoided the Kuznets effect – their growth was not accompanied by a deterioration in income distribution. There were also impressive reductions in the incidence of poverty in the region, for instance it dropped from 37 per cent to less than 5 per cent in Malaysia in the 30-year period between 1960 and 1990.

A reaction set in to this approach with the election of Ronald Reagan in the United States in 1980 and Margaret Thatcher's ascent to prime ministership in Britain the year before. The two, often working together, introduced a new economic philosophy for managing national economies. What came to be called "Reaganism" and "Thatcherism" redrew the boundary between the state and the market place, pulling back the former in favour of the latter. Reagan proclaimed, "government is not the solution to our problem; government is the problem".

The man who gave real substance to this philosophy was Alan Greenspan, who served 18 years as the Chairman of the United States Federal Reserve Bank, the country's central bank.[9] Greenspan, a careful analyst of the United States economy, came to two conclusions that were applied to the management of monetary policy. The first concerned the level of the non-accelerating inflation rate of unemployment. He believed that as a result of the remarkable developments in information technology, worker productivity in the United States certainly, but perhaps also in other industrial countries, had increased to the point where a higher growth in national product could be allowed without igniting inflation even if there was a sharp decline in the rate of unemployment. This meant that the Federal Reserve could allow an easier monetary policy to stay in place. The second, as important as the first in terms of economic management, was an infinite faith in the ability of the private sector, in particular those operating in finance, to develop products that spread risks across a large number of players. One corollary of this faith was to leave the private sector alone, to let it self-regulate without too much intervention by the institutions of the state. Seeds were thus sown for the crisis that hit the global economy in the first decade of the 21st century.

Other events also contributed to the development of the new approach in which private enterprise was to be left to its own devices. These included the shift in China from a planned to a market economy under Deng Xiaoping and the dismantling of the "licence raj" in India starting in 1991 under the stewardship of then-Finance Minister Manmohan Singh. While for the Anglo-Saxon part of the developed world the shift of emphasis towards allowing private enterprise a free play in the economic system was by choice, for developing countries it was the consequence of the difficult circumstances with which some of them had to deal. This was certainly the case for India, which in 1991 faced its most serious economic crisis since it achieved independence in 1947. That notwithstanding, the men who guided India during this critical phase were trained in Britain and the United States. They were familiar with the debate in Anglo-Saxon economic circles and were attracted to the emerging philosophy that favoured pulling down the state from the commanding heights of the economy. They had studied the damage the prominent presence of the state had done to the Indian economy in the 40-year period between 1957 and the mid-1980s. For them, dismantling the "licence raj" was an important part of the reform programme.[10]

The approach that found favour with them was reflected in the development of *The Washington Consensus*, a set of policies advocated for or required of the emerging economies, depending on their circumstances. According to this, emerging economies needed to pull back the state in order to allow greater space to private enterprise and greater penetration by foreign entities into their economies. These objectives were to be achieved by allowing capital to flow relatively freely across national borders by lowering the walls of tariffs that were erected to protect domestic industry and services from foreign competition, by privatizing the assets held by the state, and by removing the constraints on private activity in the economy. This set of policies was called *The Washington Consensus* as they were developed by the economists working at such Washington-based institutions as the World Bank, the International Monetary Fund, the Inter-American Development Bank and the Institute of International Economics. Some of these institutions were able to go beyond simple advocacy in terms of selling this approach to emerging countries. They were able to do this by embedding them in the programmes of support that were developed for emerging economies in distress that turned to the international financial institutions for support. India was one such country. However, India, mostly for political reasons, did not go all the way. It did not entirely pull back the state, allowing several important parts of the economy to stay in the government's hands. This was particularly the case for the financial sector. The banks nationalized by Indira Gandhi in 1969 remained with the government even after the introduction of economic reforms. The reformists also found that they did not have the political muscle to do away with or even dilute the extremely restrictive labour laws that made it difficult for private enterprise managers to fire workers.

Two groups of countries in the emerging world came under the influence of the Washington-based institutions: several Latin American countries that faced serious debt crises in the late 1980s and late 1990s, and the "Tiger economies" of East Asia that found themselves suddenly vulnerable to the changing perceptions about their creditworthiness by private banks in developed countries. Both groups of countries were required to readjust government policies to more fully reflect *The Washington Consensus*.[11] However, the large Asian economies were mostly spared the need to undertake this massive readjustment in government policies. It is these countries that will come out stronger once the crisis of the Great Recession of 2008–09 is over and the world economy returns to a steady state.

The fervour with which this economic ideology was supported was replaced by an equally fervent condemnation. There is now consensus that the state has a large role to play in the management of the economy. Even if it is not placed at the economy's commanding heights, it must watch over it with great care and diligence. The countries that will do better in this respect are those that did not dismantle the state as an economic overseer, and most of those are in the emerging world. For this reason alone it is hard to accept the argument that the entire emerging world has been thrown back almost to the start of the economic race as a result of the economic crisis. Many countries in this part of the world will recover stronger than the weakened economies of the West. This will particularly be the case for the larger, continental economies of Asia. Why that is likely to be the case will be discussed in the concluding section of this chapter.

Is capitalism passé?

A debate is raging in many circles – among academics, policy-makers and policy analysts – about the future of capitalism. At the centre of this debate is the role of the state. This is how George F. Will, a syndicated American columnist, sums up the views of those who believe that we are witnessing a tectonic change in economic thinking as a result of the financial crisis: "Proponents of today's world-turned-upside-down economic policies say the policies may be wrong but are really boldly modern in their rejection of markets in favour of the pervasive government intervention in economic life. Hence, New York, which until eight months ago was the financial capital of the world, is no longer even the financial capital of the United States. Washington is."[12]

An opposing view articulated in an article by Ian Bremmer that appeared in early 2009 in *Foreign Affairs*, held that the state interventions that occurred at the start of the Obama presidency should be seen as aberrations. The line between the state and the market may have been blurred, but the state would eventually pull back since in economic matters, it is inherently incompetent. Once the crisis abates, the state will begin to look for the exit sign and an exit strategy. The state's record has not been an impressive one. State capitalism "has introduced massive inefficiencies into global markets and injected populist policies into economic decision-making", and, "deeper state intervention in an economy means that bureaucratic waste, inefficiency and corruption are more likely to hold back growth."[13]

"Some crises spread hysteria; some clear the mind and focus attention", wrote the *Financial Times* in an editorial published while the crisis was at its peak.[14] Which of these points of view are correct, which way is the global economy likely to go, and what will be the impact of the crises on the future of the emerging economies? In order to answer these questions, we may want to go back to the beginning and start with the definition of capitalism and what Adam Smith, the father of modern economics, thought about the role of the state in a capitalist system. What is capitalism and does its universal adoption as a way of conducting economic exchanges among various participants operating in the market place spell the "end of history"? The term, of course, is from Francis Fukuyama, who used it in the title of his bestselling book written and published soon after the collapse of the Soviet Union in 1991.[15] The end of European communism and the seeming triumph of capitalism had brought the history of ideological conflict to an end, he maintained. There was much to celebrate.

It would not do to look at Adam Smith's *The Wealth of Nations*, his best-known work, since the word "capitalism" is absent from the long book. Nonetheless, Smith is recognized not only as the father of modern economics but also the man who provided "capitalism" with its intellectual underpinnings. Some reference to his works is a good starting point to develop an understanding of the nature of the 2008–09 crisis and how it may affect the shape of things to come. Amartya Sen provided as good a definition of capitalism as any in an essay published in early 2009. "The standard definition seems to take reliance on markets for economic transactions as a necessary qualification for an economy to be seen as capitalist. In a similar way, dependence on the profit motive and on individual entitlements based on private ownership are seen as archetypal features of capitalism", he wrote.[16] This definition would be accepted by those who believe that the markets should be allowed to operate without too many constraints, as well as those who are of the view that the state should play a significant role in taming the wilder forces which unconstrained private initiative invariably unleashes. Where would Adam Smith find himself in this dispute?

If Smith is read at all, it is *The Wealth of Nations* that seems to draw the most attention of economists of many different persuasions. One of his most often-quoted sentences is the one pertaining to the importance of trust in economic transactions. "When the people of any particular country have such confidence in the fortune, probity and prudence of a particular banker, as to believe he is always ready to pay upon demand such of his promissory notes as are likely to be at any time presented to him, those notes come to have the same currency as gold and silver money, from the confidence that such money can any time be had for them." Trust, therefore, was the foundation on which capitalism was built. It was its loss that was the reason for the crisis that erupted suddenly but with great fury in the summer of 2008. The enormous expansion of the financial system by the incorporation of new instruments of such complexity that even experts were not able to comprehend them created opportunities that many people were not able to resist.

"Banking is an industry that failed", wrote *The Economist* in the opening paragraph of its special report on international banking published in May 2009. "Banks are meant to allocate capital to businesses and consumers efficiently; instead they ladled credit to anyone who wanted it. Banks are supposed to make money by skillfully managing the risk of transforming short-term debt into long-term loans; instead they were undone by it. They are supposed to expedite the flow of credit through economies; instead they ended up blocking it. The costs of this failure are massive."[17] There was also a massive loss of trust in the financial system of which Smith wrote so eloquently more than two centuries ago. The state can help restore confidence by putting in place a regulatory system that will be difficult to flaunt even by the most adventurous entrepreneurs. Had such a system existed, Bernie Madoff's scheme[18] would not have happened.

However, the role of the state goes beyond the regulation of the financial sector. All rich countries in the world and even those that are heading towards prosperity have been, for some time, dependent on transactions that occur outside the markets and in the domain of the state. These include unemployment benefits, social security and old-age pensions, public provision of school education and healthcare. Even those that relied more on the markets to supply some of these public goods are now turning to the state to provide them. If United States President Barack Obama succeeds in his designs, he is likely to get the American state involved much more profoundly in providing education and health to the people than was the case in the second half of the 20th century. If he succeeds, he will have reversed the trend that began with the Reagan presidency and continued under his successors, even the Democrat Bill Clinton.

According to the historian Paul Kennedy, "most sensible governments since Smith's time have taken precautions against the citizens' totally unrestricted pursuit of private advantage. States have invoked the needs of national security (therefore, you must protect certain industries, even if that is uneconomic), the desire for social stability (therefore, do not allow one percent of the population to own 99 percent of its wealth and thus provoke a civil riot), and the common sense of spending upon public goods (therefore, invest in highways, schools and fire brigades). In fact, with the exception of the few absurdly communist states such as North Korea, all of today's main political economies lie along a recognisable spectrum of more-free-market versus less-free-market arrangements".[19]

As capitalism came under pressure with the unfolding of the deep financial and economic crisis that began in 2007 in the United States, it was easy to overlook the contribution the system, in its various forms, had made to global prosperity. World GDP grew by 145 per cent from 1980 to 2007, or by roughly 3.4 per cent a year. Global health, as measured by life expectancy, also rose sharply, especially in poor countries; there was a closing of the life expectancy gap between the rich and poor nations. Even if global GDP declined by 10 per cent in 2008–10, an unlikely event, “the net growth in world GDP from 1980 to 2010 would amount to 120 percent, or about 2.7 percent a year increase over this 30-year period. This [would allow] real per capita incomes to rise by almost 40 percent even though the world population grew by roughly 1.6 percent a year over this period”.[20] Given what capitalism had accomplished since the Second World War, some economists were of the view that the policy-makers overreacted in America as well as in Western Europe. Two of these, both from Chicago University and one of them the winner of the 1993 Nobel Prize in Economics, were sceptical of some of the moves that were initiated by the young administration of President Obama. Wrote Gary Becker and Kevin Murphy, “Even though we had well-qualified policymakers, we have gone from error to error since 2007. The policies of the George W. Bush and Barack Obama administrations violate the ‘do no harm principle’ [of good economic policy-making] interventions by the United States Treasury in financial markets [since they] have added to uncertainty and slowed market responses that would help to stabilise and recapitalise the system […] Therefore, in devising reforms that aim to reduce the likelihood of future severe contractions, the accomplishments of capitalism should be appreciated. Governments should not so hamper markets that they are prevented from bringing rapid growth to the poor economies of Africa, Asia and elsewhere that had limited participation in the global economy”.[21]

This warning from several conservative economists notwithstanding, a consensus has emerged, according to which there has to be some rethinking about the nature of the relationship between the public and private sectors and the role of the state in economic management. A beginning was made in this direction by the G20, a group of large, developed and emerging markets. At the group’s meeting on 2 April 2009, the second in a series dealing with the crisis, then-Prime Minister Gordon Brown of the United Kingdom, who hosted the event, declared that the world’s economic leaders were burying *The Washington Consensus*. This was his shorthand for saying that the moment had arrived to redefine the role of the state. “The economic difficulties of today do not, I would argue, call for some ‘new capitalism’, but they do demand an open-minded understanding of older ideas about the reach and limits of the market economy”, Sen wrote (see note 16). The reference to the “older ideas”, of course, was to Smith, whose lesser-known work, *The Theory of Moral Sentiments*, investigated in some detail the powerful role of non-profit values. While stating that “prudence” was “of all virtues that which is most helpful to the individual”, Smith went on to argue that “humanity, justice, generosity and public spirit are the qualities most useful to others".[22] It is this part of Smith's work that those who pursued capitalism in its most naked form either did not know or did not fully understand. However, will balance be restored between the state and the market place as the lessons of the crisis are digested? Will one type of capitalism dominate the global system or will there still be many different interpretations, given the differences in the makeup of the societies and differences in historical experiences? Where will Asian capitalism fit into the evolving global system? In the context of the last question, is it even appropriate to speak of one Asian capitalism?

In theory – or at least the theory that came down from such founding fathers as Adam Smith and David Ricardo – capitalism was based on simple and easy to understand truths. Most of these concerned human behaviour. The role of the state was a derivative in the sense that those who defined it looked at how that behaviour helped others in society. It was inevitable that, based on these simple foundations, several different types of capitalist structures would get built. In the American system, as practised during the eight years of the Reagan presidency and as developed after he left office, the state was pushed back to the margins of the national economy. Greed became the main driver. However, even then those who minded the system were not able to dismantle the safety nets created by President Franklin Roosevelt's New Deal and President Lyndon B. Johnson's New Society programmes. When President George W. Bush tried to privatize the social security system, he discovered that the constituencies that supported them were far too powerful for him to overcome.

In the European system, Britain excepted, there was much greater emphasis placed on social justice. This was the other truth Smith had put forward in his lesser-known work mentioned above. Even in Britain there were some safety nets available in the sector of health, which the Americans had tried but failed to establish. Given the size of its economy and its ability to communicate more forcefully and effectively, the Americans were able to export some features of their system across the Atlantic. This was the case particularly in the sector of finance where the American type of risk taking and leveraging became the norm. Open markets led to the ability not only of good things going across borders, but also those that were less desirable.

Some aspects of the American system also went across to Asia. For instance, even though the Indian financial system was not well integrated with the structure of global finance, corporate governance allowed some of the more adventurous owners to take the types of risks that had become common in the United States. For instance, the owners and directors of Satyam, the information technology company that had a sterling reputation, were able to undertake the kind of practices and risks that had driven such large corporations as Enron and Worldcom into bankruptcy in the

United States. The Satyam crisis was a vivid reminder of the basic truth of capitalism – that unattended and untended human greed can take any entity, anywhere, towards antisocial behaviour. This is why, in the reaction to the economic and financial crisis of the early 2000s, much greater attention was given to the redefinition of the role of the state. The state became more actively involved not only in the management of the domestic economy but also in minding economic interactions among the states.

Is Asian capitalism really different from the type of economic system advocated by Smith? Is there an Asian exceptionalism akin to the one that the Americans focus on with respect to their country? There are several analysts who believe that this is indeed the case. One of the more notable among these is Kishore Mahbubani of Singapore, the author of an influential book on the subject.[23] While "neither China nor India has lost faith in capitalism, because both have elites who well remember living with the alternatives", Mahbubani wrote in an article in May 2009, "the desire for an orderly society is deeply ingrained in the psyche of all Asians, which helps explain why virtually all Asian states hesitated to copy America in deregulating their financial markets. Instinctively, they felt government supervision remained critical. This was equally true in India's democratic system and in China's Communist party system." However, a larger and more visible role for the state is not the only difference between the Asian and American interpretation of capitalism. Culture is also important in differentiating the Asian and American systems. "Asian culture has been honed by centuries of hard experience, which explains why Asians save more. All Asian societies have memories of turbulent times. They know from experience the importance of preparing for the bad days that will follow the good".[24]

There cannot be any doubt that after the near-death of American capitalism there will be a considerable amount of rethinking about the role of the state. The state will watch both domestic and global economic transactions. How that should be done is a question that will be debated within countries as well as in the numerous international forums that will be convened for the purpose. Some of these, the G20 for instance, have been tasked to come up with suggestions to redefine the role of the state. The two countries that will play an important role in changing the structure of global finance will both be Asian: China and India. However, the role of the state in these two large Asian economies has been very different.

The state's role in the Asian economies

In Asia, there have been not one but at least three models of the role of the state in economic management. There have been variations even within these three models. Starting in the continent's north-east, we have the model in which the state guided private enterprise while leaving a great deal of initiative in the hands of the private sector. This was done in full recognition of the fact that the private sector was more competent in directing capital to the most productive use. The capitalist system encouraged risk-taking, rewarding those who succeeded but punishing those who failed. That said, it was a slow process. The Asians in the north-east, starting with Japan, were in a hurry to catch up with the economies of the more developed West. They wanted to compress the period during which this transition could be made. There was also the belief, correct for those times, that the size of the markets needed by the private sector to develop could not be provided by domestic consumers, who were too poor to provide the scale needed by private enterprise to make investments that would produce high rates of return. Such markets would have to be found abroad. Combining the need for guidance by the state and developing external markets became the distinguishing features of the East Asian model. Its first successful operator was Japan's Ministry of International Trade and Investment, the MITI.

Japan's spectacular success encouraged the countries in its neighbourhood to go in the same direction. They followed Japan and developed an active state to propel their economies forward. Economic historians called the follow-the-leader approach the "flying geese" model, in which, according to one interpretation, the leading bird falls behind, giving the lead to those that are a little behind in the formation. However, even while following Japan, the state in countries such as South Korea, Taiwan, Hong Kong and Singapore had to create the human resources needed by modernizing economies. Accordingly, the state invested heavily in education, skills development and healthcare – the types of investments the Japanese had made in the period before the Second World War. This export-led, human development-focused model of accelerating the rate of growth and economic change, with the state playing an active role, worked for East Asia.

The Chinese had an example to follow when Deng Xiaoping turned his attention towards adopting some elements of capitalism to bring about economic modernization in his very poor but very large country. The development experiences of Japan and East Asia were well-known in Beijing. However, as the Chinese model evolved through much experimentation, one thing remained constant – the presence of a powerful state that more than directed the economy; it actively participated in the economy as the most important player. In looking at the Chinese approach to economic development and social change, what impresses is the pragmatism of the leaders who followed Mao Zedong. However, it must be recognized that without the contributions made by the much vilified Mao, China would not have achieved its own economic miracle. Mao forced social change on a very conservative and backward society. Although done at a tremendous human cost by the time Mao left the Chinese scene, the country's population was better educated and considerably healthier than was the case when the Communists took control of the Chinese state 30 years earlier. There was much experimentation on the way, some of which produced disastrous consequences – especially during the Great Leap Forward in the late 1950s and the Cultural Revolution in the late 1960s. Leaving ideology aside, Mao, like the leaders who guided East Asia's miracle economies, also wanted to compress history. Given the size of the country and its relative backwardness, Mao's task was considerably more difficult.

Deng was also a man in a great hurry; he, too, wished to compress history. His ascent to power, following the chaos during the "Gang of Four" period, resulted in a number of structural changes in the Chinese economy. Initially, the most significant of these was the end of the communalization of land ownership and the return of land to the peasantry. Unlike the Soviet Union, the Chinese had not destroyed individual farms; their privatization, therefore, could proceed smoothly. The transfer of land produced a quantum jump in agricultural productivity, in the total output of agriculture and in the income of the peasantry. The next question Deng and his reformist associates faced was channelling the increase in rural incomes. Pragmatism came into play once again. The government allowed the peasantry and rural communities to invest in what came to be known as "town and village enterprises" (TVEs). This was a uniquely Chinese form of asset ownership. The TVEs initially became active in small-scale manufacturing, transport and warehousing. They increased in scale once they were allowed to receive capital resources other than their own. Eventually, foreign investment was also allowed. Several large Chinese enterprises today have their origins in the TVEs.

The Indian model also evolved over time. The role the state plays today in the Indian economy is very different from the one given to it by Nehru in the period immediately following independence. Today's state is not as intrusive as it was in the early decades. While it has pulled back from the direct management of the economy, it remains engaged in some of the more important areas. A significant part of commercial finance remains in the hands of the state. While there have been important changes, one element remains strong in the Indian model. The direction the economy should take is determined by an open democratic process. It is not dictated by leadership groups as is the case in China and East Asia. The leaders can certainly influence but they cannot direct the extent of change. This is done democratically. India elected its 15th *Lok Sabha* (the lower house of the parliament), in May 2009, confirming the direction in which the Congress Party trinity – Indira Gandhi, her son Rahul Gandhi and Manmohan Singh – was taking the country. This was not the case in the elections of 2004, when a highly confident Bharatiya Janata Party (BJP, the Hindu nationalist party) was convinced that it would be rewarded for the "Shining India" it claimed to have produced, by the electorate. The BJP lost, giving way to rule by the Congress, which may well last for more than a decade.

What seemed to have pleased the voters in particular in 2009 was the way the Congress used the state to help the less advantaged people, the vast majority of the Indian population. The National Rural Employment Guarantee Scheme, a huge public works programme from which the government says 44 million families have benefited, was especially popular. A massive debt write-off scheme for 43 million farmers was also a vote-winner. This was an imaginative, as well as democratically rewarding, use of the state. If the Congress election manifesto is any indication of the role of the state, it appears unlikely that the public sector will pull back any further. The party totally rejected the "policy of blind privatization followed by the BJP led […] government". Had Western capitalism not been so thoroughly discredited by the crisis of 2008–09, and had *The Washington Consensus* not come to be regarded as passé, India may have pressed on with more economic realization. Now, in the current global economic environment, a move in that direction may not be politically feasible.

When some analysts speak or write about the dawn of the Asian century and the attractiveness of the model of capitalism that has worked so well for Asia, it is not clear which of the three models they have in mind – the East Asian, the Chinese or the Indian. Each, as discussed above, had the state play a very different role in economic matters. That said, one thing is clear – the state in the coming decades will have a much more active role in the management of both national and global economies. With the experience the Asians have gained in using the state, they have much to teach the world, and there is much that policy-makers around the globe could learn. To discuss this as well as the failure of the state in some of the large countries of Asia, we will undertake a detour into politics.

The state in China and India – the two rising stars of the global economy

There is debate in development circles, in economics as well as political science, as to which of the two systems operating in the world's most populous countries with billion-plus populations will succeed in producing the next economic superpower. The Indians are confident that they have the better system, based on democracy and an increasingly decentralized system of governance. Former United States President Clinton seems to agree. In 1997 he told Jiang Zemin, then President of China, that his country's authoritarian and highly centralized system "was on the wrong side of history". The Chinese seem not to have been persuaded and their confidence increased as the country's economy began to bounce back from the severe economic crisis of 2008–09 much more quickly than the world's other major economies. Even the loss of jobs for 20 million workers, most of them immigrants from the countryside, did not produce the kind of discontent the country saw in 1989 with the eruption in Tiananmen Square.

The apologetic tone that leaders once adopted on political issues was replaced by more confident claims about the benefits of the Chinese model. Zhou Xiaochuan, head of the central bank, said in May 2009 that given the indications that the country was recovering from the crisis faster than other large economies, China had demonstrated its "superior system" when it came to making important decisions. In fact, some analysts believe that the "fate of the Communist party – whether it maintains its tight grip on power or is forced to give way to more democratic forms of government – will be the defining moment of the century".[25] The Chinese, unlike the Communist Party of the Soviet Union, have gone in for a significant amount of political engineering to keep their party current with the developments taking place in the country. "The lesson from the Soviet experience is clear: adapt and change or atrophy and die. The Chinese Communist Party (CCP) has clearly chosen the former option", wrote David Shambough, the American scholar of modern China in his most recent book.[26] In adapting and remaining relevant, the party leaders borrowed freely from modern and Western management practices. "Training of officials has been improved, including the opening of MBA-style colleges for party members. The CCP's all powerful personnel department has imposed rotation of officials to reduce the scope for corruption and broaden experience, as well as enforcing retirement for older officials. In 2007 alone, about 200,000 local government officials changed positions".[27] The main idea behind all this is to make the one-party system more effective.

Another lesson the Chinese have learnt from the experience of the Soviet Union is not to leave senior leaders in place for an indeterminate time. Since Deng, they have strictly followed the party's and country's Constitution by not allowing the top leadership to serve for more than 10 years and to carefully plan for transition. Hu Jintao was identified as the leader several years before he took office. Similarly, his and his prime minister's successors seem to have been identified. In 2012 Xi Jiping is expected to take over as president and Li Keqiang as prime minister, succeeding Wen Jiabao. The real challenge may lie ahead. A prosperous population may seek greater political participation. There is a belief among some political scientists who have studied political modernization in developing countries that pressure for democracy begins to build up when per capita incomes approach the level of US$5,000–$6,000. This is where China is now in terms of purchasing power parity, although in conventional accounting terms its income is still half of that. The succession in 2002 was relatively smooth and free of acrimony, but its institutional base, unlike the one that brings about leadership change smoothly in India, was weak.

The Indian system, being truly democratic, shows all the chaotic manifestations typical of that system of governance. That said, what the nation has achieved is unique in developing countries with large populations. It has not only maintained a democratic system but also developed it to accommodate the changes that the society has experienced since the adoption of the Constitution in 1950. As discussed in the previous section, the Indians have used the state in economic matters in ways very different from China and East Asia. Also different is the development of regional politics in India, which has been able to accommodate differences within the established, but malleable, political framework. This has been a dominant theme in the analysis of Indian politics. Some pundits see an end to this trend. "They argue that Indian voters, showing unsuspected perspicacity, have recognised the need for stable central governments".[28]

Cases of state failure in Asia

The previous three examples – East Asia, China and India – are of the successful development of political institutions that created a functioning and effective state. Without a reasonably efficient state, these three parts of Asia would not have written the narratives of economic success. However, right next to these successful examples of statecraft are those of the failure or near-failure of the state. The most glaring example of state failure is Afghanistan, which has not been able to put together a political system that can help the state perform some of its basic functions. These include ensuring security of life and property of citizens, protecting the territory from foreign intrusion, and meeting the people's basic needs. Some of those who have studied the country suggest that it has never really been a functioning state, but a collection of autonomous regions in which the central government is allowed only a very limited amount of authority. Some external powers tried to impose order on this highly fragmented political system. The British tried it in the second half of the 19th century. The Soviet Union attempted it in the 1980s, but ended up suffering a major military defeat and withdrawing from the country. This was also the intention of the United States after it invaded the country in 2001. However, President Obama, after assuming the American presidency in January 2009, indicated that his Administration would follow a very limited agenda in Afghanistan. It would not attempt nation-building, but would limit its involvement in order to achieve the total defeat of al-Qaeda.

While the failure of the state is complete in Afghanistan, in a number of other places in South Asia the state is trying to find a firm footing. Across the border in Pakistan both the nation and the state are struggling to be born. Pakistan's failure to create a nation based on religion out of a number of diverse people has not worked.[29] Muhammad Ali Jinnah's two nations theory on the basis of which Pakistan was created as a separate homeland for the Muslim community of British India, was tested within a few years of the founding of the state. In January 1972, less than a quarter century after the birth of the original Pakistan, the country's eastern wing parted company and became the independent state of Bangladesh. What was left of Pakistan was at least geographically contiguous, but even then a nation and a state were not created. This was in part because the Pakistani people have found it difficult to find a basis for nationhood. This is an interesting phenomenon deserving of both deep analysis and explanation. If Pakistan was founded on the basis of an unworkable proposition, it is not unique among the world's 200 or so states. Many of them exist as a result of colonial legacy; for them the colonial rulers simply drew lines on the map which cut across well-defined ethnic communities and cultures. One reason why Pakistan still cannot be declared a success is that having been created on the basis of an idea – that the people belonging to one religious identity should have their own political space – it was required to demonstrate that the idea was workable. Israel, the only other country created on a similar idea, is going through a similar struggle.

A strong Pakistani state could have brought stability to the country. Pakistan could have followed the East Asian model of creating a nation on the basis of a fulfilled promise to deliver economic benefits to the citizenry. This was done not only in the miracle economies of East Asia but also in China. The Chinese leadership is always anxious to keep the economy expanding at a rapid rate so that the rewards of growth are available to at least most, if not all, segments of the population. The pursuit of economic growth as a nation-building objective was pursued explicitly by President Ayub Khan in the 1960s and Pervez Musharraf implicitly in the early 2000s. In his autobiography, published after a decade of rule, Pakistan's first military ruler indicated that his main reason for throwing out the civilians was their failure to adequately develop the economy.[30] This conclusion was also reached by several prominent development economists of the day, in particular Gunar Myrdal of Sweden. In his seminal work, *The Asian Drama*, Myrdal developed the concept of the "soft state". This, he thought, was the state that did not have the will or the political muscle to bring about the structural changes in the economy and society, without which sustained economic development could not take place. The countries in South Asia had such soft states under the influence of vested interests that did not permit the structural transformation of these countries.[31] President Khan drew comfort from such findings by prominent academicians. They gave him and his form of government – he called it "basic democracy" – legitimacy.

President Musharraf also wrote his biography when he was confident that his rule had brought economic growth and stability to the country.[32] Both Khan and Musharraf lost power two years after the publication of their autobiographies. The obvious conclusion is not that military rulers should not write their memoirs. What their separate experiences demonstrate is that high rates of economic growth cannot be sustained unless two requirements are met. One, the working of the state must draw strength from institutions that will remain in place over time. These institutions need not be based in democratic structures; they can be part of semi-democratic (or semi-authoritarian) structures, as was the case in all four miracle economies of Asia, or as is the case in China. However, they must have a reasonable amount of political longevity. Two, the system must permit the citizenry a voice. As the economist Albert O. Hirschman pointed out in one of his important works on development, not allowed a voice, those who are unhappy will either exit the system or bring it down.[33] Popular discontent brought down the two leaders, the first by street agitation and the second by the electorate process.

Bangladesh is the third example of the weakness of the state and its consequences for sustainable economic progress. Although the country has done reasonably well – the rate of GDP growth has averaged five per cent a year over the last decade and income per head of the population has increased at a respectable rate of 3.5 per cent per annum – there is considerable uncertainty about the future. Some Bangladeshi analysts suggest that the country has still to come to terms with its identity – is it a state created on the basis of ethnicity and culture or on the basis of religion? There are obvious problems with both suggestions. If the common element is ethnicity, then there are a lot of Bengalis living outside the country, especially in the Indian state of West Bengal. If religion is the common element, then why did the country seek separation from Pakistan? It is the resolution of this tension (or the lack thereof) that has kept the country from developing a viable system of governance. The military has intervened occasionally, as it has in Pakistan, ostensibly to help with the process of nation-building. Its most recent intervention was in 2007 when, working largely behind the scenes, it put the country in the hands of a caretaker administration that governed for two years before supervising another general election. Before opting for the electoral route, the caretakers attempted some political engineering of their own. They tried to put forward the "minus-two" formula which would have removed the two previous prime ministers, Sheikh

Hasina Wazed and Khaleda Zia, as political contenders. Musharraf had tried a similar approach in his own country by having the parliament adopt the 17th amendment to the Constitution to effectively bar the two prime ministers who had dominated the 1990s, the decade that saw a great deal of political uncertainty.

The conclusion to be drawn from this brief analysis of the failure to create a functioning and effective state is that for South Asia, to carve out a reasonable amount of economic space for itself in the emerging global order, it must first create within all countries in the region political systems that work. India may be tempted to go it alone, but I would suggest this will not be possible as it will get constantly distracted by instability somewhere around its periphery. Also, as suggested in a later chapter, India has contributed to perpetuating some instability in the region. It must actively participate in creating the conditions that will address these issues.

The Asian state and economic management

The point of this detour into politics is to suggest that for the Asian model of economic governance to work for other parts of the developing world, Asia will have to first deal with some of the countries that have lagged behind in nation-building. There are a number of countries in the region that have to first demonstrate that the near-failure experienced by their state was an aberration from the course taken by the continent's more successful members. This is needed not only to indicate that the various models of statecraft can work for some of the sick nations in the continent as well, but also two other reasons. One, the success of an approach is contingent upon its ability to deal with aberrant behaviour. Two, even more important, what Smith said a couple of centuries ago still holds true: he laid emphasis on trade as an engine of economic growth as well as in bringing about social transformation. However, trade will only play this role if Asians are able to resolve a number of outstanding intra-state as well as inter-state disputes.

Smith also said that prudence is "of all virtues that which is most useful to the individual", and, by extension, to the society of which he is a part. This is where culture enters the picture. Although some Asians like to gamble, Macau now houses the world's largest casino and Singapore has built two, they seem to indulge in this activity with some restraint. This restraint is reflected in the making of public policy. In the United States speculation has entered economics, adding another element to the inventory cycle that was supposed to be the main reason for the ups and downs in the capitalist economies that appeared with almost predictable frequency. This was noted by a chastened Alan Greenspan as he reflected on the most recent economic and financial crisis of 2008–09. "Free market capitalism has emerged from the battle of ideas as the most effective means to maximise material well-being but it has also been periodically derailed by asset-price bubbles and rare but devastating economic collapse that engendered widespread misery. Bubbles seem to require prolonged periods of prosperity, damped inflation and low long-term interest rates. Euphoria-driven bubbles do not arise in inflation-racked or unsuccessful economies […] Once a bubble emerges out of an exceptionally positive economic environment, an inbred propensity of human nature fosters speculative fever that builds on itself, seeking new unexplored, leveraged areas of profit".[34] The Asian cultures and, therefore, the Asian economies seem less prone to these kinds of speculative bubbles. Even if there was a tendency to go in that direction, the state seems to have the will to correct the move. The only time the state failed to do that produced the Asian Financial Crisis of 1996–97. However, this crisis was largely the result of exposure to Western financial institutions that suddenly withdrew from countries such as South Korea, Indonesia and Malaysia.

Where the Asian state works – as it does in the miracle economies of East Asia, China and India – it has demonstrated its ability to deliver economic growth, human development and better distribution of incomes among different segments of the population and different regions of the concerned country. Where the state has not been fully effective, it has still delivered growth but has not been able to ensure equality and human development for the entire population. Where the state has failed, is failing, or has done poorly in delivering to the people what is expected of the state – which is the case in much of South Asia, not including India – the state's poor performance is the result of poor political development. Therefore, much work remains to be done in South Asia before the state becomes an effective instrument for bringing about economic and social change.

The state has done particularly well in East Asia in one area of political and two areas of economic activity. In politics, various institutions of cooperation that the countries have put in place have minimized inter-state disputes. In the area of economics, the East Asians have done well in handling financial crises that went beyond national boundaries and in creating the framework within which inter-regional trade can be promoted. Both functions are critically important for the future of the global economy. For the current century to become the Asian century, the countries of the region will have to show the rest of the world that what they have done with the state in these two areas can also be done globally with the right choice of public policies and with the establishment and development of the right set of institutions. For several months and years ahead, as the debate on the restructuring of the global economic system proceeds, the large countries of Asia which have been invited to participate in various international forums, will be called upon to show why some of the Asian policies and practices have worked within the broad capitalist framework. In most areas of regional cooperation, much of the advance occurred in moments of crises. This was the case with the launch and evolution of the Association of Southeast Asian Nations (ASEAN) and with the adoption of economic policies which, by creating large national foreign exchange reserves, were able to protect the region from *some* shocks in the global financial system. While this debate occurs, the Asians will need to keep on moving in the area on inter-state cooperation, particularly in trade. As will be discussed in a later chapter, there is still a great deal of hard work to be done to develop a regional trading system in South Asia and also to link the systems in East Asia and South Asia into one pan-Asian enterprise. As Mahbubani wrote in the article mentioned earlier, “recent history has taught Asians a valuable lesson: more trade leads to greater prosperity. In the Asian way – two steps forward, one step back – trade barriers will gradually come down. By the middle of the twenty-first century, intra-Asian trade will far surpass that of any other region”.[35]

Conclusion

What, then, is the Asian model of the state for managing the national economy? Can this model be used to improve the structures of cooperation among economies? Could the Asian model be exported to the rest of the world as it deals with the worst economic and financial crisis since the Great Depression of the 1930s? The model has many features, some of which are also relevant for the economies of the West. The first is that the state remains active regardless of the level of development. The state’s functions continue to evolve with the evolution of the economy. In the initial stages of development the state guides private enterprise in the use of capital. Not only that, it also helps with the distribution of capital by directing, but not owning, the banks. For more mature economies, although the allocation of capital is left to the market, the state keeps a sharp eye on its use and distribution. For this, it needs a regulatory system that is transparent and works according to a well-defined system of law.

Second, recognizing that cultures play an important role in the accumulation of capital and its use, the state inculcates – through the education system in particular but also through the systems of communications and entertainment – habits of prudence and thrift. This has been done to a limited extent in Europe, but has been largely ignored in America. Third, the state helps to expand the market by taking an active role in international trade. Given the layering of the international trading system with the evolution of regional arrangements, the state must simultaneously work on regional agreements as well as in fine-tuning the multilateral trading structure. This role is particularly important in South Asia, one of the regions that has lagged behind in integrating itself in the global trading system. Much of the responsibility for the creation of regional arrangements rests on the largest economy of the area. In that context, India will have to be an active player in developing a workable, stable and effective regional trading arrangement in South Asia. This is a recurrent theme of this book.

Fourth, the state must take an active interest in human development, a role played well by the governments in East Asia even when they were pursuing different ideologies. There is now a growing recognition in the United States – this was an important plank in the manifesto of President Obama – that the American state has underinvested in educating the population and giving it the skills it needs to participate in a modern economy. Fifth, the state must protect and provide for the poor. This not only needs safety nets that come into play during periods of economic stress, but a permanent set of institutions to provide basic needs to all segments of the population. This function cannot be left to the markets. This is what distinguishes European capitalism from the American variety.

Sixth, and finally, the state must develop the skills and aptitude to work with other states in the region and in the world. At the same time, the global community has to develop institutions that allow full participation to all parts of the world. A United Nations-type system of one state, one vote is not practical to oversee the working of the global economy. Equally, the system that has kept policy-making power with the economies that were once large and dominant is not practical either. With the "rise of the rest", there has to be much greater accommodation for several emerging economies. The system that worked well for a few decades after the end of the Second World War needs to be reformed in a fundamental way. Tinkering with the established order will not work to deal with the economic and financial crisis the world faces in the 21st century.

4 History's many burdens

Introduction

Most regions carry the weight of history. For many of them the weight is heavy. In this respect South Asia is not all that much different from many other parts of the world. The only difference is that while other regions have been able to find ways to cast off these burdens, South Asia still carries them as it enters the 21st century. This is unfortunate since this is likely to be a century of change with significant realignments among the world's large economies. A recurrent theme of this work is that for South Asia to gain a position in the fast changing global system it will have to resolve some of the many inter-country conflicts that have bedevilled the region for so long. How several other world regions managed to cast off the burdens of history has lessons for South Asia.

Since a great deal can be written – in fact has been written – on the subject of persistent inter-country conflicts in South Asia, I will treat this subject only sparingly in this chapter, but from a very different angle. My preference is to call this subject the burden of history. I call it a burden since it is my view that the weight the South Asians have carried for decades needs to be lifted if the region is to realize its considerable economic potential. One important point to be made in this context is that the purpose of delving into history a bit is not to open old wounds. In the past South Asian countries have shown considerable suspicion in dealing with one another. The reason why that has happened is that the past is interpreted by each country from its own perspective. The South Asians are like the various players in the Japanese drama Rashoman, where several people see the same crime committed but tell it from their own perspective. There is a great need for the countries to develop a common narrative. This work is a modest attempt to tell the South Asian story in a way that should be acceptable to all those who took part in it.

The discussion that follows is presented in several sections. We open the subject by providing a brief overview of how both in the distant past as well as in the more recent present, complex societies have managed to shed their differences and work together for the common good of the citizenry. Sometimes this happened because enlightened leaders emerged simultaneously in different places and were able to look beyond the past and convince their people that working with their neighbours would lead to greater rewards than labouring against them. Sometimes the impulse for integration was generated by the realization that past conflicts had been extremely costly and continuing them was not in anybody's interest. In the second section I will suggest that a great deal has gone wrong in the South Asian region because of the way India and Pakistan regard each other, and the near-paranoia about each country's perceived intentions with regard to the other has cost the area a great deal in terms of lost opportunities. These "what if…" exercises – what would have happened had the countries behaved differently towards each other, for instance – are hard to quantify.[1] However, based on some of my earlier work along these lines concerning the cost to Pakistan of the Kashmir dispute, it would not be an exaggeration to suggest that had India and Pakistan not been so much obsessed with each other and had they not consumed so much public resource on defence, their combined gross domestic product (GDP) might have increased by as much as two percentage points each year.[2] Compounded over so many years, this is not a trivial amount. But for the concentration of so much energy against each other, India and Pakistan today would have much larger economies, much higher income per capita and far fewer people living in absolute poverty. It appears that India is breaking out of this mould and Pakistan may be similarly disposed, but the two countries are doing this for different reasons. For India, continuing obsession with Pakistan is costing it a more prominent place in the global economy and the evolving international political system. For Pakistan the realization appears to have finally come that the country's real enemy is within its borders. Its fixation on India has already encouraged the development of the *jihadist* culture among some segments of the country's population. If this reading is correct, the economic rewards will come sooner for India than for Pakistan, since the latter will remain engaged with the internal enemies for quite a while.

Although economists have ignored the dividend of regional peace in identifying the determinants of growth for the "miracle economies" of East Asia, the fact remains that the absence of inter-country conflict in this area was an important contributor to economic growth. This too could happen in South Asia if the various conflicts that have persisted in this area were resolved. Among them also is the long-enduring suspicion between Afghanistan and Pakistan. This is the subject of the chapter's third section. India also became a participant in this game, complicating the relationship between Kabul and

Islamabad. However, change may also be coming here for the reasons I will discuss in that section.

There are other intra-regional conflicts that need to be tackled as well. The third one I will spend some time on – in the chapter's fourth section – involves Bangladesh, India and Pakistan. Some analysts believe that both China and Myanmar may have entered the picture as well, while Pakistan is now only a marginal player. However, the source of this regional conflict was the inability of the leadership groups in what was then West Pakistan to absorb East Pakistan as an equal participant in the economic and political structures that were then being built. This led to a conflict between the two groups which eventually led to a civil war between the regular army from West Pakistan and Bangladeshi freedom fighters. Bangladesh rightly calls this conflict its War of Independence. Nevertheless, the fact remains that Bangladesh would not have gained independence that quickly had India not intervened on its side of the dispute. With India having midwifed the birth of Bangladesh, it should have been expected that the two countries would have developed a close relationship. That has not happened. There are a number of disputes between the two countries over matters such as water rights, sale of Bangladeshi natural gas to India and the question of transit rights through each other's territory, which have kept the two countries apart.

Following the three sections on particular inter-country conflicts, I will turn to the area where each of the mainland South Asian countries has essentially adopted a mercantilist approach. This concerns the grant of transit rights to one another, allowing the passage of goods and commodities originating in one country for the markets of the third by first passing through the territory of the second. If guilt is to be assigned it can be equally shared by the three mainland countries – Bangladesh, India and Pakistan. Opening one's territory for commercial use by the neighbours is perhaps the best way of demonstrating why working together, rather than against one another, could have such high rewards for South Asia.

The sixth and the final section in the chapter looks at the recent statement issued by the prime ministers of India and Pakistan when they met in the summer of 2009 at the Egyptian resort of Sharm-el-Sheikh to restart the process of confidence building that was interrupted by the terrorist attacks in Mumbai in November 2007. Has South Asia turned the corner and should there be some hope that this small, tentative move may prove to be a giant step in creating a new South Asian entity?

How several world regions cast off the burdens of history

The Europeans, after having fought many wars over many decades, have reconciled themselves to a future in which narrow national interests have little space within which to work their mischief. The idea of European integration has been fully embraced. The geographic space occupied by a political entity called the European Union (EU) has been expanding not by conquest but by the willing, in fact, the eagerly sought entry of new nations. The EU now has 27 states as its members. There have been many setbacks in moving towards a better-defined "United States of Europe", including the attempt to provide the Union with a constitution. The first attempt failed when some of the member states did not ratify the draft when people were asked to vote for it in referendums, but it should be recognized that attempts for reconciliation among people who have borne grudges for long periods of time will not proceed smoothly all along the way. These attempts will hit rough patches, as the northern and southern states in America did in the middle of the 19th century. The American Civil War was a particularly vicious affair, but when it was won by the north, the Union was saved. In the early summer of 2010, the Greek financial crisis brought about by that county's profligate ways put an enormous amount of pressure on the EU. This will undoubtedly have profound implications for the future of the European experiment.

The United States of America is another successful enterprise at bringing diverse people together within one political framework. The United States is one of the world's oldest democracies, in the sense that a representative form of government has existed for more than two centuries. It functions according to a Constitution that has been amended only 26 times. The Constitution's interpretation by the Supreme Court has kept it current, which is one reason why any new appointment to the nine-member Court so convulses society. Much rides on the composition of the Court for the country's move forward economically, socially and politically.[3]

As already discussed, less than a century after the founding of the United States, the Union was threatened by secessionist forces that sought separation on the basis of differences with respect to slavery. The conflict pitted the rural south with a plantation-based economy against the rapidly urbanizing north with a developing manufacturing base. However, the struggle was more than about slavery; there were serious differences involving economic interests.[4] The preservation of the American Union was made possible by the spilling of a great deal of blood. The Confederacy of the southern states was defeated by the Union army in a civil war that cost hundreds of thousands of lives. In a world that has known many conflicts, this was one of the bloodiest. It was launched and won by President Abraham Lincoln, who was gunned down by an individual unhappy with his policies and the war's outcome. While a significant number of Americans may not have appreciated the way Lincoln handled the crisis, he remains America's most popular and revered president.

Some other world regions have also bonded diverse people together into large federal systems. Australia in the southern hemisphere and Canada just north of the United States were able to keep together fairly different peoples within well-defined political unions. Both were new countries founded by settlers from Europe. They were able to overcome the differences they had among themselves and managed to coalesce into political unions. China and Russia, two other large countries, were always large and were always inhabited by people who basically shared the same culture, religion and social norms, but not necessarily the same history. There were uprisings in these countries by those who were unhappy with their situation. This was particularly the case in China, where the ruler and the ruling elite had to deal with peasant uprisings which were put down sometimes with the use of great force. In these and many other countries the desire to live together overcame any tendency towards going separate ways.

In more recent history, South Africa is an example of a country that has successfully dealt with a very heavy burden of history. It took an exceptionally charismatic leader with an extraordinary character and ability to forgive and forget the past to brought about the smooth transition of the country from white to black rule. Nelson Mandela was as critical for nation-building in South Africa as was Abraham Lincoln more than 100 years ago for his country.[5]

South Asia, however, has been different. Even in modern times, it has had to deal with separatist forces, two of which succeeded in creating separate states for what were regarded separate people. The first such fission occurred in 1947, as Britain was winding up its Indian empire and leaving the reins of government in the hands of not one, but two successor governments. Pakistan was carved out of British India to accommodate the people who thought themselves separate from the majority. The Muslims of India succeeded in creating a state for themselves with two "wings", one on either side of the large Indian body. The state of Pakistan did not survive in its original form and in December 1971, less than a quarter century after the partition of British India, the state of Pakistan was partitioned to create Bangladesh and today's Pakistan. There are some serious analysts who believe that the present state of Pakistan will not survive in its present form and that it currently faces an existential threat in the form of the rise of Islamist extremism, as well as separatist movements in the ever-restive province of Balochistan. Separatists have for decades waged a low-level revolt, eyeing a bigger share in income from the province's natural resources, but the "violence appears to be its most intense since the early 1970s…"[6]

South Asia has other problems as well. In the south, the Tamils fought for autonomy – or for a state of their own – in the northern corner of Sri Lanka.

After a struggle that cost 100,000 lives over a period of 26 years, including that of the leader of the revolt, the Tamil struggle seems to have ended as the Sri Lankan military advanced into the areas that had become the preserve of the separatists. However, the problem remained, since the Sri Lankan leaders, led by President Mahinda Rajapaksa, have not shown much willingness to find a place for the Tamils in the country's political and economic systems. Once again, history had a role to play with the Tamils looking at their past – most of the Tamil population traces its origins to the waves of migrants from India's south to Sri Lanka – to follow a course different from the one that the majority Sinhalese wished to take. Conflict on ethnic grounds is not confined to Sri Lanka in South Asia, however. India has been dealing with the forces of separatism in its north-eastern part, as several hill tribes refuse to accept the rule of a centralized state. There are Maoist guerrillas operating in the forests of central India that the state has not been able to subdue. Acts of violence against the state continued in 2010, with Maoists killing 67 members of the Indian security forces in March of that year. In mid-May they beheaded six villagers picked up from the depths of the forest on charges that they were spying for the government. In the same month the guerrillas killed 50 people by blowing up a bus with an improvised explosive device. Seventeen of the dead were members of the security forces. On 19 May P. Chidambaram, the minister of home affairs, offered to talk to the insurgents if they ceased their operations for 72 hours; the offer went unheeded.

History was also the reason why India departed from the original intention of the fathers of the country's Constitution, to create a unitary form of government in which most of the power resided with the central government. This proved to be difficult given the grievances nurtured over centuries by one set of people against another, which could only be kept under control by allowing the states considerable autonomy to govern. For several decades now, the evolution of the Indian political system has taken the country towards what national analysts call "regionalism", but what in other large federal systems would be called the "fight for state rights". The elections of April–May 2009 proved to be a triumph for the Congress party, one of the two parties that have a national presence. Even then, the Congress was not able to win the majority of seats in the *Lok Sabha*, the lower house of the Indian parliament. That said, the fear that a dozen or so regional parties would be able to obtain a larger slice of representation for themselves in the *Lok Sabha* did not happen and the move towards the further weakening of the Indian state did not materialize.

The persistence of these tensions in the societies of South Asia will get in the way of the creation of a larger South Asian economic entity. They will have to be overcome before South Asia can begin to move towards the successful regional integration that is required in order for the region to take advantage of the many changes that are taking place in the global economy and in the international trading system. It could be argued that India is large enough to go it alone; it can afford to ignore the countries around its periphery; it could leap-frog over its boundary and cultivate strong relationships with the large economies in different parts of the world. To some extent, this has been the trend in the shaping of India's foreign relations.[7] In August 2009 India concluded a free trade agreement with the Association of Southeast Asian Nations (ASEAN), thus ignoring its immediate neighbourhood and reaching out to distant places. Even for India, however, it would be more productive to work first with neighbours and create a strong regional South Asian entity before venturing farther afield. That is the course on which other parts of the world are embarked. Even the United States, still the largest economy in the world and one that could ignore the rest, has found it useful to create the North America Free Trade Area (NAFTA), involving its two immediate neighbours, Canada and Mexico. However, before the South Asians can move in that direction, they must cast off the burden of history that has left them with so many unresolved territorial issues.

This focus on history is not to suggest that perceived wrongs in the past can somehow be corrected. The attention given to history in this work is for a different purpose. It is to underscore that the way a nation reads its history forms attitudes that are hard to shake. A reference to past conflicts – how they came about and how they continue to affect relations among states – is appropriate in a work such as this, which focuses on public policy. In suggesting a course of action that may be different from those being pursued by the policymakers, it may be useful to underscore that the preferred options may not be the more appropriate ones given the changes in the global economic and political order. More often than not, these options are based on the notions cultivated by a particular reading of history.

Of the many conflicts that have shaped the history of South Asia, Pakistan occupies a central place in three of them – the long-enduring conflict with India, the equally long and sharp conflict with Afghanistan, and the tensions that led to the creation of Bangladesh as a separate state. This is not to say that Pakistan has a special propensity to make trouble in its neighbourhood or that the people of Pakistan find it difficult to work with those from different cultural and ethnic backgrounds. The reason perhaps lies in the circumstances of the country's birth. Pakistan was carved out of a functioning state. It had, therefore, to justify its existence to those who were not particularly supportive of the idea of creating a state based on religion. Even more than 60 years after its birth, the logic used for Pakistan's creation continues to inform its relations not only with India but also with

Afghanistan. Surprisingly, this logic also continues to shape the nature of politics in Bangladesh.

In three other conflicts, India has been a central player. These concern relations with Bangladesh, Nepal and Sri Lanka. However, we will confine our discussion to the conflicts involving Pakistan, since these will have more profound implications for South Asia's economic and political development.

The India–Pakistan conflict

To understand why India and Pakistan have remained locked in an exceptionally bitter conflict for so long, it is instructive to go to the beginning of time for these two separate political entities. In fact, full understanding requires even going back to an earlier period – perhaps to the time when Islam entered South Asia, or to the time when the Indian independence movement against the rule by the British picked up momentum. For a work such as this, though, a shorter historical perspective based on economics and not on politics, culture and religion would be more appropriate. It would be mostly – but not entirely – economic imperatives that would bring together the countries of South Asia into some kind of workable regional arrangement. Also, by focusing on economics we will be able to demonstrate how political decisions that nations take which affect each other have many unintended consequences. That has certainly been the case for India and Pakistan and the relations between them.

The first generation of leaders of independent India was forced to get engaged in not one – against the colonial masters – but two conflicts. The second was against the Muslim separatists. Their leader, Muhammad Ali Jinnah, and his party, the All India Muslim League, had persuaded the majority of Indian Muslims that it was in their interest to carve out a separate homeland for themselves. Pakistan was the result. Even though the Congress party finally agreed to the creation of Pakistan, many of its leaders were not convinced that the country Jinnah had created was economically viable.[8] This was certainly the case with Jawaharlal Nehru, who was, after Gandhi, the most influential leader within the Congress community. Some of these leaders believed that the separatist Muslims would return to the Indian union after a few years, once they had realized the folly of their initial move. What Nehru thought about the economic prospects of the state of Pakistan mattered since he was to govern India for 17 years as its prime minister. Some of his earlier moves with reference to Pakistan seem to have been aimed at bringing closer the moment when Pakistan would return to the Indian fold.

The first of these moves came a few months after the departure of the British from India. The British had left a pot of money behind, some of it as compensation for the contribution their Indian domain had made to the war effort. They were called the "Sterling balances" and they were to be divided between India and Pakistan according to a formula agreed between the two sides. Independent India inherited a functioning state with a functioning system of government finance and accounting; Pakistan was an entirely new political, economic and financial entity. Everything had to be developed from scratch. Compounding the problem for the new managers of new Pakistan was the arrival of 8 million refugees from India. India had also received its share of people displaced by partition, but the proportion of refugees from Pakistan in India's population was much smaller than was the case with Pakistan. For India, a much larger country, the proportion was only 8 per cent.

A few months after the country achieved independence, the refugees from India constituted one-quarter of Pakistan's population. The sudden arrival of refugees in Pakistan constituted the largest concentration of refugees in a population in recorded human history. Pakistan needed money in its coffers to build a new state and to settle this vast army of refugees. One source of this money could be the Sterling balances left by the British, but to Pakistan's horror Nehru refused to release the funds. Even Gandhi was troubled by the move by Nehru, calling it India's moral duty to stand by the agreement it had signed as one of the "transfer of power" documents related to the partition.[9] Before India agreed to release the money due to Pakistan, Liaquat Ali Khan and Ghulam Muhammad, Pakistan's prime minister and minister of finance, respectively, had to travel to New Delhi to plead their case.[10] This incident and the two others that followed convinced the first generation of leaders of Pakistan that they had to work hard to create an economic entity in their country which was not dependent on India. This line of thinking was to profoundly affect the development of the Pakistani economy and its structure.

The second conflict arose soon after the first one was resolved. This concerned the division of the waters of the Indian river system. The way the line of partition was drawn by the British in the province of the Punjab, the head-works that controlled the flow of water into Pakistan remained with India. This meant that the Indians had the ability to cut off the supply of water to Pakistan. To avoid this happening the two countries signed a "standstill" agreement in 1948 that provided for the maintenance of the status quo. In the period between 1949 and 1950, it seemed to Pakistan that India was violating the agreement. Very briefly, India stopped the flow of water into the Upper Bari Doab Canal on which the city of Lahore and its hinterland depended. Liaquat Ali Khan was so provoked by the perceived Indian acts as to go to the balcony of his house in Karachi, Pakistan's first capital, and wave his fist at New Delhi, threatening war if India did not desist from diverting water for its own use. It took a decade to resolve this issue and needed the involvement of the World Bank and the expenditure of more than US$130 billion in today's prices before the two sides had a system that worked to their satisfaction.[11] This was a very large amount of money which could only be mobilized by the engagement of an institution such as the World Bank in the enterprise. The idea of dividing the five tributaries between India and Pakistan was proposed by David Lilienthal, the architect of the Tennessee Valley Authority who was engaged as a consultant by the World Bank to help with the Indus Water dispute.

While Nehru was inclined to be very tough with Pakistan on economic issues, he was more forgiving than some of his colleagues on other matters. He took a very different position from the one advocated by Sardar Vallabhai Patel, Prime Minister Jawaharlal Nehru's deputy and also the minister of home affairs, concerning the way Pakistan was treating its minorities. While "ethnic cleansing" – the term only gained currency after the disintegration of Yugoslavia – had removed most minorities from the country's western wing, there were still a large number of Hindus who continued to live in East Pakistan, now Bangladesh. There were communal disturbances in East Pakistan that had resulted in the deaths of many Hindus. Patel, "more forgiving of Hindu extremism and harsher on Pakistan",[12] advocated military action against the neighbour. Nehru opposed any such move, arguing that it would only serve to inflame India's large Muslim minority, which had to become comfortable with the idea of living in India. Patel pressed hard and, in response, Nehru offered his resignation. There was no contradiction in Nehru's overall stance concerning Pakistan. He was inclined to make life for Pakistan difficult in the hope that the act of partition could be reversed, but was not prepared to do anything that would alienate the Indian Muslims. For him, alienating a minority, no matter its size, worked against the idea of India. According to this, a working political system that gave voice to all segments of the population would overcome the problems posed by disparity.[13]

The next crisis with Pakistan came in 1949, when Britain and all members of what was then called the Sterling Area and is now called the Commonwealth decided to devalue their currencies with respect to the American dollar. Pakistan refused to follow on good economic grounds, which were advanced by the minister of commerce, a Bengali politician, in the first Pakistani cabinet. Pakistan's principal export than was jute, produced entirely in East Pakistan, and its demand was price inelastic. Lowering it through devaluation would not increase the volume of exports. The decision by Pakistan changed the rate of exchange between its rupee and that of India's. It was again Patel who pressed for action arguing that "he would not accept a hundred Pakistani rupees in return for 144 rupees from India". This time the deputy prime minister prevailed and New Delhi ordered a trade blockade against Pakistan. This proved to be one of those actions that was to have many unintended consequences. It was to alter for good the structure of the Pakistani economy and make it more independent of India. In response to the Indian action, Karachi pressed ahead with the rapid industrialization of the country and also began the search for new markets for Pakistan's exports, as well as new sources for the imports it needed. Before the trade war with India, more than one-half of Pakistan's exports went to India and India was the source of about the same proportion of imports; afterwards, both exports to and imports from India were reduced to a mere trickle.

If a "what if…?" type of analysis were to be undertaken concerning the consequences of the approach to Pakistan by the first generation of Indian leaders some interesting conclusions could be reached. This type of analysis has been popularized by Niall Ferguson, the British historian, who asked his fellow historians to speculate as to what would have happened if certain events had not occurred or certain decisions had not been taken by those who were in power. For instance, what would have happened to the world had Hitler's Germany won the Second World War? Or in which direction would America have gone had President John F. Kennedy not been assassinated?[14] We can extend this type of analysis to ask "what if…" questions for South Asia. For instance, where would South Asia be today if the rebels in 1857 had succeeded in defeating the British in India in what the British call the Great Indian Mutiny, and the Indians call the First War of Independence. What would have happened had the Congress party not rejected the Cabinet Mission Plan, which would have created a confederation of three states in India, two smaller ones with a Muslim majority and a third with a Hindu majority? What would have happened had "ethnic cleansing" not occurred in South Asia following the decision by the British to quit India earlier than their announced intention? How would Pakistan have developed politically had Muhammad Ali Jinnah not died so soon after creating a separate homeland for India's Muslim population?

Applying this type of analysis to South Asia, it is not hard to see why structurally the Pakistani economy today would be very different and the region economically more integrated had such intense rivalry not erupted between India and Pakistan so soon after the two countries gained independence. Agriculture would be a more important part of the Pakistani economy and India would have remained a large importer of Pakistan's agricultural produce. Rather than develop an industrial structure totally independent of the Indian economy, Pakistan's industry would have been fully integrated with that of India's. Just to take one example of the way the industrial sectors of the two countries would have developed in tandem, it is not too difficult to see how Pakistan could have become integrated into the Indian automobile industry. Pakistan had inherited a number of skill-intensive but small-scale industries specializing in metal working, located in the areas north of Lahore – some Pakistani economists call this the "golden triangle", with Lahore, Sialkot and Gujranwala as its three angles. The industries in this area could have become suppliers of parts and components to India's automobile manufacturers. India would also be Pakistan's major trading partner, as suggested by the gravity model of trade according to which the direction of trade is determined by the mass of the countries and the distance between them. This holds for most countries, but not for Pakistan, for which the United States and not India is its largest destination of exports.

It is, however, Kashmir that has remained the principal source of contention between India and Pakistan.[15] The other causes of irritation somehow got resolved even though they resulted in sub-optimal allocation of economic resources so far as Pakistan was concerned. However, the dispute about Kashmir proved considerably more difficult to resolve. It remained to produce ill will between the two countries. Both countries view this problem from very different historical perspectives – another example of the burden of history. India treats the state as an integral part of its territory. "No Indian prime minister – certainly not me – can countenance any alteration in the boundaries of India. The Indian democracy would not permit this", Manmohan Singh said to me in a conversation I had with him in New Delhi in December 2005. "I have said this to President Pervez Musharraf whenever he has raised the issue." The Indians believe that their position has a strong legal basis. The Maharaja of Kashmir, the state's ruler in 1947 when British India was partitioned, acceded to India. The partition agreement left to the princes of the more than 500 states that the British had not absorbed into their empire the choice between India and Pakistan. The people did not have any option, as they did in the provinces in which the Muslims and non-Muslims were almost evenly divided. The citizens of Bengal and the Punjab were given that right, which was exercised though the elected provincial assemblies. In both cases the provincial legislatures opted to partition their provinces on the basis of religion.

Pakistan's case for Kashmir was based on the logic that led to the partition of British India and specifically the provinces of Bengal and the Punjab – that Muslim majority areas had the right to secede from India and form a state of their own. These two arguments have proved to be irreconcilable. When I asked President Pervez Musharraf about the position Prime Minister Singh had taken, his response was equally uncompromising. "Sometimes democracies have to swallow the bitter pill," he said in a conversation with me in March 2006. "I am not arguing for dividing the state on religious grounds. Kashmir has seven distinct ethnic and linguistic groups and these should be accommodated as groups in other parts of India have been accommodated." It was clear that the solution of Kashmir could not be found by the force of logic.

Pakistan seems to have reached the same conclusion. While accepting that it did not have the strength to impose a military solution, it resorted to other means – the use of non-military personnel to foment trouble for India in the state. Once again history played its part. In 1948–49 Pakistan used non-regulars – mostly people from the country's tribal areas – in an attempt to take Kashmir by force. Later, when the Indians brought their army into the state, Pakistan also sent in its regular troops. The result was the first of several wars fought over Kashmir. When the United Nations brokered a ceasefire, Pakistan was left holding a part of the state. It calls this Azad Kashmir; the Indians refer to it as Pakistani Occupied Kashmir, or POK. A lot of academic blood has been spilt in contesting which of these nomenclatures is the most appropriate.

A variant of the same approach was tried by President Ayub Khan in 1965, with the infiltration of thousands of soldiers camouflaged as civilians. The strategy did not work. The result was a full-scale war between the two countries with a ceasefire brokered this time by the Soviet Union. The Tashkent Agreement, so called because it was signed in the city that was at that time a part of the Soviet Union, had the two countries agree to resolve their disputes through dialogue. The treaty was to have significant political and economic consequences for Pakistan, demonstrating once again how developments involving India have profoundly affected the country on many occasions in its turbulent history. The agreement was opposed by Zulfikar Ali Bhutto who was at that time Ayub Khan's foreign minister. Bhutto resigned from the cabinet after returning from Tashkent, formed his own party, the Pakistan People's Party, went into opposition to Ayub Khan's rule and actively participated in the anti-Ayub movement of 1968–69 which led to the latter's resignation. He sided with the military in the conflict with East Pakistan, which eventually led to the independence of Bangladesh and, finally, was called upon to take the leadership of the country that had suffered enormous humiliation as a result of the surrender of the army in East Pakistan. Once in power, Bhutto dramatically restructured the economy.

Applying the "what if…?" analysis to speculation on the impact on Pakistan of the various decisions its leaders took at different times in its history, we can argue that Pakistan today would be a very different place had Ayub Khan not taken the country on an adventure in Kashmir. First, Pakistan's remarkable spell of economic growth in 1960–65 would have most probably continued; Zulfikar Ali Bhutto would not have come to power six years later and fundamentally altered the structure of the economy and the course on which it had been set by the government of Ayub Khan; and, possibly, some accommodation would have been reached with India on the issue of Kashmir.

To return to the conflict over Kashmir with India, I have argued in an earlier work using a simple economic model that the economic cost of the way Pakistan handled the dispute was much greater for it than for India. To quote from my own work, "had Pakistan resisted a very active involvement in the Kashmir dispute its long-term growth rate could have been some 2.25 to 3.2 percentage points a year higher than that actually achieved. A growth rate of this magnitude sustained over half a century would have increased the county's gross domestic product by a factor of between 3.4 and 4.4. Indeed, had the country been at peace with India over the past decades, Pakistan's 2003–2004 GDP would have been three and a half times larger than it then was, $330 billion rather than $95 billion – and its income per head could have been $2,200 rather than $630. These estimates, of course, are very rough. They are based on a series of heroic assumptions about the efficient use of resources diverted from military to development expenditure; about a significant increase in trade with India; about Pakistan becoming an attractive area for FDI; and about domestic savings and investment increasing as a result of tranquillity in the region. Even if half the benefits estimated above had been actually realized, they would have changed the economic, political and social complexion of Pakistan."[16]

In March 2006 I mentioned these conclusions to President Musharraf, saying that I wanted him to be aware of them since I was about to publish them. I said that I would understand if he was unhappy with my line of thinking since I was suggesting that Pakistan had paid a very heavy economic price for staying engaged in Kashmir for such a long period of time. The president's response surprised me. "I am happy you are planning to publish your findings. They will help me to change the mindset in Pakistan about Kashmir", he said. He suggested that I should use my weekly column in *Dawn* to spread my conclusions. It would help him to mobilize public opinion in favour of the type of solution he was seeking, which did not involve changing the boundaries, but would make them "soft", open to the traffic of goods and people.

The social and political cost has also been much higher. One of the unintended consequences of Pakistan's approach to the dispute was the rise in Islamist extremism in the country. This is related to the decision to throw the *jihadists* into the battle. Initially trained and equipped to fight the Soviet Union in Afghanistan – something that was done with the support of the United States and Saudi Arabia – the *mujahideen* were diverted into Kashmir once the Soviets had left the region. This approach provided the extremists with the raison d'être for their existence. They not only participated enthusiastically in the insurgency in Kashmir, but also declared India to be an enemy. Two high-profile attacks on India are blamed on *Lashkar-e-Taiba*, a group that has been declared a terrorist organization by the United States, the EU and the United Nations, but has been tolerated in Pakistan under the various guises it has taken in order to continue its operations. The two attacks against India that almost resulted in war between India and Pakistan were the December 2001 attack on the parliament in New Delhi and the attack on several sites in Mumbai in November 2007.

Starting in 2008, the extremists expanded their operations against the state of Pakistan. They were finally challenged by a highly provoked Islamabad when it became clear that negotiations and agreements with them – such as the one concluded by the government concerning Swat in February 2009 – was not the way to handle the problem. In May the military launched a full-scale operation against the extremists in Swat. "The militants neither laid down their arms nor stopped challenging the writ of the state", said President Asif Ali Zardari, in a long discussion with the *Financial Times*. "They openly defied the state, the parliament, the constitution and the judiciary". Having tried dialogue and development, the first two Ds of the counterinsurgency strategy on which it seemed to have embarked, "the government was left with no alternative but to resort to deterrence". It went to war.[17]

Pakistan at this moment stands at a cross roads. The choices it makes could take it towards instability and destruction. Islamist extremism poses what several people, including senior officials of the Administration of President Barack Obama, have called an "existential threat" to the country. Or, it could finally begin to address some of the structural problems the country has faced in its economy and in its political system. Shortly before the Swat operation was launched in May 2009, a majority in the country did not accept that terrorism was the most important threat the country faced. This was revealed by a survey carried out by the International Republican Institute, a non-profit organization based in Washington that has a presence in a number of countries that the United States views as strategically important. "Most saw economic issues as the nation's most pressing problem, with only 10 per cent saying terrorism" was a real worry. That said, the most striking thing about the survey was that it "showed signs of an increase in the willingness of the Pakistanis to cooperate with the United States against extremism, with the number supporting such cooperation climbing to 37 per cent from a low of 9 per cent in January 2008".[18] A window of opportunity had thus opened up for the adoption of public policies that could take the country in the right direction. However, what matters is the quality of leadership that the country has at such a critical moment in its history. The same survey found the approval rating for President Zardari at only 19 per cent. "Asked which leader could most effectively handle Pakistan's problems, 55 per cent chose Nawaz Sharif, the opposition leader who served twice as prime minister, while just 9 per cent said Mr. Zardari".[19] No matter which leader or which leadership group pulls Pakistan out of the difficult corner in which it has placed itself, one thing is obvious. The country's policy towards India will be an important part of the resurrection strategy.

This somewhat detailed detour about the cost to Pakistan of the use of Islamist extremism in the context of the country's relations with India was undertaken on the assumption that had the relations between the two neighbours not been soured for so long, Islamabad may not have been tempted to use the *jihadist* groups as a way of intimidating India. However, the strategy did not pay-off. It rebounded on Pakistan and exacted a heavy price on the economy. This was calculated in two annual reports issued by the Lahore-based Institute of Public Policy in 2009 and 2010. According to these reports, domestic terrorism had cost the economy between 3 per cent and 5 per cent of GDP.[20]

Building close relations with the neighbour to the south that is now widely regarded as a potential global power has many potential rewards for Pakistan, but this can only be done if the burden of history is cast off and if the policymakers in India appropriately reciprocate to the positive overtures that may be made by Islamabad. A tentative step in that direction may have been taken on the sidelines of the summit of the Non-Aligned Movement held in July 2009 in Sharm-el-Sheikh, Egypt. After a four-hour meeting, with one hour spent without aids being present, Prime Ministers Manmohan Singh and Yusuf Reza Shah Gillani issued a short statement in which the two countries agreed to delink the terrorism issue from the pursuit of the composite dialogue initiated four years earlier. Mr. Singh also agreed to look at the insurgency in Pakistan's Balochistan province in the context of the relations between the two nations. The Sharm-el-Sheikh statement was well received in Pakistan but was the subject of intense criticism in several influential Indian quarters.[21] According to M.J. Akbar, a respected Indian analyst, "curiously the joint statement includes a reference to Balochistan lending implicit credence to Pakistan's assertion that India is behind its troubles […] India may have gone to Sharm el Sheikh as the victim of terrorism and return[ed] as the accused. Action on terrorism should not be linked to the Composite Dialogue Process and these should not be bracketed".[22]

There were some further advances presumably because of the pressure applied on New Delhi by the United States Administration of President Barack Obama. The Obama Administration, as we will discuss in greater detail in the section that follows, wanted to begin the process of disengagement with Afghanistan. For that to happen it needed Pakistan's cooperation and that, in turn, depended on the level of comfort Islamabad was able to develop with respect to its relations with India. Under United States pressure, the foreign secretaries of India and Pakistan met in New Delhi on 25 February 2010 for "talks about talks". These were followed by more substantive discussions in Thimpu, Bhutan between the prime ministers of the two countries. The meeting took place on the sidelines of the summit of the South Asian Association for Regional Cooperation (SAARC) heads of state. It was agreed that the two sides would resume their dialogue, which was suspended following the terrorist attack on Mumbai on 27 November 2008.

The Afghanistan–Pakistan conflict

Pakistan lives under another historical burden. Like the weight of the dispute with India, this too has deep historical roots. It goes back to the time when Britain fought the Great Game in Central Asia with its rival from continental Europe, the Russian empire. It was inevitable that the two empires would come into conflict. The British were fearful that the Russians would establish their domain over Afghanistan and thus gain access to India. The Russians had always been interested in reaching the warm waters of the Indian Ocean. This they could do either through Iran or though Afghanistan and northwestern India, the parts over which London in the second half of the 19th century had not managed to establish full control. Given the fierce nationalism of Iran, the former did not seem an attractive option to Moscow. It began to probe the possibility of getting through to the warm waters by using the Afghan route.

For the British the repeated incursions into Afghanistan were part of the grand design to keep Russia out of the area, but the British expeditions into Afghanistan had tragic consequences. After having lost a large number of its soldiers to determined resistance shown by Afghanistan, London settled for the next best solution – a border drawn between India and Afghanistan in a way that a number of tribes were split. This way the British felt that they could exercise influence over Afghanistan without actually occupying it. The border that was drawn came to be known as the Durand line, after Sir Mortimer Durand, Secretary of State of the colonial government in India, who was sent by London to negotiate its actual placement with the King of Afghanistan. The line was drawn on a map brought to Kabul by Sir Mortimer Durand and signed by Abdur Rahman Shah, the King of Afghanistan on 12 November 1893.

The British administration in New Delhi treated the Pashtun (or Pakhtun) areas south of the Durand line in a way considerably different from the other parts of their Indian domain. A degree of self-governance was allowed to the tribes in the area; they could follow the tribal system under which they lived as long as public peace was not disturbed and the state was not challenged. Any defiance of authority was dealt with by a complicated set of rules administered by the representatives of the government called the Political Agents. Many of these served for long periods in the area and developed a special affection and respect for the Pakhtuns and their ways. Olaf Caroe was one, who went on to write *The Pathans*, one of the most definitive works about the people who lived in the tribal belts and their customs.[23]

The Pakhtuns – both those in the settled districts of the North West Frontier Province (NWFP) and those in the tribal areas – were not keen on the idea of Pakistan. The opposition was led by Dr. Khan Sahib and his brother, Abdul Ghaffar Khan – the Khan brothers – who were closely allied with the Congress party. In fact, Ghaffar Khan was called the "frontier Gandhi" because of his close association with the Mahatma. However, as Mohammad Ali Jinnah's movement for the creation of an independent Muslim homeland in British India gathered momentum through the mass appeal it generated, the Pakhtun political elite continued to resist the idea. Jinnah was persuaded to accept that a referendum should be held in which the province's citizens would be asked to vote "yes" or "no" for Pakistan. It was not clear what would have happened to the NWFP had the people cast a negative vote since independence was not one of the options given to the people who were polled. Staying with India would have created a geographically split entity, as was to happen in the case of Pakistan. In any event, the vote went for Pakistan. In overcoming the reluctance from the tribal areas, Jinnah agreed that the arrangement the British had worked out would be kept in place.

Even though the NWFP became a part of Pakistan, the government of Afghanistan did not support the creation of a Muslim homeland in the areas to its south if it meant that the Durand Line would become the boundary between it and the new Muslim state. Afghanistan was the only country to oppose the entry of Pakistan into the United Nations. It supported the other option Ghaffar Khan had come to advance – the creation of an autonomous political entity to be called Pakhtunistan – the land of the Pakhtuns. The Pakhtun homeland would have stretched to the east as far as the western bank of the Indus River, but it was not clear whether its western part would include the Pakhtun areas in Afghanistan.

While India did not formally endorse the Pakhtunistan idea, it gave it informal support which drew Kabul closer to New Delhi and more distant from first Karachi and then Islamabad, the successive capitals of Pakistan. Pakistan had little leverage over either Kabul or New Delhi to persuade the former to give up its implicit claim on its territory. The only option available was to make it more difficult for the Indians to reach Afghanistan. In spite of pressure from New Delhi, Pakistan refused to grant transit facilities through its territory for trade between Afghanistan and India and points beyond. Since the only land route available to landlocked Afghanistan was through Pakistan, trade between Pakistan's two neighbours did not develop. Once again, politics had intervened to disrupt normal economic exchanges.

The hostility towards Pakistan on the part of some of the leadership groups in Afghanistan increased when history produced another burden in the relationship between the two countries. This happened in the period of two decades between 1979 and 2001, when Pakistan sided with a number of Pakhtun *mujahideen* leaders in their war against the Soviet Union's occupation of Afghanistan. A bitter 10-year war was the consequence which eventually led to the expulsion of the Soviet troops from Afghanistan. However, Pakistan's dream of creating a state that would now be friendly towards it was not realized as the leaders it had supported fell out with one another.[24] This led to a civil war in the country which was as destructive as the one fought against the Soviet Union. Peace returned to Afghanistan only briefly when the Taliban, another group supported by Pakistan, established its control over much of the country. The group's creation was helped by Inter-Services Intelligence (ISI), the intelligence arm of the Pakistan army. The type of government run by the Taliban turned out to be as brutal as any that had governed the country. This was especially the case in the way it enforced its version of Islam on the country. It also gave haven to al-Qaeda, which was to lead to the rise of Islamist extremism on both sides of the Afghanistan–Pakistan border. To this day, both Afghanistan and Pakistan carry this particular burden of history.

The fact that the terrorist attacks of 11 September 2001 were planned by al-Qaeda on Afghanistan soil once again drew the United States into that country. The United States, under the leadership of President George W. Bush, moved quickly. It pressed Pakistan to give up its support of the Taliban and grant Washington use of its airspace to launch an attack on Afghanistan. Within a few days, the United States had gained mastery of Afghanistan's skies, which it used to support the advance of the forces that went under the name of the Northern Alliance. Afghanistan's capital fell and a government largely controlled by the leaders of the Tajek and Uzbek minority groups formed a government in Kabul. Hamid Karzai, a Pakhtun leader, was appointed the country's president but the centre of power was not in the Pakhtun areas. This, at least from Pakistan's perspective – and, in the long run, also from the perspective of the United States – was an unfortunate development, since the Northern Alliance was under the influence of India. Although Hamid Karzai had spent considerable time in exile in Quetta, the capital of Pakistan's Balochistan province, he was also much closer to India than to Pakistan. The Pakistanis were troubled by this turn of events. Having provided full support to the United States invasion of Afghanistan, they had ended up dealing with a government that was not sympathetic to their interests. Pakistan reacted by looking the other way as the resurgent Taliban began to challenge the Karzai government, and the presence of the United States and North Atlantic Treaty Organization (NATO) forces in the country.

Pakistan, Bangladesh and India

Bangladesh carries its own weight of history, different from the one Pakistan has borne. In the case of Bangladesh, the resentment its citizens have built up against some of the communities of South Asia – not just the Hindus, but also the Muslims in the minority provinces of British India – can be traced back to a number of developments in its history. Some of these date back to the period when political power was being transferred from the Muslim ruling classes to the British. This transfer was accompanied by the rise of the *bhadralok*, the Hindu middle class that had benefited from the collapse of the area's agrarian economy.[25] According to the Indian Census of 1871, a report authored by the government following the population count of that year, "Hindus, with exceptions of course, are the principal Zamindars [landowners], Talukdars (owners of large sub-infeudatory estates), public officers, men of learning, moneylenders, traders, shopkeepers, and [are] engaging in most active pursuits of life and coming directly and frequently under notice of the rulers of the country; while the Muslims with exceptions also, form a very large majority of the cultivators of the ground and day labourers; and others engaged in the humblest form of mechanical skills and of buying and selling have been largely ignored".[26] Even though the British rulers noticed these differences they did little to address them in Bengal, while allowing the state to play a more active role in other parts of their empire.

The situation in Bengal was a bit different from that of the Punjab, a Muslim majority province in British India's north-west. In the case of the latter, there was a class of large Muslim landowners. Some of these had owned large pieces of land for decades if not for centuries. Some had benefited from the introduction of surface irrigation to large tracts of virgin land in the province.[27] In allocating the newly irrigated land, the British had favoured the loyalist landlords.[28] However, there was also a class of smallholders and peasants belonging to the Muslim community. The smallholders lacked capital to work their holdings and relied heavily on loans from the *arthis*, or traders. A significant number of these were non-Muslims. The introduction of a new system of land administration had created economic space for the urban middle class, most of it non-Muslims.

Hindu moneylenders, operating out of the numerous *mandi* towns that the British had built to colonize the land, had lent large sums of money to the Muslim peasantry. There were many defaults on the land pledged as collateral, which led to foreclosures in favour of the moneylenders. This encroachment on the land owned by the Muslim peasantry had political ramifications that made the British administration nervous. This resulted in a response that was very different from the one the rulers adopted to deal with the Muslim *bhadralok* problem in Bengal. In the Punjab, given the role that the Muslim recruits to the British East Indian Company Army played in putting down the 1857 mutiny and in aiding the British effort to add Afghanistan to their expanding Indian empire, the administration's reaction was quick and effective.[29] It classified the province's rural population into two categories, agriculturalists and non-agriculturalists, barring the latter from acquiring land from the former. *The Land Alienation Act of 1901* was to have profound consequences for the Punjab. It created a large class of British loyalists who remained on the British side, neither favouring the Indian independence movement, nor the movement for the creation of Pakistan. That said, the memory of impoverishment continued to inform political attitudes. In his seminal work on the poverty of the Punjabi peasantry, Malcolm Darling continued to come across communal explanations. Darling published his work in 1925, a quarter century after the passage of the 1901 legislation, but the extent of the peasant's indebtedness to the moneylenders, most of whom were non-Muslims, still remained significant.[30] In 1946 Darling returned to India and went on horseback to ascertain the attitude of the Punjab peasantry towards independence and the partition of their province. Some peasants he interviewed said that "if there was no [Muslim] League, the Hindus would get the government and take away our land".[31]

The dynamics unleashed in Bengal were very different. There the British initially reacted to the concerns of the Muslim majority by partitioning Bengal into two provinces in 1905, merging the eastern part with Assam, which would have a clear Muslim majority. Chowdhury calls this Partition Mark I. However, the Hindu *bhadralok* deeply resented the move. "It was hoped that the reduction of the size of Bengal would render it more governable. Also, enhancing Assam's access to the port of Chittagong in East Bengal would invigorate the rather neglected Assam province which, together with its now larger size and population, would make it attractive for covenanted civil servants".[32] However, the British administration seldom acted purely for the promotion of economic development. That was not the reason for acquiring an empire in India. In fact, when they made large investments in developing India's economic resource base – as they did by developing an extensive irrigation system in the Punjab – they ensured that the amount spent would be recovered from the beneficiaries.[33] In the Punjab, the British levied the *abiana*, a water charge, to recover the investments they had made. Similarly there were many non-economic reasons for the partition of Bengal. According to H.H. Riley, a senior British official, "Bengal united is power. Bengal divided will pull in different ways. That is what the Congress leaders feel; their apprehensions are perfectly correct and they form one of the great merits of the scheme [...] one of our main objects is to split up and thereby weaken a solid body of opponents to our rule".[34]

There was intense opposition to the partition of Bengal by the Hindu *bhadaralok* and in the end they won. The British annulled the partition in 1911, adding to the disenchantment of the Bengali Muslims not only with the British but also with the Hindu community. This added communal flavour to Muslim Bengali politics and contributed ultimately to the second partition of Bengal – Chowdhury's Mark II – when the province's eastern part became the eastern wing of the new state of Pakistan.

Both the British and Muhammad Ali Jinnah were in a great hurry to have India partitioned into two states. The British were reeling under the financial burden left by the Second World War – this time, as was the case in the First World War, there were no victor's spoils to take care of the war expenditure – and were very wary of the cost of holding on to India. There was also some American pressure on London to relinquish control, which the British could not ignore since they were in great financial debt to Washington. London, therefore, was anxious to quit India as soon as circumstances allowed. Jinnah, by the time the British announced their intention to depart, was a sick and dying man, a fact not then widely known, and certainly not to the British who may have delayed the decision to partition India. He was equally anxious to complete his mission. Had more time – and hence reflection – been allowed, Pakistan may not have arrived on the scene in a grotesque physical form. Wiser councils might have prevailed and the reins of government might have been left in the hands of three and not two governments – that happened in January 1972 when Bangladesh won independence from Pakistan. This was Chowdhury's Mark III partition.

In the interim, the two wings of the country became increasingly estranged. The Bengalis were unhappy with the unwillingness of those in power in the western wing to allow them the amount of representation in the political system warranted by the size of the population of the eastern wing. At that time, East Pakistan's population was about 10 per cent larger than the population of West Pakistan. They were also resentful of the fact that a significant proportion of export earnings from the sale of the commodities produced in their province was used for industrializing West Pakistan. Jute in its raw form was the largest export earner for Pakistan – it was for good reason called the "golden fibre" – while Bangladesh was still a part of the country. It was grown entirely in East Pakistan and had a very large market in the world before being replaced by man-made fibres. Finally, the Bengali economists had developed a solid case to show that their province had not benefited as much from Ayub Khan's "decade of development" when Pakistan's GDP increased at the rate of almost 7 per cent a year.[35]

Given the build-up in resentment, it was not surprising that the Bengali politicians came up with a plan for provincial autonomy that would have left only defence and monetary policy with the central government, transferring every other function to the provinces. This was called the "six point plan" and was presented by Mujibur Rahman, the leader of the Awami League, to the West Pakistani politicians once Ayub Khan's fall in March 1969 opened the field for serious political activity. The formula was not acceptable to the West Pakistani leaders, in particular to those from the Punjab who would have seen their province weakened. The stage was thus set for the escalation of tension between East and West Pakistan, which eventually led to a civil war and the emergence of Bangladesh as an independent state.

The Bangladeshi War of Independence fought between a regular force from West Pakistan and irregulars called "freedom fighters" or *Mukti Bahini* by the people of East Pakistan, and simply "miscreants" by the people in the West, turned nasty, as many civil wars do. There was large-scale killing of the Bengalis by the West Pakistan forces. Many civilians got caught-up in the fight and atrocities were committed. Hundreds of thousands of refugees left their homes and took refuge in the adjoining parts of India. The burden for caring for a vast army of refugees – the Indians said that 3 million Bengalis had crossed the border, a figure noisily contested by the West Pakistanis – was one reason India sent its regular troops to the aid of the Bengali freedom fighters. Islamabad had hoped that the United States under President Richard Nixon would prevail upon New Delhi to stay out of East Pakistan. Washington made a faint attempt, including the dispatch of its Seventh Fleet to the Bay of Bengal, but Prime Minister Indira Gandhi rudely turned the Americans away.[36] Once the Indians had formally joined the conflict, events moved quickly towards their inevitable conclusion. The Pakistani army under the command of Lt. Gen. A.J.K. Niazi formally surrendered to the Indian forces at a ceremony held in Decca (now Dhaka) on 17 December 1971. Back in Pakistan, the attempt by the military leaders – President Agha Muhammad Yahya Khan and his senior associates – to hang on to power was thwarted by the younger officers, and Zulfikar Ali Bhutto, who had worked closely with Yahya Khan during the final days of the war in East Pakistan, was invited to become president and chief martial law administrator.

Civil wars leave bitter memories – more so than the conflicts fought according to the rules of war. The Americans – in particular those who live in the country's south – still carry with them the memories of the south's struggle against the northern states even a century and a half after the end of the war. In the case of Bangladesh's War of Independence, the healing process began soon after the emergence of the country as an independent state. Zulfikar Ali Bhutto, an extraordinarily charismatic leader, was able to carry the people with him even though they had been fed a great deal of negative propaganda about the people of Bangladesh and what had led to the war in the first place. Using large public meetings as the forums, he was able to order the release of Sheikh Mujibur Rehman from a prison in West Pakistan and send him back to Dhaka. The Bengali leader was immediately elected the new country's president. A few months after that Pakistan recognized Bangladesh – once again a decision for which Zulfikar Ali Bhutto won the approval of the public in a highly attended public meeting – as an independent state, followed by an exchange of visits by the leaders of Bangladesh and Pakistan.

There was some minor bickering over the division of assets between the two countries, but this was quickly resolved – much more quickly than the disputes between India and Pakistan after the two countries achieved independence. The most consequential step taken was the award of 50 per cent of the quota Pakistan had for exports to America, Europe and Japan to Bangladesh. This laid the basis for the emergence of the ready-made garments industry in Bangladesh, which not only lifted the rate of economic growth in the country, but by giving employment to hundreds of thousands of women, it brought about a social transformation and a demographic revolution.

Pakistan was able to make quick economic adjustments of its own to the loss of East Pakistan. I was summoned back from Harvard University to lend a helping hand with the process. Working at the Ministry of Commerce, we launched an intensive effort to divert the country's exports to East Pakistan into other channels. We massively devalued the rupee from Rs. 4.76 to the American dollar, to Rs. 11, and eventually fine-tuned it to Rs. 9.9. With the price of its exports thus significantly lowered, Pakistan was able to win new markets for the products that had previously been sold in East Pakistan.

Given Pakistan's India-centric approach to the making of foreign policy, it has continued to look at Bangladesh through the Indian prism. One of the main arguments advanced in this work is that the nations of South Asia have to formulate their relations not on the basis of sharp memories of the past – the perceived rights or wrongs of one country against the other – but rather on the benefit of the peoples of the entire region. A conscious effort needs to be made by the region's leaders – with India and Pakistan taking the lead – to cast off the burden of history and set in place a process whereby they, along with other countries in the area, can work together to create a regional economy that works for the people. One area where much progress could be made is on the issue of trade and transit rights, where each country also allows its territory to be used by neighbours to buy and sell from each other. There is much the countries could trade among themselves. At this time they do very little of that in defiance of what economists call the "gravity model of trade".

The Indian conflicts with its smaller neighbours

The fact that in the move towards achieving independence, Dhaka received assistance from India should have ensured warm relations between the two countries. That happened for a while, but then the South Asian tendency to place national over regional interests took over and soured relations between New Delhi and Dhaka. There are a number of areas in which the two countries have come into conflict. These involve the sharing of the waters of the Brahamaputra and Ganges River systems; transit rights sought by each country, in the case of India for access to its isolated states in the north-east as well as to Myanmar, and in the case of Bangladesh to Bhutan and Nepal; and the supply of natural gas to India by Bangladesh, which at this time has a large surplus, much larger than its domestic needs. It could not have been imagined in December 1971, when the hard-fought civil war in East Pakistan was brought to an end by India's intervention in favour of the Bengali freedom fighters, that relations between the two sides would not be warm and close. However, disputes began soon after Bangladesh began to assert what it regarded as its rights, and to follow its own rather than India's strategic interests. This was the case in the way Dhaka approached China and Pakistan. New Delhi was not appreciative of Dhaka's close ties with Beijing and the warming trend towards Islamabad.

While India's relations with its larger neighbours – with Pakistan, in particular, but also with Bangladesh – have been difficult, they were not easy with the much smaller ones either. However, the resentment that often built up in the capitals such as Colombo, Kathmandu, even Male, the capital of the Maldives, was the consequence of two factors: Indian paternalism and the difficulty of trading with India. Once asked by Prime Minister Manmohan Singh for my impression of how India's neighbours felt about his country, I surprised him by saying that there was only one capital that felt some warmth about New Delhi. That was Islamabad. I had then completed a round of the South Asian capitals as part of a fact-finding mission to write a report on the South Asia Free Trade Area (SAFTA). This was a USAID-funded project on which I was working with the help of a team of economists drawn from six SAARC countries. There was one common element in the conversations I had in the various capitals I visited: it was felt that India was not an easy country with which to trade. In Kathmandu I was shown all the regulations that the Nepalese traders had to follow in order to export their products to India, which amounted to a pile a foot and a half high. I heard the same complaints in Dhaka and Colombo. Islamabad's wish for better relations with India had not been sullied by the countries trading with India: the Pakistani business community was anxious to work with its Indian counterpart and they had not come across the Indian bureaucracy, which was still – more often than not – implemented by the long-discarded licenser raj. The prime minister accepted my reasoning. India, he said, was now much more decentralized than was envisioned by the country's founders. While international commerce was the responsibility of New Delhi, the officials who minded the borders were often from the border states. They shared the sensitivities about possible harm that the easy movement of goods and commodities between countries could do to the local economy; hence their effort to impede the flow of trade.

This attitude is not unique to India. The United States offers another example of a country in which border states sometimes take matters into their own hands. The signing into law in May 2010 by the Republican Governor of Arizona of a draconian piece of legislation that will allow the state policies to ask for the papers of any resident, has raised concerns in many other states. The idea is to apprehend and deport illegal immigrants from Mexico, across the border. Some other states, including California, have threatened to introduce an economic boycott unless the law is repealed. The main point being made here is that in federal systems, state rights must not be allowed to stand in the way of national interest. For India, having close economic relations with all its neighbours is in its interest and in the interest of the South Asian region. Narrow political interests must not be allowed to stand in the way, especially when on the other side of a trade dispute is a small and relatively weak country.

Conclusion

There have been few moments when the different countries in South Asia have seen national and regional interests taking them in the same direction. Such a moment arrived, however, in the summer of 2009 when, with the establishment of democratically elected administrations in the three large countries of the South Asian mainland, this conflict-torn area began to take small steps towards regional cooperation and eventually towards regional integration. Governments responsive to the wishes of the citizenry are more likely to give greater weight to economics than administrations dominated by the military. For a considerable part of their respective histories, Bangladesh and Pakistan were directly or indirectly ruled by their armies. Since the armed forces did not have to gain and retain power through elections, they were not compelled to give economics – and, therefore, poverty alleviation and improvements in income distribution – much consideration in the way they governed. Sometimes the quest for legitimacy made the military governments adopt policies they believed would win them favour with their populations. In the context of much of South Asia, an anti-Indian stance was such an approach. This was adopted with enthusiasm by the military-ruled countries.

The other important development in the region was the realization that religious extremism and an extreme focus on ethnicity posed real threats to the long-term interests of the people of South Asia. While the Islamist extremists are currently at the forefront of the use of violence against both the state and ordinary people to promote their interests and agendas, other religious extremists have also been active in the region. The threatened encroachment of Hindu extremism on the Indian state was checked by the elections of April–May 2009 in India, which unexpectedly gave a much larger margin of victory to the secular Congress party and to Manmohan Singh, the party's candidate for premiership. The Bangladeshi elections of December 2007 will also prove to be as much of a turning point in the history of South Asia, as will the elections of February 2008 in the case of Pakistan. In the latter case, the military was pushed away from the centre of the political stage and it is likely to stay out of politics unless something even more dramatic happens than the decision by Islamabad to use the military to defeat the extremists in the country. The Sri Lankan military's triumph over the decade-long struggle of the Tamil separatists and the support it has received from the people are an indication that there is a limit to tolerance of the pursuit of ethnic rights.

As suggested in a later chapter, with these and other events South Asia may have begun to turn the corner, moving away from a total adherence to the pursuit of national interests even at the cost of doing damage to the region. Should the meeting at Sharm-el-Sheikh between the prime ministers of India and Pakistan, where the leaders of the Non-Alignment Movement gathered for one of their periodic summits, be viewed in this context? If the short statement issued after the meeting is read as an indication of things to come, New Delhi seems to be correctly interpreting the change in mood of the Pakistani population and the course that the elected representatives wish to take. Given Pakistan's precarious economic situation and the strong desire of the people to have their economic problems urgently addressed, there is a growing sentiment in the country that a hard stance towards India would not yield any reward; it would only further burden the economy that is already straining under many pressures. People are doing a cost-benefit analysis and seem to have concluded that the balance is in favour of a major improvement in relations with India. It is this sentiment that further lent momentum to the movement towards an Indian-Pakistani détente at Thimpu, Bhutan, when the two prime ministers met again on the sidelines of another multinational meeting, this time the summit of SAARC leaders.

It is in India's interest, as well, to reach out to Pakistan and restart the process for solving some of the major issues it has with its neighbour. Without bringing a degree of tranquillity to the region, India's ambition to be regarded as a major global power would be difficult to achieve. Its leadership must have realized that while Pakistan may have initially encouraged the *jihadists* in order to balance India's enormous superiority in conventional arms, the strategy has backfired. The Islamist extremists who once had the support of the state have turned on the state itself. The human cost to Pakistan of this misadventure is a multiple of that borne by India in the attacks for which the responsibility has been assigned to these groups. Both countries would undoubtedly benefit if the persistent tensions between them were eased. By doing so they would be removing one of the causes that the *jihadists* have espoused.

The Sharm-el-Sheikh pronouncement and the statement at Bhutan became the subject of extensive analysis on both sides of the border. Considerable attention was given to them for two reasons. First, because Manmohan Singh agreed to delink the dialogue on the many issues that had created so much tension between the two countries. This was not an entirely popular move in India, where there was a strong sentiment that Pakistan had to take visible steps to show that it was not prepared to have its territory used to launch terrorist attacks on India, even if such attacks did not have official sanction. Second, at least implicitly, New Delhi seems to have recognized that some outside pressure – particularly when applied by the United States – has been useful to move forward its relations with Islamabad. Under President Barack Obama, Washington has become a sort of guarantor of good behaviour for the two long-competing capitals, Islamabad and New Delhi. With Washington pushing a bit and watching a great deal, the two countries seem to have engaged themselves in the process of casting off the heavy burdens of history and beginning the journey towards peace and amity.

5 South Asia may have turned the corner

Introduction

There are two – perhaps three – nation-building ideas that have been in conflict in South Asia since the British left the sub-continent in the late 1940s. One was espoused by Jawaharlal Nehru, the first prime minister of India, who governed the country for the first 17 years after independence in 1947. According to this belief, even in a country with such diversity as India it was possible to construct economic, political and social systems that would protect all citizens, not only those who constituted the majority. Sunil Khilnani, the Indian political theorist, has called this the "idea of India".[1] There were, in fact, two ideas, each one supported by Nehru and each with good historical justification. These two ideas were melded together in the Indian Constitution promulgated in January 1950. As noted by the historian Ramachandra Guha, the Constitution brought together what he calls the "national" and "social" revolutions. "The national revolution focused on democracy and liberty – which the experience of colonial rule had denied to all Indians – whereas the social revolution focused on emancipation and equality, which tradition and scripture had withheld from women and low castes".[2] The idea of India, in other words, was a composite idea.

This idea, however, was rejected by Muhammad Ali Jinnah, the founder of Pakistan. He maintained that the land over which the British ruled was not inhabited by one Indian nation but by two – one Hindu and the other Muslim. Jinnah believed that each nation deserved its own political space within which it could order the lives of its citizens according to their religious beliefs and social norms. This came to be called the "two nations theory", which became the basis for the creation of Pakistan as a homeland for the Muslims of British India. The American political scientist Stephen Cohen has called this the "idea of Pakistan".[3] However, there were serious contradictions in Jinnah's theory and in the idea of Pakistan. Two of these had significant consequences for the history of South Asia. First, the Muslim population was not concentrated in one place; Islam had been present in the sub-continent from almost the time of the birth of the religion. Muslims were to be found in all parts of India. Even if the two Muslim majority areas – one in British India's north-west and the other in the north-east – could be separated to form the state of Pakistan, that state would be territorially unique. Its two parts would be separated by 1,000 miles of Indian territory. Second, the Pakistan that Jinnah demanded could not accommodate the entire Indian Muslim community, which then had a population of about 120 million. No matter where the boundary was drawn it would still leave a sizeable Muslim community in India. If rescuing the Muslims from Hindu domination was the purpose of the idea of Pakistan then it should have applied to all Muslims, not only to those who lived in the Muslim majority areas. In any event, the line the British drew as the boundary between the two states they created left about the same number of Muslims in India as there were in today's Pakistan, over 160 million in each case.

Jinnah must have seen these contradictions. This is one reason why some revisionist historians, in particular Ayesha Jalal, have suggested that he was not entirely serious about the idea of Pakistan. His demand for the creation of a separate homeland for the Muslim community of British India was meant to obtain protection for them from the Hindu majority once India became independent. It was a bargaining tool, suggests Jalal,[4] but the leaders of the Congress party – as suggested by Jaswant Singh in his 2010 book that cost him his membership of the Bharatiya Janata Party (BJP, the Hindu nationalist party) – granted the Muslim leader his wish and, in Jinnah's own words, a "moth-eaten" Pakistan was born on 14 August 1947, a day before India gained independence.[5]

However, religion as a glue for nation building turned out to be a weak material. The leaders of West Pakistan were reluctant to fully accommodate the wishes and aspirations of the citizens of East Pakistan. The result was a number of serious differences – on political, economic, cultural and linguistic grounds – between the leadership groups of the two halves of the country. These turned into bitterness and eventually resulted in a civil war fought over a period of nine months, from March to December 1971. The result was the emergence of East Pakistan as an independent Bangladesh led by Sheikh Mujibur Rehman, whose "six-point" formula for the grant of considerable autonomy to the eastern wing was not acceptable to the West Pakistani leaders. The six points were, in fact, the third nation-building idea to take hold on the South Asian mainland. According to this, ethnicity and culture are powerful attributes of nationhood, even stronger than religion.[6] This line of thinking began to be pursued in Pakistan's Balochistan province.

This line of thought in terms of nation building was also pursued by the Tamil Tigers of Sri Lanka, a separatist group that fought for a couple of decades to establish an autonomous – perhaps even an independent – state in the north-east of the island. This group resorted first to militancy and then to open rebellion against the state in pursuit of its ends. The "Tigers" were the first group in modern times to use suicide bombers as weapons. It was a young Tamil woman on a suicide mission who assassinated Rajiv Gandhi in 1991 as he campaigned in the Indian state of Tamil Nadu as the head of the Congress party and as that party's candidate for the position of prime minister.

These three ideas have contributed to the persistence of tensions in South Asia. These have been very strong in the case of Pakistan's relations with India. Religion was at the centre of this conflict at least from the perspective of Pakistan. This religion-based conflict between the two nation-building ideas sharpened after Pakistan, beginning in the late 1970s, became a religiously more conservative society. It is not clear from Jinnah's speeches and the few writings he left behind as to what were his precise intentions with respect to the role of religion in the state of Pakistan. He often spoke about the need to be guided by the teachings of Islam. This was inevitable, since he had used the idiom of religion to make his case for a separate homeland for the Muslims of South Asia. However, it appears that he was inclined to lead the country towards a secular democratic system, not too different from the one Nehru and his colleagues were able to enshrine in their country's Constitution. The Indian Constitution has proved to be a flexible instrument of governance. It has been amended scores of times to keep it current with the demands of a society that has seen rapid economic and social change. To take just one example, the political system embedded in the Constitution was unitary in form with a strong centre – the union government – and only limited rights were granted to the constituent states. This was to change through the amendments to the Constitution as well as the practice of governance. Today India is a federal system of government with a considerable amount of authority devolved to the states. Some of this has happened because of the changes made through amendments in the Constitution and some because of the need to govern a large multi-cultural and multi-linguistic country. India also keeps increasing the number of states in order to keep the government closer to the people.

Religion and politics in South Asia

For Pakistan, the case for keeping religion out of politics was weakened by the unanticipated transfer of population that occurred around the time India and Pakistan obtained independence. I have estimated in an earlier work, using the censuses conducted by the two countries in 1951, that some 14 million people moved across the border in a few months in the summer and autumn of 1947. This was the largest movement of people in recorded human history.

Some 8 million Muslims migrated from India to Pakistan, while 6 million Hindus and Sikhs moved in the opposite direction.[7] By 1951 Pakistan had been thoroughly ethnically cleansed – a term that was not used then, but gained currency when Yugoslavia fell apart in the early 1990s. For Pakistan the event was traumatic; when the country took the first census in 1951, 25 per cent of its population of 32 million was made-up of refugees. This was perhaps the largest concentration of displaced people ever in a country as large as Pakistan.

What was not realized then but proved to be a political trauma in the long run was the "Islamization" of Pakistan. In the late 1940s non-Muslims in the areas that make up today's Pakistan constituted about one-third of the population; today the religious minorities account for less than 5 per cent. It was inevitable that with Muslims constituting such an overwhelming share of the population, religion would become a force in politics and in social discourse. Islamic parties fought hard for the inclusion of religious clauses in the Constitution, one reason why constitution-making became such an arduous exercise in the country. A preamble promising that no laws would be made that were considered to be "repugnant" to the tenets of Islam was incorporated in the short-lived Constitution of 1956. The Constitution was abrogated in 1958 by the first military ruler, General Ayub Khan, who went on to give his own Constitution in 1962. The only thing in common between the two constitutions was the preamble's repugnancy clause. However, to appease the Islamic forces, Ayub Khan changed the name of the country to the Islamic Republic of Pakistan. He also named the new capital he had decided to build close to the garrison town of Rawalpindi, Islamabad. The third Constitution was promulgated in 1973, after Pakistan broke into two halves. It represented a broad consensus among the remaining four provinces and provided for a federal state with considerable devolution of power to the provinces. The repugnancy clause remained, as did the name of the country. When Prime Minister Zulfikar Ali Bhutto came under pressure from the Islamic parties, he made some more concessions including banning the sale and consumption of alcohol.

The move towards Islamization began in earnest under General Zia ul-Haq, Pakistan's third military ruler. He brought both cosmetic and real changes into the way the country was governed. Zia interrupted a trend that had gone on in the Muslim community of British India since 1857, when, according to Ishtiaq Ahmad, a scholar from Sweden who has studied the theoretical underpinnings of an Islamic state, people had "been living in a milieu in which Islam, as a form of worship and social consciousness has existed without the state sitting in judgment on it. In other words, in an essentially secular political framework. The ulama hope to undo this historical evolution, bringing religious faith under state vigilance, while the modernists seek an equilibrium between faith and politics".[8] As a result of the influence of the ulama on President Zia, they scored some significant successes. Not only were the political and legal systems to be brought closer to what he thought were the diktats of Islam. He created a separate *Sharia* branch of the Supreme Court to lend legal enforcement and teeth to the repugnancy clause of the Constitution, according to which the legislators could not pass laws that went against the spirit of Islam.[9] He also moved to incorporate such Islamic practices as the banning of interest rates in economic transactions. Since the impracticality of such a move was soon demonstrated, his government decided to set up a separate Islamic banking system to co-exist with modern banking. However, all these moves need not have bred religious extremism, but for the way America, under President Ronald Reagan, decided to fight the Soviet Union's advance into Afghanistan. Since it was not practical to send in American troops to counter the Soviet occupation of Afghanistan, Washington decided to use surrogates to do the fighting. These were the *mujahideen* who were trained and motivated in a string of *madrassas* set up in the dozens of refugee camps that were established on the Pakistani side of the border to accommodate 3 million–4 million refugees who left Afghanistan to escape the Soviet invasion. The *mujahideen* eventually morphed into the Taliban.[10]

While the idea of India worked in India, it did not keep religion entirely out of politics. The BJP, one of the two national political parties in the country, traces its origin to Rashtriya Swaynamsevak Sangh (RSS), an organization founded in 1925 to protect what were perceived to be the rights of the Hindu population in British India. The party gained political ground in the 1990s by drawing upon the grievances of those who believed that the Indian state had given too much space to the lower castes in the population and to the Muslim minority. The party drew support, in particular, from the Hindus of upper castes and from those who had migrated from what was now Pakistan. L.K. Advani, the party's leader in the elections of 2009 and its declared candidate for prime minister, was born in Karachi and left for India at the age of 20. The party's overt pursuit of Hindu interests led to the demolition of the Babri mosque on 16 December 1992. The mosque's destruction occurred at the culmination of a long march led by Advani. The mosque was located at Ayodhya in the state of Uttar Pradesh. It was supposed to have been built on the ground where Rama, an incarnation of Lord Vishnu and the ruler of Ayodhya, was said to have been born. The assault on the mosque led to riots, in particular in the always restive city of Bombay (now Mumbai). Thousands of people were killed, many of them Muslims. The dissolution of the mosque – who motivated it, why it was allowed to be carried out, why the state did not stop it from happening – remains a contentious issue in Indian politics. A commission of inquiry was appointed headed by a senior judge soon after the incident took place, but it took 18 years for it to complete its report. The delay in the report's completion was attributed to the political storm that would be raised by it no matter what its findings. Religion remains a sensitive subject even in an avowedly secular India.

Elections in South Asia

Three elections in South Asia and two firm state actions against insurrections against the established authority may make 2008–09 the turning point in the subcontinent's history. First in Pakistan in February 2008, then in Bangladesh in December 2008, and then in April–May 2009 in India, the people seem to have spoken out against the expression of radicalism in religion and extreme nationalism. The parties that have come to power in the three countries have openly expressed their opposition to the use of religion in politics. The firm action by the state in Sri Lanka and in Pakistan against the forces of extremism and politics of exclusion may have set the stage for the further reduction in the force of religion in politics. This chapter uses these five developments – three elections and the state's response to two insurrections – to suggest that South Asia may be on the verge of another dramatic change in the way it manages the lives of its citizens. It also briefly discusses the Maoist insurgency in India, but unlike the states in Pakistan and Sri Lanka that decided to use all the force at their command to deal with their problems, the Indians in the summer of 2010 were engaged in an intense debate on how to handle the rebels.

I will devote much more space to the war against the rise of Islamist extremism in at least two states – Afghanistan and Pakistan – in the belief that this is where the countries in South Asia may begin to work together. If they do, it will be out of both conviction (that secularism must be the foundation on which the state's structure and the political system is built) and expediency, since by not working together they will only prolong the struggle.

Elections in Pakistan, February 2008

There is change afoot in Pakistan. The elections of February 2008 were decisive in favour of rejecting the past in which the military dominated the political stage by claiming to be the custodian of national security and also by suggesting that it could govern more efficiently and effectively compared with any grouping of civilian politicians. The voters were not impressed by its economic record. In the five-year period between 2002 and 2007 Pakistan's gross domestic product (GDP) grew by an average rate of 7 per cent a year, but that did not win the hearts and minds of the ordinary citizens. This was the "shining India" moment for Pakistan. Much as the BJP-led coalition in India in 2004 had failed to translate good economic performance into electoral success, Pervez Musharraf in Pakistan failed similarly and for the same reason in 2008. The two regimes had followed similar economic models; they produced high levels of GDP growth which were exclusive rather than inclusive in their orientation. The rich and the well-to-do benefited; some large cities saw booms and prosperity; levels of consumption improved significantly for a small number of people; and many shiny, imported goods appeared in the market place. On other hand, the incidence of poverty did not decline perceptibly; inter-personal and inter-regional income distribution disparities worsened; and for the less-advantaged peoples and regions in India and Pakistan there was not a great deal of faith in the future. The price for the neglect of the countryside and the poor was paid by the BJP in the Indian elections in 2004. The same price was exacted by the electorate in Pakistan from President (no longer General since shedding his uniform a few months earlier, when he was replaced by General Ashfaq Pervez Kayani) Musharraf and the Pakistan Muslim League (Quaid) in the elections of 2008. The Pakistan People's Party (PPP) won the largest number of seats in the national assembly, but not enough to form a government on its own in Islamabad. It lost to the Pakistan Muslim League (Nawaz) (PML(N)) in the important province of Punjab, but won a majority in Sindh. In the remaining two provinces – Balochistan and the North West Frontier Province (NWFP) – the parties with regional appeals outperformed the national mainstream parties.

The most important result of the election was the extremely poor performance of the *Mutihida Majlis-e-Amal* (MMA), a collection of six religious parties that had exercised considerable influence on President Pervez Musharraf. The MMA had ruled the NWFP (now called Khyber-Pakhtunkhawa) after the elections of October 2002. It had allowed the Islamist extremists to spread their wings over the province, allowing them considerable space to operate and build contacts with the people. The MMA was also against Pakistan's active participation in the war in Afghanistan, arguing that it was America's and not Pakistan's conflict. The approach taken by the religious coalition no doubt affected the way President Musharraf and his administration looked at the increasingly bloody conflict, not only across the border but in the north-western areas of Pakistan. The "forces of Islam" operating in Afghanistan had much support in Pakistan's tribal areas, a subject that will be discussed at much greater length later in this chapter.

The difficult transfer of power from the military to civilian rule in Pakistan also produced hope once the process was complete. What was also important was the fact that the Pakistan People's Party and the Pakistan Muslim League were not at each other's throats any more, but were willing to work together; they produced a grand coalition, but it lasted for only a few weeks. President Zardari went back on his promise to rid the Constitution of Section 58.2(b), which gave the president the power to dismiss the prime minister and his cabinet, dissolve the national assembly and call general elections. This power was given to the president originally by the eighth amendment, a condition laid down by General Zia ul-Haq in 1985 to bring the country out from under martial law. It was removed by the 13th amendment passed in 1997 by the parliament during Nawaz Sharif's second term as prime minister, but was reinserted by President Pervez Musharraf in 2003 by way of the 17th amendment. In the Charter of Democracy signed in London in 2006 by Benazir Bhutto and Nawaz Sharif, the leaders respectively of the PPP and PML(N), the two parties committed themselves to the removal of 58.2(b) and restoration of the power of the parliament. This commitment was reconfirmed by Asif Ali Zardari who, in December 2007, succeeded Bhutto, his assassinated wife, as the PPP's co-chairman. Once elected president, Zardari refused to follow through on the pledges that he and his party had made.

Zardari also stalled on the other promise made by his wife and party: to bring back the judges fired by Musharraf in November 2007 from the Supreme and High Courts and to make the judiciary independent of control by the executive. After his failure to move on this pledge, Nawaz Sharif decided to join the lawyers' movement that had been agitating for months to achieve these goals and march on Islamabad to force the Zardari government to act. This was a direct challenge to the PPP and Zardari and for one day, 16 March, Pakistan teetered on the edge of political disaster as Sharif led a huge procession that began to crawl towards Islamabad. After midnight the government caved in and Prime Minister Yusuf Raza Gilani went on television to announce that the government would bring back the dismissed judges.

This decision began to yield dividends for the opposition. Zardari had attempted to use the old tactics to force Nawaz Sharif's party, the Muslim League, out of government in the Punjab, the country's largest and richest province. He succeeded only for a short time; the League's Chief Minister, Mian Shahbaz Sharif, was restored to his office by the courts soon after the officers of the courts themselves were restored. In 2010 Zardari succumbed once again to the pressure of the opposition parties and civil society to allow his party to participate in the process of drafting the 18th amendment to the Constitution, which removed the distortions introduced by two military presidents. On 19 April he signed the amendment into law following its passage through the two houses of the parliament.

All these fast-paced developments suggest the birth of a new Pakistan. It will become really new if it sheds some of the India-centric approach it has followed in its view of the world and in the way it has conducted international relations.[11] That may also happen, but the reason for it is the growing recognition in the country – in particular by the large middle class and now by the military – that the rise of Islamist militancy and radicalism has to be checked, even if it means the use of a great deal of force.

Elections in Bangladesh, December 2008

The next epoch-making elections in South Asia were held in Bangladesh in December 2008, following two years of rule by a caretaker administration that took office following a period of political chaos in which the mainstream parties were fighting each other mostly through unconstitutional means. The army forced a cooling period and placed the country in the hands of a group of technocrats led by Fakhruddin Ahmed, who had served for a number of years as an economist at the World Bank. Upon leaving the Bank, he took up the position of Governor of Bangladesh Bank, the country's central bank, and won the respect of his countrymen for his professionalism. Under his leadership, the caretakers achieved their objective. They cooled the political temperature, stabilized the economy and prepared the country for another general election. This brought the Awami League back to power and Sheikh Hasina Wazed returned as prime minister. Under the Awami League, Bangladesh may be able to resolve some of its outstanding differences with India and also steer the country towards secular politics.

According to Iftekhar Ahmed Chowdhury who served as the caretaker administration's foreign minister, while "Pakistan is a category by itself", other somewhat smaller neighbours of India are prepared "to live in concord [with India] but distinct from it […] The government as well as the very vibrant civil society in Bangladesh tend to be secularistic, which sits in very nicely with the Congress [party]" in India. "Yet there seems to persist in Bangladesh a deep suspicion of India, justifiably or otherwise. These involve the issues of sharing of the water of the common rivers, questions of transit and connectivity in which each side suspects the other of wishing to secure undue advantages, the complaints of non-tariff barriers in India by Bangladeshis impeding their exports, and the allegations by India that Indian insurgents secure safe haven in Bangladesh even if unaided, [something] which Dhaka forcefully refutes. Then there is the question of maritime boundaries yet to be settled, which is important as the Bay of Bengal is said to be energy rich. There are no easy solutions to these problems".[12]

Whenever there are deep suspicions on the part of those involved in a dispute, nations do better by using a multinational forum for making advance. Such a forum exists in South Asia. The South Asia Free Trade Area (SAFTA), is the by-product of the endeavours of Bangladesh. It grew out of the South Asian Association for Regional Cooperation (SAARC), founded in 1986 at the urging of then-president of the Bangladesh, General Zia ur Rehman. However, as indicated elsewhere in this book, this forum has not worked to resolve inter-country disputes in South Asia.

Elections in India, April–May 2009

The last of the three elections in South Asia that may change the area's political and economic landscape was held in India in April–May 2009. The elections attracted worldwide attention for a number of reasons. They were an impressive exercise in the management of the largest electorate to ever vote in human history. The large size of the electorate meant that the elections had to be staggered over a period of more than a month. A record number of candidates took part. The electorate was basically asked to address three issues. Should India turn away from its secular tradition and adopt a stern approach towards the religious minorities? This question was put on the front burner by a statement by Verun Gandhi (son of Sanjay Gandhi, Indira Gandhi's youngest son, and estranged cousin of Rahul Gandhi, the son of Rajiv Gandhi, Indira Gandhi's oldest son and once also the prime minister). Verun Gandhi's crude threat to the Muslim community landed him in jail but won him a large victory as a candidate for the BJP. The second issue concerned the degree of inclusiveness in India's economic development model. The Congress had launched a couple of programs to directly help the less advantaged segments of the population. Its promise to pursue those programs and its campaign suggesting that the BJP's record in office had demonstrated that it stood for economic growth without regard for the poor, won the party a significant amount of support, in particular in the countryside where the vast majority of the Indian population still resides. The fact that the BJP won decisively in one state, Karnataka, one of the richest in the country and also the one in which the Hindu extremists had run a vicious campaign aimed against modernization, underscored the image that the general population had formed of the BJP. The third issue concerned the Congress's record of dealing with terrorism sponsored by some of the Pakistan-based Islamist extremists. The BJP maintained in the campaign that Manmohan Singh and his party had shown weakness in not punishing Pakistan for the attack on Mumbai in November 2008, which was carried out by Islamist extremists who had travelled by boat from Karachi. The Congress suggested that it had shown maturity in dealing with India's neighbour, which had also been hit hard by the same terrorist groups. The fact that about the time the Indians went to the polling stations to cast their votes in this important election, the government of Pakistan launched the military against the Islamist dissidents in the Swat district underscored the validity of the Congress party's position.

The Congress won a decisive victory not anticipated by most analysts in the pre-election period. The elections confirmed the longevity of the "idea of India". The party won handily against the BJP-led alliance, as well as an alliance of regional parties that would have liked to see further weakening of the central authority. Although it is difficult to impose a national narrative on the individual choices made by 420 million Indian voters, the electorate appears to have given its collective voice against Hindu extremism and also against the further weakening of the Indian state. The BJP's national decline seems to indicate that most Indians want economic development rather than attachment to some romantic religious past.

The 2004 Indian election was a positive-negative moment in the sense that the voters were rejecting the past and challenging the leadership groups to produce a better future for them, their children and grandchildren. The five years that followed seemed to have vindicated their choice. The rates of growth produced by the Congress party-led government were even more impressive than those achieved by the BJP in the previous period. The government employment guarantee scheme in the countryside and the write-off of the debt of small farmers persuaded the ordinary voter in the villages, where most of the electorate lives, that Manmohan Singh had both his heart and mind in the right place. Exceptionally good monsoons also helped the Congress's victory. By voting Manmohan Singh into office, the Indian electorate seems to have broken the long tradition of throwing out the incumbents.

Insurgencies in South Asia

The other important development is the move by two South Asian governments to deal with two different types of insurgencies: those that have roots in ethnicity, drawing strength from religion, and those that felt that the economic and political systems had excluded them.

Ethnicity has inspired the three insurgencies – it was the common cause among several others – that brought a great deal of trouble to South Asia. It was the main reason why the Bengalis in Pakistan's eastern wing, having failed to have their grievances redressed, decided to take up arms against the Pakistani state. They fought a bitter civil war against the Pakistani military for nine months in 1971 and finally created an independent state for themselves – Bangladesh. Although India helped the Bengalis achieve their objectives there is little doubt that they would have eventually succeeded on their own. It would have taken longer for them to separate from the state that Mohammad Ali Jinnah had won on the basis of religion. As already discussed, religion proved to be a weak glue for binding two very distinct ethnic groups.

Ethnicity and the Tamil revolt in Sri Lanka

Ethnicity was also the basis for the long struggle that the Tamils of Sri Lanka waged against the state dominated by the Sinhalese community. In this case ethnicity was reinforced by religion, since the majority Sinhalese community of the island did not share the Hindu religion of the Tamil minority. The two communities would have found a way of living together had the country succeeded in establishing a political system that gave space and the opportunity to have its voice heard to the Tamils. Over time the Tamils convinced themselves that the Sinhalese-dominated state was not prepared to accommodate their interests. As the economist Albert O. Hirschman suggested some time ago in his book, *Exit, Voice and Loyalty*, those who are unhappy with the dispensation on offer choose exit from the system as an option. This is what the Bengalis did in Pakistan and what the Tamils attempted to do in Sri Lanka. Since a significant number of Tamils were concentrated in one part of the island, the north-east, they felt that it was practical for them to attempt secession. That remained their objective for decades and they fought hard to gain their goal. Their struggle, however, took a heavy toll on the Sri Lankan economy and political system. Physical separation from West Pakistan made it possible for the Bengalis to secede, but Sri Lanka was one country. On 19 May 2009 Mahinda Rajapakasa, the Sri Lankan president, went on television to declare that the military had won the final victory against the Liberation Tigers of Tamil Eelam (LTTE). Their leader, Velupillai Prabhakarn, had been killed. However, the victory was not without controversy. The president faced severe international criticism over "the more than 20,000 civilians that leaked United Nations estimates indicated have been killed or injured in the conflict".[13]

The Tamil defeat was ultimately the result of the emergence of a strong leader in Colombo who went about executing the war against the Tamil separatists with ruthless efficiency. Once the state had taken the decision to use all the force at its disposal and not worry about the consequences – about collateral damage in the language of the counterinsurgency strategies that gained currency when Colombo executed the war against the secessionists – the Tamil movement was put down quickly, albeit at great human cost. This cost continued to be exacted long after the civil war had ended.

Ethnicity, religion and disaffection: The Taliban and terrorism in Pakistan

The Taliban insurgency in Pakistan's north-western region is also the consequence of the coming together of a number of contributing factors to produce a perfect storm. Once again, religion and ethnicity have played their parts, but so have the underdevelopment of the regions where this activity was centred and the economic backwardness of the people who were involved. Much has been written on the rise of the Taliban in Afghanistan and Pakistan and much more will be written because of the intense involvement of the United States in this development. The outline of the story is well known and not much purpose will be served by repeating it here.[14] The events leading to the rise of the Talban can be traced to the 1980s war against the Soviet Union's occupation of Afghanistan and the decision by Washington to raise a force of religiously motivated fighters – the *mujahideen* – to wage a *jihad* against the invading infidels. The *mujahideen* succeeded beyond most expectations and forced Moscow to pull out its troops, which it did in 1989. However, the Soviet departure did not bring peace to the country. The seven *mujahideen* groups that had fought the Soviets now turned on one another and the bloodshed and destruction that ensued was worse than that experienced during the Soviet occupation. Out of this mayhem emerged a force in Kandahar in south-western Afghanistan, the Taliban (literally "the students", since members were recruited from the many schools that were set up by the United States with help from Pakistan and Saudi Arabia in the refugee camps all along the Afghanistan–Pakistan border). Aided by Pakistan's Inter-Services Intelligence (ISI), the Taliban were able to quickly establish their control over most of the country save a small strip of land that remained with a group of warlords of Tajik and Uzbek descent who went under the name of the Northern Alliance.

The Taliban government in Kabul gave sanctuary to Osama bin Laden, a renegade Saudi millionaire who had founded a group called al-Qaeda to espouse a conservative form of Islam as well as challenge the authority of the ruling class in his home country. The American support of the rulers of the Kingdom of Saudi Arabia was reason enough for bin Laden to turn against Washington and to hatch a conspiracy that resulted in the terrorist attacks of 11 September 2001 on New York and Washington. The attacks brought the Americans back to Afghanistan, this time not to wage a proxy war against the Soviet Union, but to get directly involved against the Taliban. The involvement of a superpower in the conflict gave the rise of the Taliban another dimension.

What has given such prominence to a study of insurgencies at this time is the fact that some stateless people belonging to the Islamic faith have decided to challenge the United States in particular, but other Western states as well, by using the weapon of terrorism. The United States' initial response to the problem was the use of force to defeat the Islamist extremists that are threatening its interests. This was called the "shock and awe" approach – to use so much military power against an essentially primitive enemy to obtain its submission. This was largely the strategy followed by the Administration of President George W. Bush until the final year of his tenure. Then, under the influence of General David Petraeus, who was responsible for developing the counterinsurgency strategy for the United States, the Bush Administration changed course in Iraq by combining economic and political development along with the use of force to beat back the insurgents. The strategy seems to have worked. The level of violence in Iraq subsided significantly, and December 2009 was the first month since March 2003 (when the United States went into Iraq) in which the Americans did not lose a single soldier in the conflict.

Whether the same strategy should be adopted in Afghanistan, the other area of insurgent activity, is a question that was debated for four months between August and November 2009 by the senior officials, including the president, of Barack Obama's Administration. Obama had taken office convinced that part of the problem was the widespread impression among the Muslim populations around the globe that the Americans were fighting a war against Islam. Early on in his tenure he decided to address this issue head on. In a major address aimed at the world's Muslims and delivered before an audience in Cairo he said, "I have come here to Cairo to seek a new beginning between the United States and Muslims around the world, one based on mutual interest and respect". He promised that he would build bridges between his country and the world of Islam. He wanted the Muslims to recognize that the fight against those who were committing acts of terrorism was not just America's war or the war being waged by the West, but it was also their war. He did not wish the people in his own Administration to lose sight of this fact as he prepared to define a new strategy to beat back the insurgents operating from the secured havens in the mountainous regions on the border between Afghanistan and Pakistan.

In August General Stanley McChrystal, the commander of the United States forces in Afghanistan, sent in a request for 40,000 additional troops to the president. McChrystal wanted the kind of troop surge in Afghanistan that appeared to have brought relative peace in Iraq. After an intensive discussion led by the president, Obama announced his decision to give the General 30,000 troops, but also indicated that he would begin the process of withdrawal of the American contingent in July 2011. All these developments have seriously affected Pakistan, which had already seen a build-up in Islamist extremism. However, just as the American Administration had convinced itself that it had found a way and justification for combining strong military action against the extremists with a serious development effort, the situation was complicated by the attempt made by a young Nigerian man to blow up an American airliner as it was coming in to land in Detroit. This happened on Christmas Day 2009. It was revealed that Abdulmutalleb, the young man,[15] had received training in Yemen from a group that called itself al-Qaeda in the Arabian Peninsula. Preceding this act was the attack by a Muslim doctor, a psychiatrist, on his fellow workers at Fort Hood in Texas, in which 14 people were killed. It was revealed that the doctor was also in email contact with a Yemeni imam. On 1 May Faisal Shahzad, a 30-year American citizen of Pakistani decent, attempted to set off a car bomb in Manhattan's Times Square. The bomb did not work, but this once again focused attention on Pakistan as "terrorism's supermarket". There was thus a focus once again on Islam as the main reason for terrorist activities, especially those that targeted the West, and there was attention once again directed at Pakistan. Under pressure from his critics who were troubled by the new president's focus not on the use of force alone but the combination of force with other types of efforts, Obama seemed to be shifting his ground. He began to use language that resembled his predecessor's: "We are at war against al-Qaeda and we will do whatever it takes to defeat them", he declared upon returning to Washington from Hawaii, where his vacation was interrupted by the news of the Christmas Day failed bombing. Some of those who had supported Obama in his quest for the presidency were troubled by the direction the new president was taking under the pressure of events. "Even as he fights al-Qaeda and its allies, Obama needs to be Obama. He needs to continue voicing the Cairo message of outreach to the Muslim world – not as an alternative to the battling extremism but as a necessary component to that fight", wrote syndicated columnist David Ignatius. "We are confronting an enemy that wants us to draw deeper into battle, so that America is more isolated and unpopular. We avoid the spider's trap by resolving the problems that matter".[16]

The main hypothesis to be tested in this body of work is the role of economics in producing despair among certain groups of people and to persuade them to challenge the authority of the state. If this is indeed the case, it will have a profound impact on the design of public policy. A good part of the debate in the United States as President Obama was deciding on a strategy to fight the Islamist militants operating in the border areas of Afghanistan and Pakistan was concerned with assigning a larger weight to economic development in winning the war against the extremists. If economic deprivation was a powerful reason for the extremists to fight the West and simultaneously the states of Afghanistan and Pakistan, then that is where the bulk of the effort has to be directed. I will return to this subject below in the context of inter-country relations in South Asia.

Economic and social discontent in India and the rise of Maoism

Discontent in India has been brewing for a long time. It has now come to the surface with the rise of the Maoist rebellion in several states of central and eastern India. The rebels operating from the thick forests in the area have inflicted very heavy damage on the security forces that are attempting to bring the insurgency under control. Almost 100 people have been killed since 6 April, when the Maoists launched one of their more brazen attacks, killing 76 security personnel. They struck again on 17 May, blowing up a bus that was carrying 50 people; of these, 18 were special police officers, a separate force the Indians have raised to fight domestic terrorism. The Maoists triggered an improvised explosive device at a place called Chingavaram near Dantewada, the capital city of Chhattisgarh, in eastern India. On 27 May the Maoists blew up a passenger train in West Bengal, killing 120 people.

These attacks indicate a clear escalation in the activities of the Maoists, a movement that started decades ago among the hill tribes in the eastern state of Assam. It was then called naxalism. According to government sources, there were 2,250 attacks in 2009, in which year 590 people were killed by the insurgents. In the first four and a half months of 2010 the rebels launched 810 attacks; their activities had already claimed 320 lives at the time of writing (June 2010).

As Harvard University political scientist Samuel P. Huntington wrote more than four decades ago, it is almost inevitable that a society and an economy that grows quickly will leave behind many segments of the population. This will manifest itself in open discontent if the country experiencing change does not have strong political and economic institutions to absorb discontent and to provide relief to those who suffer from what he called "relative deprivation". Much of the evidence Huntington used for his seminal work came from Pakistan and some Latin American countries.[17] When he was completing his work, the Ayub Khan era was coming to an end in Pakistan and there was widespread feeling that large sections of the population had not benefited from the admittedly large increases in national output. This feeling was very strong in East Pakistan, but was also present in the western wing of the country.

Another Harvard social scientist, the economist Albert O. Hirschman, writing about the same time as Huntington, went a step further and identified what he thought were the options available to those who were not happy with their situation compared with that of the major beneficiaries of social and economic change. The title of his influential work, *Exit, Voice and Loyalty*, indicates the options he had in mind. In a well-developed political system, those not satisfied can hope to be heard by raising their voice; if those who wield power act to redress the felt grievances, they can hope to win the loyalty of the affected population. If not, the adversely affected are likely to exit, moving into the areas that are hard to reach for the forces of the government.[18] This is what the Maoists in eastern and central India have done.

That the situation described by Huntington and Hirschman could lead to violence and ultimately regime change was understandable in a country such as Pakistan in the late 1960s when the political system of the times did not provide adequate space to the disaffected. "Exit" was the only choice available and was exercised by the people not only against Ayub Khan, but also against Prime Minister Zulfikar Ali Bhutto a few years later. India was different, however. For more than half a century it has had a political system that successfully accommodated many diverse people. Why is it, then, that groups such as the Maoists have taken up arms against the Indian state? Why, too, is the Indian state finding it so difficult to control the situation?

The answer to the first question is that the mode of development pursued in recent years by New Delhi has led to the creation of much visible wealth for one class of people, but little material change for the masses. Income inequality has increased to the point that the high rates of growth of the last two decades have made little change to the incidence of poverty. The poor in the large Indian countryside have not seen much improvement in the quality of their lives. The pursuit of growth has led to the exploitation of the areas that are rich in mineral wealth, but without adequate compensation given to the people who have lived there for centuries. It is the mining of coal in some of the forested areas that led to the rise of the Maoist movement there. In a statement issued by the Communist Party of India (Maoist), which has provided the political umbrella under which most of the dissident groups are operating, the blame was laid at the government's doorstep. "As long as the government refuses to see the socio-political roots of naxalism and continue to treat it as a problem […] Dantewada type attacks will continue to take place at an even greater frequency and intensity. An all-out war has already been declared. Maoist counter-violence will take on new and deadly forms which these apologists of state terror cannot even imagine". This statement was issued before the attack on the train on 27 May.

The Indian state's slow and somewhat clumsy response to the situation was reminiscent of the one initially adopted by the government in Islamabad in dealing with the Taliban movement. It was only after a great deal of damage had been done to the Pakistani economy and to the country's reputation that the authorities developed a position that began to yield results. In India there was intense debate in the media and among the political circles about the best approach to follow. P. Chidambaram, the home affairs minister, was in favour of using as much force as possible, equipping the security forces fighting the rebels with helicopter gunships. Several ministers in Manmohan Singh's cabinet preferred using a softer touch – negotiations and development to persuade the Maoists to give up their fight. The home affairs minister, perhaps under the pressure of his cabinet colleagues, invited the Maoists to a dialogue with the government. His condition was that insurgents suspended their operations for at least 72 hours. That was on 19 May 2010. Two days later, on 21 May, the Maoists responded by killing two soldiers with an improvised explosive device while a convoy of military vehicles was passing on a road in an area of insurgent activity.

The South Asian governments have had to fight various insurgencies in their countries in the middle of an information revolution that delivered news instantly to hundreds of millions of houses. This was the case when the military launched an attack on Islamabad's *Lal Masjid*, the red mosque, in 2008 to push out the Islamists who had turned it into a military fortress. The spin given by some sections of the media did not help the government in its fight against extremism. The same was the case with the treatment of the Maoists by some sections of the Indian media. According to Robin Jeffrey of the Institute of South Asian Studies in Singapore, "the Maoist insurgency comes at a time when India lives in a totally new media environment. Every group in this drama struggles with these new conditions and seeks to use them to achieve its aims". The information revolution has been produced by the spread of new and old mediums of exchange. "In 2010, another new medium has spread throughout India: 580 million cell phones […] India has close to 130 million television households, which means more than half the country sleeps each night in a place with a television set. India has more than 50 new channels, many of them plugging particular lines […] India publishes 100 million newspapers a day for 1,150 million people (11 people to a daily newspaper). Up to 15 per cent of the population had access to the web".[19] In such a rich information environment any movement that had some popular following was becoming hard for the state to suppress. This is an area where the South Asian states can help each other by focusing on economic development rather than pursuing their old grievances.

Economics as the basis of cooperation

We have suggested in this work that the stage has been set for the movement of South Asia towards reconciliation and more meaningful attempts at regional economic cooperation. This process could be advanced by India and Pakistan shedding the burdens of history and using economics as the basis of their evolving relationship. They could also help – India in particular in the case of Islamist extremism in Pakistan – in dealing with the insurgencies that the two countries are fighting at this time.

There has been a significant shift in the positions of most countries involved in the current Afghanistan conflict. The process started with President Obama's speech on 1 December 2009. Among the more important developments was the decision by New Delhi to give up its position that it would not talk to Pakistan about resolving the many issues that had soured relations between the two countries unless Islamabad took steps to prosecute those who had masterminded the terrorist attack on Mumbai on 26 November 2008. India had also demanded that the infrastructure used in Pakistan by various terrorist groups should be dismantled. On 4 February 2010 New Delhi proposed the resumption of talks at foreign secretary level but did not suggest an agenda. The response from Islamabad was quick. Abdul Basit, the foreign office spokesman, said that "if India dispenses with its traditional inflexibility there is a possibility of moving ahead. Pakistan has always believed that it is only through genuine and meaningful talks that Pakistan and India can resolve their disputes".

On the same day P. Chidambaram, India's home affairs minister told the media in New Delhi that the handler of the group that had penetrated Indian defences on 26 November 2008 to attack Mumbai may have been an Indian, something the Pakistanis had suspected all along. "When we say he could be somebody who acquired Indian characteristics, it doesn't necessarily mean he is an Indian. He could have infiltrated into India and lived there long enough to acquire an Indian accent, and familiarity with Indian Hindi words."

On 5 February, a day after the announcement from New Delhi, Shahid Malik, Pakistan's High Commissioner in India, met with Nirupama Rao, India's foreign secretary, to discuss the timing and content of the high-level meeting between the two countries. "All possible issues which are of concern to Pakistan or India will be discussed", he told the press after the meeting. "Kashmir is an issue we have been raising with India at every possible opportunity and forum. Terrorism will certainly be one of the areas of discussions because we have issues relating to terrorism and this is something that affects Pakistan."

The news that India was prepared to restart its dialogue with Pakistan, begun in 2004 but suspended in 2008 after the terrorist attacks on Mumbai, was received in Pakistan with a mixture of relief and triumph. Most policymakers were of the view that the position Pakistan had taken following the Mumbai carnage was vindicated. Its neighbour had begun to recognize that there was no official Pakistani involvement in the attacks. The terrorist activity launched by a group that called itself *Tehrik-e-Taliban in Pakistan* in the fall and winter of 2009 was a clear indication that Pakistan was also a victim of terrorism. Some 600 people were killed in these attacks in Pakistan's major cities – Islamabad, Lahore, Karachi and Rawalpindi – and in several small towns in the NWFP.

The fact that there was some disagreement over the content of the dialogue once it began is a good indication of the nature of the relationship between these two countries. Even relatively minor issues became contentious. India initially indicated that it only wished to discuss terrorism, while

Pakistan wanted to go back to the composite dialogue which covered most contentious issues that had caused so much hostility between the two South Asian neighbours.

This may be a good time to completely change the framework within which India and Pakistan have been discussing their relations ever since 2004. Then, on the sidelines of the summit of the leaders of SAARC, Pakistan's President Pervez Musharraf and the Indian Prime Minister Atal Behari Vajpayee agreed that the two countries should attempt to resolve their differences through dialogue. In the context of the history of Indian-Pakistani relations, this was a major breakthrough. As was always the case, Islamabad wanted to focus on the issue of Kashmir. New Delhi was in favour of discussions that covered the many reasons for continuing tensions between the two countries, which included territorial issues other than Kashmir. For a number of years India and Pakistan had been fighting over the Siachin Glacier in the eastern part of the disputed territory of Kashmir. There was also dispute over Sir Creek on the western side of the border between the two states. The Indians suggested that movement on these issues would build confidence and ultimately lead to the resolution of the more difficult problems, including Kashmir.

In February 2010 the two countries, once again, began to debate the content of the dialogue expected to be resumed later in the month. According to a newspaper report, what the right approach to the Indian initiative should be, was discussed at a brain-storming session at the Ministry of Foreign Affairs in Islamabad, where some concern was expressed that unless the composite dialogue was fully restored, Pakistan should not participate in the discussions. However, the diplomats left the final decision to the politicians who, it was said, might be able to think outside the box, finding a way to depart from the entrenched positions in the two bureaucracies – the Indian position that dealing with terrorism has to be the main focus of discussions, and Pakistan's position that the entire relationship should be on the discussion table.

If thinking outside the box is to be encouraged, the two countries should base the dialogue on an entirely new consideration: how to bring about greater economic integration between their economies. The objective should be to develop a stake for India in the Pakistani economy and also in its stability. This would entail a number of things, including unhindered flow of trade between the two countries; encouragement of the private sector on either side of the border to invest in each other's economy; the opening up of the border that separates the two parts of Kashmir to trade and movement of people; and the granting of transit rights to each other for trade with third countries. As the experience of Europe shows, economic integration among states that have known great hostility towards one another is a good way of easing tensions. Taking that approach would constitute real thinking outside the box. A slight movement in that direction may have occurred in April 2010, when the prime ministers of the two countries met at Thimpu, the capital of Bhutan, and decided to begin a serious dialogue that included economic relations. The meeting was held on the sidelines of the SAARC summit. The two leaders had still not found the political will and courage to meet without using the crutch of an international gathering.

6 The South Asian way: A non-conventional approach to the making of economic policies

Introduction

What lies in South Asia's future? The question is not easy to answer since the region is beset with a number of seemingly intractable problems. Depending on how it deals with the various economic, political and social problems it faces, South Asia could go in a number of different ways. It could make as rapid economic progress as India has done in recent years. By virtue of its size in the region and also because of the remarkable performance of the economy over a couple of decades – from the mid-1980s to 2008 – India will have a major role in determining South Asia's future. How could the Indian experience be shared by other countries in the region? Is the Indian growth model replicable and could India help in spreading its model of economic growth to other places in the area? Or is India likely to go it alone, leaving the countries in its neighbourhood to their own devices? One of the arguments advanced in this work is that "going it alone" is not a viable option for India. By turning its back on the region's other countries, which are much more unstable economically, politically and socially, India would be purchasing some of this instability for itself. The obvious way for it to proceed is to find a way to work with other regional states.

Since 2000 South Asia has performed well. The increase in its gross domestic product (GDP) averaged close to 7 per cent a year and income per head of the population increased by nearly 5 per cent. However, these are simple averages that hide a number of disturbing facts. The growth numbers are spectacular since India, by far the largest economy of the region and now accounting for 82 per cent of the regional output, performed spectacularly well – its GDP increased at the rate of almost 9 per cent a year during this period. This is the kind of GDP increase that has become the norm in East Asia. Pakistan, the region's second largest economy, did not do as well. In 2008–10 its GDP increased by less than 3 per cent a year, one-third the rate of increase of India. Bangladesh did better than Pakistan, but not as well as India, with GDP increasing at an average 5 per cent a year in 2007–10.

Economic development: The conventional approach

In discussing South Asia's economic and social future I will not take the standard line by suggesting how much capital needs to be accumulated and how it should be allocated among more productive sectors of the economy in order to realize a high rate of economic growth. This is the standard production function approach to economic development. According to this, income growth is a function of capital accumulation and the number of people put to work. Increasing either results in growth. For the economies at an early stage of development there is no limit to growth on the labour side of the equation. What constrains the rate of growth is the availability of capital. Several decades ago Arthur Lewis, the West Indies Nobel Prize-winning economist, presented his model of growth in labour surplus economies in which there is abundant labour available in the countryside. This labour is engaged mostly in low productive work. By transferring it to non-agricultural or non-rural activities in the urban part of the economy, the overall productivity of the economy and its rate of growth increases. This model runs its course once agriculture has surrendered the surplus labour to non-agricultural activities.[1] All South Asian economies are still in this phase of development.

Having recognized capital as a binding constraint on growth, the first generation of development economists began to work on how it could be overcome. It was widely accepted that backward economies were too poor to save much – to generate, in other words, resources from within to accelerate the rate of growth. This led to the emphasis on government-to- government development assistance made available as outright grants or at low rates of interest. There was much interest in developing the world's backward economies as the United States and the Soviet Union began to compete for the hearts and minds of the people living in these countries. New and innovative ways were found for raising additional capital for development. For instance, after much debate a new institution was added to the International Bank for Reconstruction and Development (IBRD). The IBRD itself was created in 1944 as part of the post-World War system of international economic management. The debate was on the location of the institution. Developing countries wanted it as part of the United Nations system; donor countries pressed for its creation as an affiliate of the IBRD. That's where the International Development Association (IDA) went and the IBRD was transformed into the World Bank Group by acquiring a new institution committed to aiding the poor.[2]

Several countries that had adopted communism as the governing economic ideology chose an entirely different approach to capital accumulation and its allocation. They chose not to rely on external capital flows and turned entirely inwards, squeezing resources from within the economy. This meant sacrificing current consumption in order to generate growth and thus improving the living standards of the generations in the future. The resources thus accumulated were placed at the disposal of the state for allocation to the sectors that the state believed would maximize growth. China in the 1950s was one example of a country that tried this approach. Mao Zedong believed that he could accelerate the transformation of the economy by undertaking programs such as the Great Leap Forward launched by him in 1958. These turned out to be extremely expensive in terms of human cost without quickening the pace of economic change.

Later some economists – initially Robert Solow of Massachusetts Institute of Technology (MIT), followed by several others – constructed production functions based on the data available in developed countries. This was the application of empiricism to advance theories based mostly on intuition. Solow found that for the United States a combination of capital and labour did not explain the increases in the entire amount of output as these inputs increased. He came up with what he called the "X" factor, which was outside the production function – or, in the language of mathematical economics, was an exogenous element in the growth equation. Still later, economists such as Robert Lucas and Paul Romer introduced knowledge into the production function thus making it endogenous – a part of the growth equation. According to this way of thinking, it needed more than a combination of labour and capital to explain output increases; it was also knowledge that was a critical variable. Some economists have expanded the definition of capital to include what they call social capital – how people in a society interact with one another.[3]

Instead of focusing on these standard variables to suggest how growth in South Asia could be quickened, we will concentrate on how the region could use some of the advantages it has over other developing countries and how they could be exploited to ensure a better economic future for the area's large population. In this context we will pay particular attention to five contributors to positive economic change: ideas about development that evolved in different countries of the region and then through a process akin to osmosis crossed the borders; the role the state can play; demographic change and how it opens the windows of opportunity that could be exploited for development; location and geography; and expanding the markets through the formation of regional organizations as determinants of growth. The last factor was discussed at some length in an earlier chapter. These determinants of growth are factors additional to those that figure in standard production functions.

The flow of ideas across national borders

The movement of goods and people across borders can be blocked by the use of administrative fiat. This is difficult to do in the case of ideas. The

South Asian region has erected all kinds of barriers to inhibit the movement of people and to discourage trade. This is not just the case for the way India and Pakistan have managed their joint borders. There is not as much trade among the other countries of the region as the gravity model of trade will have us believe. According to the model, trade is determined by two things: the mass of the trading partners and the distance among them. The size of India and the fact that it shares borders with all countries of the region save Afghanistan and the Maldives, should have meant that the country would be the dominant player in the pattern of international trade for the region. That has not happened; the gravity model has not worked for South Asia. Politics and bureaucratic hurdles – and to some extent protectionist instincts of the policymakers – have come in the way. India should be the main destination of exports for the countries of the region and also the origin of a significant proportion of their imports. This is not the case for Bangladesh, Pakistan and Sri Lanka. The only countries where this is true are the landlocked Bhutan and Nepal. For them trade links with India were the consequence of their geography, not necessarily the product of public policy.

The South Asian countries, on the other hand, have looked across their borders and learnt a great deal from one another in the making of public policy. Most of this learning was done by watching what was happening in the other countries. There was little formal exchange of ideas by policy-makers – even by think tanks. The forums in which such exchanges could have been made simply did not exist. This was certainly the case with India and Pakistan. There are some links between Bangladesh and India, but even these are sporadic and relatively infrequent. There were no such links between, say, Pakistan and Bangladesh, Pakistan and Sri Lanka, or Afghanistan and the rest of South Asia.

In the domain of ideas, although India was the main exporter, Bangladesh was also fairly active. Pakistan also briefly played that role when, during the presidency of Field Marshal Ayub Khan, it had begun to be taken seriously as the model of economic success. This was the line taken by the experts drawn from Harvard University's Development Advisory Service (DAS), who had helped with the development of the Pakistani approach to economic progress. Some of the books they wrote were read with a great deal of interest by the development community[4]. Pakistan, it appeared, had managed to find a cure to a disease that the Swedish economist Gunar Myrdal called the prevalence of the "soft state" in South Asia[5]. This was the state that neither had the political will nor the bureaucratic competence to deal with the strong vested interests that were not keen to see structural changes take place in their societies. Under Ayub Khan, the Pakistani state was given the task of determining the direction of economic change and was provided with the instruments for achieving its goals. However, Pakistan's success under its first military leader did not outlast his tenure. He was removed from office in 1969 by another general for whom economic development was not a high priority.

Initially the main idea imported from India was the use of central planning to allocate capital among the users favoured by the state. Jawaharlal Nehru, the first Indian prime minister, was enamoured of the Soviet style of centralized planning. He had bought into the Soviet belief that the only way time could be compressed for converting an agrarian society into an industrialized one was by allowing the state to manage the economy. This was done by Moscow by nationalizing all economic assets owned by the private sector. This included land – agricultural as well as urban. In borrowing Soviet-style centralized planning, Nehru did not go that far; he did not nationalize private property, but he did put the Indian state at the "commanding heights of the economy".

What this phrase meant was that the state had the right and the duty to control and guide the private sector – to determine how much it would invest, where it would invest, what and how much it would produce, how it would obtain the inputs required for production, and how labour would be compensated and what the conditions would be under which the workers would work. Thus was ushered in the "licence raj" in India. What it actually meant for the Indian private sector was described in vivid detail by Gurucharan Das, one of the senior executives of Procter and Gamble, a transnational corporation that had large operations in India.[6] Das's book appeared after the "raj" was dismantled by then-finance minister Manmohan Singh.

Pakistan borrowed the idea of central planning from India and started work on the First Five-Year Plan for the period 1955–60. The document could not be produced for the reason that politics got in the way. It was only in 1958 that the plan's draft was produced, but it was no longer relevant since the period it covered was almost over. However, the military government that was in place at that time empowered the Planning Commission to begin serious work on the Second Five-Year Plan for the period 1960–65. This was done and the plan began to be seriously implemented. It was a great success in terms of producing an unprecedented rate of growth in the economy. Although the idea of central planning came from India, the strategy Pakistan adopted was not Indian in origin. In Pakistan, the government wished to focus on igniting growth in the economy and placing its faith in the "trickle down effect" to help the less advantaged segments of society. Accent was on growth rather than on poverty alleviation or on improving the distribution of income.[7] There was a different set of objectives in India. There the Constitution obliged the planners to focus on the poor. It directed that "the ownership and control of the material resources [should] be to serve the common good", and that, "the operation of the economic system [should] not result in the concentration of wealth and means of production to the common predicament". There were no such constraints on the Pakistani planners.

The government headed by Ayub Khan also bought some aspects of the licensing system from India, but it was less rigorous than the one the Indians had operated. Pakistan allowed much greater space to the private sector than India did. The Indians also used the financial sector to direct credit into the favoured sectors of the economy. The same approach was followed by the Pakistani government, which, like the Indian one, created what were then called the development finance corporations (DFCs). Some of these were established with the help of the World Bank, which was then in favour of using state-owned financial enterprises to allocate capital. The Pakistan Industrial Credit and Investment Corporation (PICIC) was patterned after the corporation of the same name in India, the Industrial Credit and Investment Corporation (ICIC). However, Pakistan, encouraged by the World Bank, went much further in this direction. The Industrial Development Bank of Pakistan (IDBP) and the Agricultural Development Bank of Pakistan (ADBP) were both aided by the World Bank. The banks helped medium-sized industries with capital, while PICIC's operations were confined to large industrial enterprises.

It was only after Zulfikar Ali Bhutto assumed power that the private sector came to be tightly regulated. Bhutto in that sense was a "Nehruvian", but he went a step further. Nehru had eschewed nationalization as a way of increasing the presence of the state in the economy, preferring to do it by expanding investment in industry by the public sector. Bhutto, on the other hand, resorted to wholesale takeover of private assets by the government. The two-year nationalization spree by the government in 1972–74 changed in a fundamental way the structure of the Pakistani economy. The Bhutto administration also invested heavily in large-scale industries, once again following the Indian approach in the period before the opening up of the economy to a greater role by the private sector.[8]

Bangladesh has also significantly contributed to development practices in South Asia. The country gained independence in January 1972. Creating a new state from scratch is a formidable enterprise, as the Pakistanis had discovered in 1947, the year their country won independence.[9] However, there was one important difference between the formative years of Pakistan and Bangladesh. Pakistan in 1947 did not have a middle class of any significant size. It was economically polarized between the rich – mostly landlords – and the poor. On the other hand, by the time of its independence Bangladesh had a large presence of the middle class, the *bhadralok*, which was able to profoundly influence the direction of development and economic change.[10] The other difference was the way the emergence of the two countries was treated by the international community. While Pakistan received little help from the international community for the reason that the world's richer countries had not yet learned to get engaged in those that were backward but hoped to develop, this was not the case when Bangladesh was born. By the early 1970s development economics was a relatively mature discipline. A number of development institutions – in particular the World Bank – had gained a great deal of experience in helping poor countries with development. They were now able to learn from what they had done in the Third World. At the time of Pakistan's birth, development economics was simply a collection of concepts formulated by those who believed that poor countries could not entirely depend on traditional economics to guide them towards development. A quarter century later, at the time of Bangladesh's birth, empiricism had entered development economics in a significant way replacing intuition as the way to develop the discipline. A number of new concepts were put forth by examining data on various aspects of economic and social development that institutions such as the World Bank had accumulated. Econometric models were used to find relations among various time series. This became the standard way of coming up with new development thinking. As Bangladesh was struggling to stand on its feet, development economists had begun to discover the importance of institutions for promoting development. The new country's contribution to this line of thinking was to show that non-governmental organizations (NGOs) could play important roles, particularly in those countries where governments were weak.

The provision in the Indian Constitution about the state's responsibility for caring for the poor did not lead to the development of human capital as one way of achieving that objective. Under Nehru, the Indian government interpreted that provision as an allowance for expanding the state's role in managing the economy and using it to provide employment opportunities for the poor. Over time the state sector was to be burdened with a large workforce it did not need and could not afford. At the same time the private sector was also obliged to play a role in creating employment for the poor. Draconian labour laws were introduced that resulted in constraining the private sector rather than helping the poor.

It was Sri Lanka that was the first country in South Asia to recognize the importance of human development for alleviating poverty. Under the enlightened leadership of the people who had guided the country towards independence from colonial rule and supported by a group of economists with socialist leanings, the Sri Lankan state invested heavily in education and primary health care. It was this line of thinking that came to be called the "basic needs approach to development" at institutions such as the International Labour Organization (ILO) and the World Bank.[11]

In the early 1970s development practice had begun to emphasize the development of human resources as an important determinant of growth. As discussed above, Sri Lanka had taken the lead in developing an approach for using the state to improve human capital. In devising its own growth strategy, Dhaka focused on both the role of the state and the development of human resources. There was one problem, though. The state was weak at that time, having been created from the ashes left behind by the conflict with West Pakistan. Under these circumstances, it allowed a great deal of space to NGOs. There was also concern in development circles about the quality of governance offered by the state in poor countries, while there was greater faith in the efficiency and effectiveness of NGOs. Bangladesh offered a good opportunity to test these ideas. The performance of two NGOs – BRAC and Grameen – provided ample evidence that the trust placed in them was justified. BRAC – initially the acronym stood for Bangladesh Rehabilitation Assistance Committee – was founded by Fazal Hasan Abed in February 1972, a month after Bangladesh gained independence. Its original mission was to aid the refugees who had left for India to escape the horrors of the civil war. To begin with, funding mostly came from donors, but over the years the organization has been able to diversify the source of support including generating resources from its own operations.

In 1973 BRAC's mission was widened to focus on long-term sustainable poverty reduction. According to the organization, "over the course of our evolution, BRAC has established itself as a pioneer in recognizing and tackling the different dimensions of poverty. Our unique and holistic approach to poverty alleviation and empowerment of the poor encompasses a range of core programs in economic and social development, health, education, human rights and legal services". The NGO has grown in size: according to its website, in 2009 it employed 127,337 people, 61 per cent of whom were women. It now covers most of Bangladesh – it has operations in 64 districts and 78 per cent of all villages. Of the many contributions to development practice made by BRAC, two are particularly significant. It focused on the absolute or chronically poor, identifying them and tailoring programs to meet their needs. In January 2002 it introduced its Challenging the Frontier of Poverty Reduction – Targeting the Ultra Poor (CFPR-TUP) program. The other innovation by the organization was to use microfinance to help women, particularly those who were also the heads of households. The successes achieved by the organization persuaded the development community to invite it to other poor countries. It now operates in a number of Asian and African countries and counts 110 million people as its clients.

Grameen Bank pioneered the concept of microfinance in poor countries and provided the development community with a model for bringing the disadvantaged into the formal part of the economy. Founded in 1976 by Professor Muhammad Yunus who was then the head of the rural economics program at Chittagong University, Grameen (the word in Bangla means "rural" or "village") used the community as the collateral for providing credit to the poor. There was a belief that a community would not allow an individual to default on the loans he (mostly she in the way Grameen developed its operations) had obtained. The community would use pressure as well as moral suasion to make the borrower service the loan. On this depended the community's own creditworthiness. The concept was tested as a pilot in Jobra village near Chittagong in 1976–79. It was initially supported by the country's central bank. Now Grameen Bank is owned by the rural poor, who hold 90 per cent of the capital of the institution while the government owns the rest. In 2006 the Bank and its founder were awarded the Nobel Peace Prize.

The work of BRAC as well as Grameen influenced other countries in South Asia; a number of NGOs in these places have modelled themselves on these two organizations. Even the governments have used the experiences of these NGOs to reach the poor in their countries and to lift women out of poverty and backwardness. As some of the states in the region weakened – this happened in Afghanistan, Nepal and Pakistan – they allowed the NGOs to step in. The more successful organizations fashioned their work on BRAC and Grameen.

In the early 1990s both India and Pakistan changed the way they looked at the state as a player in the field of economics. The move in that direction was made earlier by Bangladesh. Later, India and Pakistan adopted a series of measures to reduce the presence of the state in the economy. Both economies were opened to the outside world, initially the Pakistani more than the Indian. Pakistan allowed a much easier entry of foreign enterprises in Pakistan than did the Indians. Foreign investors could hold 100 per cent of equity in the firms they established and could also repatriate 100 per cent of the profits. In these respects, the policymakers did not borrow from each other but followed what was being advocated by development economists working in a number of Washington-based institutions. Some of the members of the Manmohan Singh team that instituted reforms in India had worked at the World Bank and had participated in the development of the thinking that came to be known as *The Washington Consensus*. Sartaj Aziz, then-finance minister of Pakistan, had also worked in a multilateral agency (in his case the Rome-based International Fund for Agricultural Development – IFAD) and was familiar with the thinking in development circles.

Later, in the early 2000s, there was a significant amount of borrowing from India by the government of President Musharraf as it gave even more space to the private sector. However, there was a difference. The Indians, while encouraging private enterprise, retained a fair amount of government oversight of the private sector. This was not done in Pakistan. The Reserve Bank of India, the Indian central bank, was much more independent of government influence than was the case with the State Bank of Pakistan.

This learning by doing, either in the country itself or looking at the experience of other countries in the region, has allowed the South Asians to develop their own way of using the state as a promoter of economic growth and a facilitator of economic and social change. As shown above, this was not done by pursuing a particular design but by experimentation. The evolution towards thinking on development in South Asia was gradual, sometimes halting. One clear conclusion can be drawn from this quick overview of the evolution of development thinking over the last six decades. Several generations of policymakers in South Asia have learnt from each other's experience and have developed what could be called the "South Asian way of managing domestic economies". While the South Asians may not have traded much with one another, they have been active in learning from each other's experiences. If this were to be recognized explicitly it could perhaps help to improve cooperation in other fields as well.

The role of the state and the South Asian way

At this time there is a South Asian way of managing the economy which makes the state play a role markedly different from the one in the eastern part of the continent. In East Asia, as noted earlier in this work, the state was much more actively involved in promoting economic development and in ensuring that the area's economies were well integrated in the global economic system. It chose the "winners" on which the economy should concentrate its resources in the public as well as the private sectors, provided access to capital for those willing to take risks to produce these, and provided help with finding the selected manufactures a place in international markets. The state also invested in developing the necessary human skills to successfully manufacture these winning products, as well as doing research and development (R&D). There was considerable continuity in the state's role in East Asia. In South Asia, on the other hand, the role of the state has been constantly evolving. Those who had influence on determining the state's role learnt a great deal from the history of their own countries as well as the experiences of other countries in the region.

After trying a number of different roles for the state, governments in South Asia seem to have settled on four legitimate areas for the state's involvement in economic management. These include sharing the commanding heights of the economy with the private sector; allowing NGOs considerable operational space in the areas where the state, for whatever reason, was weak; taking some responsibility for assisting the less advantaged segments of the population and regions of the country; and allowing greater autonomy of operation to the governments at the sub-national level. We will briefly discuss each of these four areas below.

The first aspect worth noting in the evolving role of the state is its relations with private enterprise. Once it was seen that operating from the commanding heights of the economy did little good, the state climbed down and began to share the role of leadership with the private sector. It did not, however, step out of the way as much as the state did in the Anglo-Saxon world, or under the influence of *The Washington Consensus* sets of policies, as it did in Latin America. The state was prepared to allow a much greater role to the private sector, starting with the process of economic reform that began in the mid-1980s in India and in the early 1990s in Pakistan. The state pulled back but the question of how far it should recede remains unanswered. The Bharatiya Janata Party (BJP) in India was under greater influence from the private sector than was the Congress party, its main competitor on the national scene, which was prepared to allow much greater space to private enterprise. However, the occasional over-reach by the private sector raised the question of whether the state had pulled too far back. One episode in this context was the revelation in the spring of 2009 that the owners-cum-managers of Satyam, a highly regarded firm operating in the IT sector, had indulged in a number of illegal activities to enrich themselves at the expense of the shareholders. The Satyam affair highlighted the state's failure to regulate the private sector.[12] Similarly, the state in Pakistan under President Musharraf allowed much additional space to the private sector without strengthening the regulatory system. This created a widespread impression in the country of collusion among the large producers in sectors such as automobile and cement manufacture.

The South Asian state was much more accommodating of efforts by the developmental NGOs. This was in part because of the region's preference for representative forms of democracy for governance. However, even in those countries where democracy was not always the preferred option – as was often the case in Pakistan until 2008 – civil society began to be an important voice for change. Before the military was pushed back from the centre of the political stage – though not off the stage – it had governed the country for a total of 32 years. At the end of this period men in uniform were willing to allow space to the NGOs. These organizations were most active in those areas where the state lacked the competence or the political will to operate. In the countries with weak political institutions – as is the case with most of South Asia with the exception of India – NGOs also began to work closely with institution-based politics.

How effective civil society can be in pushing the often reluctant elite to open up the political system was demonstrated vividly by what has come to be called the "lawyers' movement" in Pakistan. This movement is an interesting case study of the important role civil society is playing in the political development of South Asia. In March 2007 President Musharraf tried to force Iftekhar Ahmed Chowdhury, Chief Justice of the Supreme Court, to resign. Chowdhury resisted, but was removed by the use of procedures that deviated significantly from allowed practice. This led to the launch of a movement by the legal community, and lawyers in their black coats took to the streets. As the agitation gathered momentum, the general panicked and on 3 November 2007 carried out what Pakistan's contemporary historians call Musharraf's second coup d'état, the first one being the 12 October 1999 overthrow of the government of Prime Minister Nawaz Sharif.[13]

Using the often employed device of the Provisional Constitutional Order (PCO), the president removed the chief justice once again, as he had in the meantime been restored to his position by the court. The lawyers' movement was joined by the mainstream political parties and the general was forced to pull back. The PCO was withdrawn and general elections to select the next national assembly were ordered. They were held in February 2008 in which the political party that had supported Musharraf's rule for more than eight years was trounced. Six months later the general, having been threatened with impeachment, resigned to be replaced by Asif Ali Zardari, the chairman of the Pakistan People's Party (PPP), the largest political organization in the country. Having taken over as president, Zardari balked at fulfilling the promises he had made to get himself elected. These included the reinstatement of Chief Justice Chowdhury and several of his associates who were also removed from the bench, as well as the repeal of the 17th amendment to the Constitution inserted by President Musharraf to concentrate a great deal of executive authority in his hands. Once again civil society led by the legal community went to work. In mid-March 2009, when a long march led by Nawaz Sharif was winding its way towards Islamabad from Lahore, Zardari relented. He allowed Yusuf Raza Gilani, his prime minister, to go on television to announce that his government had agreed to bring back the judges and to reinstall Chowdhury as the Supreme Court's Chief Justice. Another year was to pass before Zardari and the PPP agreed to repeal the 17th amendment. Once again, civil society and the media played important roles. On 19 April 2010 Zardari signed the 18th amendment into law. This amendment did more than repeal the previous amendment; it brought about a number of other sweeping changes and cleansed the Constitution of the distortions that were introduced by two military leaders, Generals Zia ul-Haq and Pervez Musharraf.

The main conclusion to be drawn from this case is that the South Asian people have now gained enough political maturity to know that their demand for a voice in the political system can no longer be denied. Having gained that voice in one of the countries with a more authoritarian state, they have begun to ask for an active role by the state in meeting their basic needs. One of the roles the state is now reserving for itself is to provide support to the less advantaged segments of the population. Care for the poor was a major preoccupation of the founding fathers of modern India. As discussed above, they built it into the country's Constitution. Decades before this approach became the standard prescription for the development of backward societies and economies, the Sri Lankan state was active in improving human development as a way of helping the poor. For more than a quarter century this did not become the explicit concern of the state in Pakistan. It was only after the arrival of Zulfikar Ali Bhutto and his PPP on the political scene that poverty alleviation and improving income distribution became the explicit policy of the state. Bangladesh's struggle for independence was led by a party – the Awami League – that was under the influence of a number of development economists who were wedded to the idea of using the state for social purposes, in particular for poverty alleviation.[14]

All these pledges and experiences aimed at helping the poor notwithstanding, the states in South Asia are still struggling to find a way to reach the poor. After winning the elections of 2004, the Congress party instituted programs aimed at helping the rural people who had voted overwhelmingly for the party over the coalition led by the BJP. The BJP's "shining India" slogan did not impress the rural poor. In Pakistan a succession of administrations have put in place various programs for aiding the poor, including the introduction of *zakat* as a tax on the rich the proceeds from which are distributed to the poor, a Poverty Fund run by private enterprise in association with the government begun in the late 1990s, an income transfer program called the *Baitul Maal* launched at about the same time, and the Benazir Income Support Program initiated by the Zardari administration in 2009.

Finally, albeit reluctantly, the South Asian states have gone some distance to allow governments at the sub-national level to exert some authority in financial and economic matters. This happened in India as a consequence of political expediency as the mainstream political parties had to share power with a host of smaller parties with deep roots in the states. In Pakistan this happened because of the need for a series of military rulers to gain legitimacy for their intervention in politics which led to the creation of systems of local government in which political parties were not allowed to participate. These were thinly veiled attempts to bypass the established political order.

Both Bangladesh and Sri Lanka, because of their physical size, remain relatively more centralized. Development thinking has also moved in the direction of favouring greater decentralization. For instance, the World Bank in its *World Development Report* for 1999–2000 noted that "localization – the growing economic and political power of cities, provinces and other sub-national entities – will be one of the most important new trends in the 21st century".[15]

While there is a distinct way in which the state in South Asia has been operating, its precise role continues to evolve. In this context, a number of questions remain unanswered. Two of these are significant. First, will the state be able to focus public policy on using some of the unique endowments of the region for the purpose of development? What the rewards of this approach would be is a subject addressed in the final chapter of this book. Will the states manage to throw away the accumulated burden of history to concentrate their attention on inter-regional cooperation? The first question was investigated in an earlier chapter. In the section that follows, we will discuss how the state could use South Asia's large and young population as an economic asset.

Declines in fertility and windows of economic opportunity

Economists have yet to fully recognize the important impact that demographic change plays in economic development – both retarding it or promoting it. If population has figured in their work, it has done so mostly as an inhibitor rather than a promoter of growth. This was the focus of much attention in the earlier phase of development thinking, when high rates of population growth were seen as hurting the prospects of many developing countries. In the early post-Second World War period, as health and hygiene improved in developing countries, there was an immediate impact on the rate of population increase. Mortality rates declined rapidly. In India the death rate fell from 42 per 1,000 at the start of the century, to 15 per 1,000 by the early 1970s. There were similar changes in other parts of South Asia.

For decades this decline was not compensated by reductions in the rate of fertility. There was a belief among many economists that the strong male preference and high rates of infant mortality were the reasons why parents chose to have large families. Most developing country parents wished to have at least two sons to survive to adulthood, which meant having six to eight children. However, the families did not seem to notice that declines in the rate of mortality had increased the probability of survival for boys. Inertia and hard-to-break habits made them opt for large families. With the families not reacting on their own, there was a broad consensus that the state had to intervene to reduce family size.

Population explosion became a great worry for development economists. Governments – in particular those in the already crowded South Asia – were encouraged to adopt family planning programs. The World Bank created a new department to aid this effort in the developing world. Many countries took the advice offered by the Bank and other development institutions. In the mid-1960s President Ayub Khan in Pakistan ignored the objections of the religious parties and launched an ambitious family planning program, and appointed Enver Adil, a civil servant known for his energy and dynamism, to head the effort. Foreign assistance came pouring into the program.

Across the border in India, the state's intervention in controlling the rate of population growth became even more intense. Sanjay Gandhi, the son of Prime Minister Indira Gandhi, and her principal adviser, took the lead in the effort. According to Vinod Mehta, his biographer, "family planning was [...] a herculean effort, the solving of which everybody acknowledged was important, if the nation hoped to survive let alone prosper. Family planning became the lynchpin of Sanjay Gandhi's Emergency activities".[16] Male sterilization was the preferred method and considerable pressure – in fact coercion – was applied on men who had families of reasonable size to adopt it.

It is hard to say whether this program worked or whether the decline in the rate of fertility happened because of other factors. Be that is it may, there has been a significant decline in the rate of fertility in the developing world, including the countries of South Asia. Fertility will continue to decline but at different rates in different parts of the region. In South Asia the process began in Sri Lanka several decades ago. It started in India in the 1980s, in particular in the states in the south of the country where the level of human development was relatively high, the rates of economic growth were better than in other parts of the country, and there were high rates of emigration. It started in Bangladesh at about the same time as India but for different reasons. The rapid development of the garments industry resulted in the improvement of the social and economic status of women. Women entered the workforce, had sources of income not dependent on their husbands or fathers, and also began to look for opportunities to acquire education. Husbands no longer had the decisive say in determining the size of the family. The move towards fertility decline has also begun in Pakistan. The trend became perceptible in the early 2000s but still has a way to go before the country catches up with other South Asian nations. Fertility rates are still high in Afghanistan, a trend seen in other countries experiencing conflict. For obvious reasons a feeling of insecurity leads families to increase their size. The United Nations has factored these changes in fertility into determining the size of the population around the globe. These projections are shown in Tables 6.1 and 6.2.

Table 6.1 Population growth rate (medium variant) of selected countries and regions, 1950–2050 (%)

	Bangladesh	*Brazil*	*China*	*India*	*Indonesia*	*Japan*	*Pakistan*	*Philippines*	*Russia*	*USA*	*Europe*
1950–1955	2.11	3.06	1.87	1.79	1.67	1.45	1.55	2.99	1.63	1.62	1.00
1955–1960	2.22	2.91	1.53	1.95	2.08	0.91	1.84	3.06	1.47	1.70	0.98
1960–1965	2.36	2.96	2.07	2.06	2.22	1.02	2.13	3.09	1.11	1.36	0.96
1965–1970	2.54	2.59	2.61	2.14	2.35	1.26	2.58	2.94	0.57	0.98	0.68
1970–1975	2.67	2.38	2.21	2.21	2.32	1.33	2.86	2.79	0.58	0.90	0.60
1975–1980	2.68	2.35	1.48	2.30	2.20	0.91	2.96	2.70	0.65	0.92	0.49
1980–1985	2.61	2.26	1.42	2.24	2.04	0.69	3.48	2.69	0.69	0.95	0.40
1985–1990	2.32	1.88	1.62	2.14	1.77	0.37	3.27	2.52	0.62	1.15	0.39
1990–1995	2.05	1.56	1.17	2.01	1.53	0.36	2.38	2.28	0.06	1.20	0.18
1995–2000	1.89	1.49	0.90	1.79	1.39	0.20	2.55	2.09	–0.25	1.23	–0.02
2000–2005	1.68	1.32	0.70	1.62	1.31	0.12	2.26	1.92	–0.48	1.01	0.08
2005–2010	1.42	0.98	0.63	1.43	1.18	–0.07	2.16	1.82	–0.40	0.96	0.09
2010–2015	1.27	0.75	0.61	1.27	0.98	–0.19	2.13	1.66	–0.34	0.90	0.03
2015–2020	1.15	0.60	0.50	1.10	0.81	–0.34	1.92	1.51	–0.38	0.82	–0.03
2020–2025	0.99	0.45	0.31	0.92	0.70	–0.47	1.70	1.34	–0.46	0.71	–0.10
2025–2030	0.82	0.31	0.13	0.73	0.61	–0.57	1.52	1.18	–0.53	0.62	–0.16
2030–2035	0.65	0.20	0	0.58	0.50	–0.64	1.37	1.02	–0.55	0.53	–0.20
2035–2040	0.51	0.08	–0.10	0.48	0.37	–0.70	1.24	0.87	–0.52	0.46	–0.22
2040–2045	0.39	–0.02	–0.20	0.37	0.23	–0.75	1.10	0.74	–0.51	0.40	–0.24
2045–2050	0.26	–0.13	–0.33	0.25	0.10	–0.79	0.94	0.60	–0.51	0.36	–0.26

Source: United Nations, *World Population Prospects*.

Table 6.2 Size of populations in selected countries and regions, 1950–2050 (thousands)

	Bangladesh	*Brazil*	*China*	*India*	*Indonesia*	*Japan*	*Pakistan*	*Russia*	*USA*	*Europe*
1950	43,595	53,975	544,951	371,857	77,152	82,824	41,177	102,702	157,813	547,460
1955	48,442	62,887	598,226	406,661	83,856	89,047	44,499	111,402	171,152	575,466
1960	54,138	72,744	645,927	448,314	93,058	93,189	48,778	119,906	186,326	604,464
1965	60,931	84,331	716,270	496,934	103,978	98,052	54,267	126,749	199,453	634,191
1970	69,178	95,991	815,951	552,964	116,921	104,448	61,750	130,392	209,464	656,197
1975	79,049	108,127	911,167	617,432	131,329	111,619	71,238	134,233	219,108	676,207
1980	90,397	121,618	980,929	692,637	146,582	116,794	82,609	138,655	229,469	693,113
1985	102,993	136,149	1,053,219	774,775	162,348	120,908	98,309	143,541	240,612	706,988
1990	115,632	149,570	1,142,090	862,162	177,385	123,191	115,776	148,065	254,865	720,989
1995	128,086	161,692	1,210,969	953,148	191,501	125,442	130,397	148,497	270,648	727,361
2000	140,767	174,174	1,266,954	1,042,590	205,280	126,706	148,132	146,670	287,842	726,568
2005	153,122	186,075	1,312,253	1,130,618	219,210	127,449	165,816	143,170	302,741	729,421
2010	164,425	195,423	1,354,146	1,214,464	232,517	126,995	184,753	140,367	317,641	732,759
2015	175,217	202,866	1,395,998	1,294,192	244,191	125,791	205,504	137,983	332,334	734,000
2020	185,552	209,051	1,431,155	1,367,225	254,218	123,664	226,187	135,406	346,153	732,952
2025	195,012	213,802	1,453,140	1,431,272	263,287	120,793	246,286	132,345	358,735	729,264
2030	203,214	217,146	1,462,468	1,484,598	271,485	117,424	265,690	128,864	369,981	723,373
2035	209,929	219,302	1,462,351	1,527,879	278,382	113,733	284,561	125,387	379,999	716,190
2040	215,339	220,141	1,455,055	1,564,763	283,503	109,804	302,801	122,148	388,907	708,489
2045	219,589	219,956	1,440,289	1,593,852	286,717	105,740	319,891	119,098	396,766	700,191
2050	222,495	218,512	1,417,045	1,613,800	288,110	101,659	335,195	116,097	403,932	691,048

Source: United Nations, *World Population Prospects*.

According to the United Nations projections there will be a significant decline in the rate of fertility in all the large countries of South Asia. The sharpest decline will be in Bangladesh, maintaining the recent trends. The rate of population growth will drop by 1.42 percentage points, from a 1.68 per cent increase at the beginning of the 21st century to 0.26 per cent by the middle of the century. The country will add 81 million to its population, increasing from 141 million people in 2000 to 222 million by 2050. The fall in the rate of growth in the Indian population will be equally significant, declining by 1.37 percentage points from 1.62 at the beginning of the 21st century to only 0.25 percent by 2050. That notwithstanding, India will add another 517 million people to its population of 1,043 million in 2000, reaching 1,614 million in 2050. India will overtake China in terms of the size of its population between 2025 and 2030. By 2050 it will have close to 200 million more people than China. The Chinese population stops growing sometime between 2030 and 2035, after which the rate of growth becomes negative and the size of the population starts to decline. The Chinese population is expected to peak in 2030, reaching 1,462 million. In the following 20 years the population will decline by 45 million people.

Although the decline in the rate of growth of Pakistan's population will not be as significant as for other large South Asian countries, it will also see a reduction of 1.22 percentage points between 2000 and 2050. The size of the population will increase from 148 million in 2000 to 335 million in 2050, an increase of 187 million. The population, in other words, will double in size. Looking at these numbers in a different way highlights the kind of demographic shifts we will witness in South Asia. The three most populous countries will see their combined population increase from 1.33 billion to 2.17 billion, an addition of 839 million people. The share of Pakistan in this increase will be large – 22.3 per cent. Consequently, whereas in 2000 Pakistan's share in the combined population was 11.3 per cent, 50 years later this will grow to 15.4 percent, an increase of 4.1 percentage points.

One important consequence of this declining trend in the fertility rate is that it will create a window of opportunity that will last a few decades during which time the number of active workers will far outnumber their dependants. During this time the states will not need to carry the burden of caring for those who cannot be looked after by the working members of families. Table 6.3 provides estimates of the duration during which the window will remain open. Since the decline in the fertility rate is slower than in other countries that have gone through the same kind of transition, the period of opportunity available to the South Asians is much longer. For India, it will remain open for 60 years, from 1975 to about 2035, when the number of people reaching the working age will begin to decline. Using the same

Table 6.3 Windows of demographic opportunities

Country	*Period of demographic transition*	*Span for the window (years)*
Afghanistan	2007–	?
Bangladesh	1975–2025	50
Bolivia	1995–2040	45
Chile	1970–2015	45
China	1965–2007	42
India	1975–2035	60
Italy	1975–1995	20
Japan	1955–1995	40
Pakistan	1995–2045	50

Source: World Bank, *World Development Report*, 1997, p. 7; Author's calculations for Bangladesh and Pakistan.

methodology as applied by the World Bank for determining the time over which the windows will remain open for Pakistan, it appears that the duration for that country will be 50 years; the window opened in 1995 and will not close until 2045, 10 years later than in India.

Could South Asia build a future for itself and create a significant space in the evolving global economy by concentrating on the development of, say, modern services in which countries with a large and young population have a comparative advantage? Another set of numbers helps us to answer this question: the median age of the population. Pakistan has by far the youngest population of all large countries, not just in the region but worldwide. As population growth rates increase, the median age of the population – the age at which the number of younger people is the same as the number of older people – begins to decline. This is what has happened in Pakistan. The median age in 1950 was 24.2 years; by 1990 it had dropped to only 18.2 years, a decline of six years. The population had become much younger. The median age in 1990 was almost three years less than that of India, at 21.1 years, and the same as that of Bangladesh, at 18.2 years. The rapid demographic transition that has occurred in some parts of South Asia saw significant increases in the median age. Between 1990 and 2005 it increased by 1.8 years in Pakistan, by two years in India and by an impressive 4.4 years in Bangladesh. If the changing character of the economies of today's rich countries is any guide, much of the future growth in the global economy will come from services. These are labour intensive to produce and provide, and some of the more modern ones need highly developed skills.

Both the state and the private sector will need to invest in young people to draw the most benefit from the windows of opportunity that are now available in all South Asian countries. In those that have serious resource constraints – as is the case in Pakistan – the private sector will need to play a more active role. However, equipping the workforce with the right kinds of skills will not only help the domestic economies to improve their productivity, but could also supply services for export – something that India has achieved in an impressive way.

Developing the human resource

Developing the human resource means investing in education, an area in which South Asia has not done particularly well. For some reason, the states in South Asia have given very little attention to improving human resources, including through education and skills development. Unless this bias disappears from the making of public policy, South Asia will not be able to benefit from the opportunities being created in the global economy for developing countries. The countries of the region will need to give attention to the youth in their population, particularly those of 12 to 24 years in age. This holds true particularly for Pakistan, in which the situation has regressed.

There are some areas of noticeable success in South Asia in terms of youth development, but these were mostly accidents made in terms of public policy choices. They were not the consequence of well thought out development strategy. Two examples are worth noting. The first is the development of highly developed skills of a small segment of the population of India, particularly in the county's south-western states. The grounds for this were laid by the choice made by Jawaharlal Nehru in the late 1950s. At that time the Americans offered technical assistance to both India and Pakistan to help them with economic development. Nehru requested help with setting up institutes of technology patterned on MIT. Ayub Khan in Pakistan asked for assistance in improving the capacity of the Planning Commission at the centre and the Planning and Development Departments in Dhaka and Lahore, the capitals of the country's two provinces. Nehru's choice laid the foundations of the world-renowned institutes of technology in India, the IITs. Once these institutes started to turn out well-trained graduates, the Indian economy, growing at the "Hindu rate of growth", did not have the capacity to absorb all of them. Many of the unemployed headed towards the United States, which, at that time, did not have very restrictive immigration policies. The Indian scientists and engineers climbed the corporate ladder in many technology firms in the United States. They were in a position to introduce India to their firms. This was important for many firms that were struggling to find a way out of the problem that was not foreseen when some of the older computer programs were written. These programs, with not much memory available at that time, had economized in indicating time (date and years) embedded in them. As the new millennium approached,

Table 6.4 Median age of populations in large countries (years)

	Bangladesh	*Brazil*	*China*	*India*	*Indonesia*	*Japan*	*Pakistan*	*Philippines*	*Russia*	*USA*	*Europe*
1950	20.5	19.2	23.9	21.3	20.0	22.3	24.2	18.2	25.0	30.0	29.7
1955	19.7	18.9	22.5	20.6	20.2	23.6	22.9	17.5	26.5	30.2	30.1
1960	19.0	18.6	21.8	20.0	20.0	25.5	21.8	17.0	27.4	29.6	30.7
1965	18.2	18.2	20.4	19.4	19.5	27.3	21.0	16.9	28.5	28.4	31.1
1970	17.7	18.6	19.7	19.2	18.9	28.9	19.8	17.1	30.6	28.2	31.8
1975	17.4	19.4	20.6	19.7	18.9	30.4	18.9	17.6	30.8	28.8	32.1
1980	17.3	20.3	22.1	20.2	19.4	32.6	18.3	18.1	31.3	30.1	32.7
1985	17.4	21.3	23.6	20.6	20.3	35.1	18.3	18.7	32.1	31.5	33.7
1990	18.1	22.5	25.0	21.1	21.7	37.4	18.2	19.3	33.3	32.8	34.8
1995	19.3	23.9	27.2	21.7	23.2	39.6	18.3	19.9	35.0	34.0	36.1
2000	20.8	25.3	29.6	22.6	24.8	41.4	19.0	20.9	36.5	35.1	37.6
2005	22.5	27.0	32.1	23.7	26.5	43.1	20.0	22.0	37.3	36.0	38.9
2010	24.5	29.0	34.2	25.0	28.2	44.7	21.3	23.2	38.1	36.6	40.2
2015	26.5	31.3	35.6	26.5	30.1	46.6	22.5	24.5	38.9	37.2	41.5
2020	28.4	33.6	37.1	28.1	32.0	48.6	23.7	26.0	40.0	37.9	42.7
2025	30.4	35.8	38.9	29.9	33.8	50.6	25.0	27.5	41.7	38.7	44.0
2030	32.3	37.9	41.1	31.7	35.4	52.2	26.4	29.0	43.5	39.5	45.3
2035	34.3	39.9	42.8	33.5	37.0	53.5	27.9	30.4	45.3	40.3	46.4
2040	36.2	41.9	44.1	35.3	38.5	54.4	29.4	32.0	45.5	40.8	46.9
2045	37.8	43.8	44.9	36.9	39.9	54.9	31.1	33.5	44.5	41.2	46.8
2050	39.2	45.6	45.2	38.4	41.1	55.1	32.7	35.0	44.0	41.7	46.6

Source: United Nations, *World Population Prospects*.

there was considerable fear that the older programs would not be able to handle the transition. Also some of the older programs were written in the languages that were still being used in India, but that had been replaced in the West by newer versions. This came to be known as the year 2000 crisis, Y2K for short. The crisis offered an opportunity for those from India who had stayed behind to provide their services to keep the computer programs working in America. This laid the basis of the development of the outsourcing industry in India, a story well told by American journalist Thomas Freidman in his bestselling book, *The World is Flat*.[17]

The other example of a success in human resource development is from Bangladesh. As already discussed above in the context of the remarkable demographic change in Bangladesh, the country has done well in terms of educating its women. This, too, was the consequence of the coming together of a number of positive developments. One of the legacies of the country's union with Pakistan was the decision by the textile importers to split their quotas evenly between Bangladesh and Pakistan. However, there was no textile industry in Bangladesh. With a large quota now at its disposal, Dhaka invited those countries that faced import restrictions in the West to invest in the country. This "quota hopping" resulted in the rapid development of the garment industry which increased the demand for female labour. This, in turn, created opportunities for women to be employed outside their homes and also for female education. Bangladesh today has one of the highest ratios among poor countries of women's enrolment in educational institutions and of women's participation in the workforce. Luck, however, was not on Pakistan's side. In fact, some developments in the country created an environment which discouraged education, including the growing influence of Wahabi Islam that paid almost no attention to education in modern sciences and was openly hostile to the idea of educating women.

In its *World Development Report* for 2007, the World Bank identified five phases for the development of a human being – for a person to become a contributor to the full extent of his or her potential. The phases are continuing to learn, starting to work, developing a healthy lifestyle, starting a family and exercising citizenship. The government has a role in each phase. A "youth lens on policies affecting the five phases would help to focus on three directions: expanding opportunities, enhancing capabilities, and providing second chances […] To mobilize the economic and political resources to stimulate such reforms, countries must resolve three issues: better coordination and integration with national policy, stronger voice and evaluation", wrote the Bank.[18]

The World Bank's analysis, supported by an expanding literature on the subject, provides a perspective from which to evaluate the performance of South Asia and to point to some areas where significant changes in the direction of public policy are required. The World Bank in the above-mentioned study attributes more than 40 per cent of higher growth in East Asia over Latin America in 1965–90 to the faster growth of its working age population and better policies for trade and human development. South Asia has had a high rate of population growth over the last several decades. Although rates of fertility are declining – more in Bangladesh, India and Sri Lanka than in Afghanistan and Pakistan – because of demographic inertia, the working population will continue to increase for several more decades. The region, therefore, has one of the three determinants of growth – a growing work force – that propelled the East Asian economies forward. The second determinant is absent in South Asia: the countries in the region have not made an effort to increase their share of international trade. That could happen, but it would require a significant structural change in the economies of the region. The third area is the one that holds the most promise – to take a large slice in international trade and services by developing the region's large populations to contribute to the development of this part of the economy. The emphasis on investing in the next generation for promoting development would be timely for the countries of South Asia, since most of them now have windows of demographic opportunities that have opened up in recent years.

Of the several South Asian countries, Afghanistan and Pakistan are by far the most underdeveloped in terms of preparing the next generation for economic uplift. As is the case in other parts of South Asia, the state in these two countries has largely ignored the development of education and skills. Compared with the countries in East Asia, government investment in education at about 2.5 per cent of GDP is about one-third as much. This has to be increased significantly if the next generation is not to be wasted. In addition to investing a very small amount in education and skills, Pakistan has introduced another distortion in the educational system. As indicated earlier, the arrival of conservative Islam in the country has introduced one more hurdle that has to be crossed to prepare the youth for the modern sectors of the economy – the sectors that provide the most attractive opportunities to the countries with large, young populations.

The progressive Islamization of the country since the presidency of General Zia ul-Haq (1977–88) has contributed to the further underdevelopment of the education sector. Under Zia, *madrassa* education was encouraged. This was not an entirely new feature of education for the Muslim communities in South Asia, where most parents seek a hybrid education, combining both religious and non-religious components, usually followed simultaneously. In a comparative study of religious education in Bangladesh and Pakistan, educationist Mathew Nelson found that in Pakistan "the so-called non-religious side of this education – for example in government and non-elite private schools – tends to be associated with a particular understanding of religion, one that remains persistently apprehensive about the treatment of and, in many ways, even the acknowledgement of religious, sectarian, ethnic, and linguistic diversity".[19] This approach to education is not conducive to producing the type of workforce needed by the modern components of the service sector. Students graduating from the institutions that provide this kind of environment will not be able to function in the ethos that prevails among the workforces in the service sector.

The states in South Asia, therefore, have to give greater attention to the development of the area's large human resource in order to benefit from the opportunities that have become available because of demographic changes worldwide. The attention they have paid has been sporadic and without a strategy aimed at using the abundant human resource for accelerating the pace of development, as well as modernizing society. If successes came – as they did to a limited extent in Bangladesh and parts of India – they were the cause of historical accidents rather than the product of well thought out public policy.

Migration: Past patterns, present trends, future prospects

Migration has been an important aspect of life in many parts of South Asia. Even though Hinduism discouraged travel, the followers of the faith have shown a remarkable capacity to search for opportunities outside the country's borders. Today, India has more that 20 million people living and working abroad[20] – a subject to which we will return later in this chapter. Migration takes many forms: it can be voluntary or involuntary; it can be over short distances, as in the movement from village to an adjacent town, or from the countryside to the large cities some distance away; it can be beyond the country's borders; or, finally, it can be for short periods of time or permanent.

The pace of urbanization will continue at its present brisk pace, but with one important difference. In the first 50 years after the South Asian countries emerged from colonial rule, internal migration was directed towards large cities. Some of these cities – Chennai, Dhaka, Karachi, Kolkata, Mumbai and New Delhi – became megacities, with populations of more than 10 million people, within a few decades. This trend will change. A significant part of urban growth will occur in the smaller cities of the region, which are expanding along highways and coalescing near crossroads and coastlines. As South Asia invests in improving its highways – a process that began in Pakistan in the 1990s with the construction of the Lahore–Islamabad motorway, which has now been extended to Peshawar in the north and Faisalabad in the west, and picked up pace in India with the work on the Golden

Quadrilateral – new population growth centres will emerge. By 2025 South Asia may have a billion people living in urban areas, most of them in 100 or so cities strung along the two highway systems being developed in India and Pakistan. The changes in the pattern of migration this suggests will have enormous consequences – economic, political and social.

Not only will the pattern of urbanization change in South Asia, but there will also be inter-state, inter-provincial and inter-district migrations. This will imply the movement of people out of the economically distressed areas towards those that are advancing economically at a much higher pace. This has already happened in all states of continental South Asia. There have already been important political consequences of these moves. The most vivid example of this is Karachi. The city expanded rapidly in size after being chosen as the first capital of the new state of Pakistan. The construction boom that followed and lasted for a decade and a half attracted workers from other parts of the country, particularly the North West Frontier Province (NWFP) and northern Punjab. Consequently, within a couple of decades Karachi grew from a city of 250,000 people in 1972, to 5 million in 1972 – a 20-fold increase in 25 years. This was one of the highest rates of growth of any major urban centre in the world. Mumbai is another example of a South Asian city that grew in size by attracting migrants from all over the less developed parts of the country, in particular those that – like the state of Bihar – had a tradition of migration.

Karachi's political travails are well known. They can be traced to migration – to the arrival of 1.5 million refugees from India soon after independence in 1947. These migrants – who began to call themselves the *muhajirs* (refugees) – were to constitute themselves into a political force in the 1980s when they began to fear that the political and economic power they had accumulated soon after their arrival in the city was slipping away. The Muhajir Qaumi Mahaz (MQM – National Refugee Front), later rechristened the Muhajir Qaumi Movement (a change in nomenclature that suggested less militancy than implied by the earlier name) was to become a potent political force in the country. Much of the violence for which Karachi earned a well-deserved reputation was between the MQM and the Pakhtuns (or Pashtuns), who arrived later as unskilled construction and service sector workers. The wave of migration that Pakistan received from the two Afghan wars in the 1980s and the one that is still underway, swelled the ranks of the Pakhtuns in Karachi. Karachi is now the world's largest Pakhtun city, larger than Peshawar, Kandahar and Kabul.

Some of the periodic violence in Mumbai can also be traced to migration as the city became more diverse ethnically and religiously. A large number of the city's natives turned to fundamentalism in the form of a Hindu revivalist movement that openly and aggressively challenged the migrants, a significant number of whom were Muslims from the more economically depressed parts of India. Bihar state in the country's east supplied tens of thousands of economic migrants to the city, many of them Muslims. A highly lucid account of how these forces clashed in Mumbai and affected its economic life, growth and performance is to be found in Seku Mehta's *Maximum City.*[21]

Economic policies influence the movement of people. A good example of this is the highly restrictive labour laws that are a legacy of the "licence raj" in India, but remain on the books in spite of the opening up of the economy in the 1990s and the early 2000s. These laws inhibit the movement of people across state borders and are thus getting in the way the development of enterprises in the modern sectors of the economy that have begun to experience shortages in skilled workers. If the labour laws were to be relaxed, there is no doubt that a significant number of workers would move from the crowded parts of the country in the north-east, where the rates of economic progress have been relatively slow. The result of this would be the mingling of the very different cultures and languages of the north-eastern and south-western parts of the country. This would be bound to produce important political and social consequences of the type already seen in some of the large cities of South Asia.

Finally, there is the movement of people across national borders, a tradition that goes back to the 18th and 19th centuries, when labour was recruited from what was becoming British India. Workers from India went to many parts of the world, in particular East Asia, the West Indies, and East and South Africa. These resulted in the formation of Indian colonies in these areas. Although there was only a trickle of Indian migration to Britain in the colonial period, this turned into a large surge in the period immediately following the Second World War. The British, having suffered large losses of young people during the war, needed workers and these were available from what was still their Indian colony. Workers were also required to rebuild some of the industries that had suffered heavy losses because of the war. There was, consequently, a large movement of people from what was to become Bangladesh and also from India and Pakistan. This migration became the base on which the three communities built their diasporas in Britain. There are now some 6 million people from South Asia in Britain, the largest foreign community in the country.

Two new South Asian diasporas were formed in the world: one in North America and the other in the Middle East. There were major differences in the economic and social backgrounds of the people who migrated to these two places. The Middle East went through a construction boom that lasted for a decade and a half – from the mid-1970s when the oil prices quadrupled, to the beginning of the 1990s when the United States went to war with Iraq.

The construction workers needed for this boom came mostly from Pakistan's northern areas. Later there was a new wave of migration to provide for the service sector in the oil-exporting countries and a large number of these came from Bangladesh and India. Later still, professionals were provided mostly by India, but also by Pakistan, to the rapidly developing modern sectors of the economy – in particular banking, finance and tourism. While the construction workers returned to their home countries, skilled and unskilled workers in the service sector have stayed on. There are about 10 million workers from South Asia in this part of the world.

The third large South Asian diaspora is in Canada and the United States. It is made up largely of professionals – computer scientists from India, engineers, economists, and physicians from both India and Pakistan. The South Asians in North America number about 4 million, 2.5 million from India and about 1 million from Pakistan. This is by far the richest South Asian diaspora in the world, with average per capita income of more than the American average. The total income of the South Asians in this part of the world is US$250 billion, 17 per cent of the combined GDP of South Asia.

Conventional wisdom treats migration as a drain on the domestic economy, particularly when it involves well-educated and skilled people. This would seem to be the case since the education and training of the people involves considerable expense and social cost for the economy and society. The benefits of this investment accrue to the countries that receive the migrants and not to those from where they come. This, however, is a static view of the situation. As revealed by South Asia's recent history pertaining to the movement of people, migrants provide a great deal of benefits to their home countries. As shown by India's experience with the people it calls non-resident Indians (NRIs), the migrants not only provide a large and reliable source of external finance for the homeland, but they are also a source of technical and managerial expertise that is usually scarce in the home country. The NRIs have also become important contributors to the development of venture capitalism in the country. They have been actively involved in setting up world class businesses and technical schools in India. The management school in Hyderabad that quickly gained international recognition owes a great deal to the efforts of NRIs.

The Bangladeshi and Pakistan diasporas have also come to the aid of their homelands. In the case of the former, worker remittances are an important source of external finance. The money that the country receives from this source is the largest "export" item in its balance of payments after the earnings from the sale of ready-made garments. For Pakistan – more reliant on external finance for domestic investment than most other South Asian countries – remittances have been an important and reliable source. This is the case, in particular, since the terrorist attacks on the United States on 11 September 2001, when the authorities in the United States and other Western countries became vigilant in terms of the sources used for transmitting money across borders. This was done since investigations had shown that *hundi* and *hawala* were the conduits used by terrorist groups to finance their activities.[22] Over the last few years the United States has become the largest source of remittances for Pakistan, overtaking Saudi Arabia.

There is a life cycle associated with the diasporas.[23] When they are formed their members use their savings to establish themselves in their new place of work and residence. Remittances per worker are relatively low, essentially limited to assisting the members of family in the homeland to satisfy their urgent needs. The exception to this is when workers move temporarily and without their families, as was the case with the migrant construction workers who went to the Middle East in the 1975–90 period. In that case, remittances started flowing back almost as soon as the workers began work on the construction sites. The second phase in terms of remittances begins when the migrants feel that they are secure in their new homeland. They then begin to transmit larger amounts of money, mostly to help family members in the home country. The third phase involves the migrants more fully in organized charity. This is now the situation with respect to the Pakistani diaspora in the United States, which is now active in supporting charitable causes at home. As Adil Najam has pointed out in his pioneering work on the Pakistani communities in the United States, the Pakistanis living abroad are one of the largest contributors of charitable dollars per capita in the world.[24] The fourth phase begins when the diaspora is well established and members have created assets that provide a reliable stream of income. It is at this stage that the members of the diaspora begin to think about making investments in the homeland. This is the stage reached by the NRIs, with the Pakistani diasporas not far behind.

By pulling together the various strands of analysis presented above, we can begin to see the contours of public policy that would turn the large, young and still increasing populations in South Asia into economic assets rather than social and economic burdens. Because of the decline in the rate of fertility that is now perceptible in South Asia, there are windows of demographic opportunity available that would turn people into important determinants of economic growth and modernization. These windows will stay open for about half a century. Once they close, a very different type of demographic dynamics will come into play. During this time public policy needs to be shaped so that it fully reflects the demographic situation in different parts of South Asia. However, there is more in common between these situations than different. For several decades to come the Lewisian model of surplus workers from the countryside feeding the non-agricultural sectors with the labour they need will continue to apply. The state's role in this process is minimal. It should not get in the way of this movement.

However, the state should work with the private sector to equip the youth with the education and skills they need to participate productively in the modern sectors of the economy. No South Asian state – not even India, with significantly higher rates of domestic savings – has the resources to do this in the public sector. What is required is partnership between the public and private sectors, with each sector playing the roles in which it has an advantage. In this context, the government needs to ensure at least three things: that the teachers employed in public institutions are well trained; that the textbooks do not give the wrong message to the students; and that adequate physical facilities are available to public institutions. The private sector needs to ensure that even when educational institutions are being run on a for-profit basis, they adhere to minimum standards of instruction. A regulatory system is required in which both the public and private sectors have roles.

If the states fail to use the demographic window of opportunity that has become available in all South Asian countries, the cost could be enormous. This has been the Pakistani experience over the last three decades, since the advent of the rule by General Zia ul-Haq, the country's third military president. He encouraged the Islamization of education in the country, insisting upon the incorporation of Islamic studies in the curriculum. However, the text books used for this purpose gave the students a grounding in Wahabi Islam that was not the mainstream religion in the country. This was to profoundly affect the development of the *jihadist* culture among some segments of Pakistani society.[25] The state, in other words, must bring modernization to these populations and not inculcate in them the attitudes and patterns of behaviour that render the young misfits in the world.

Location and geography

Economic geography is a relatively new discipline. Like all new and evolving endeavours of human thought this does not yet have well-established contours and frontiers. It is finding its way as it develops the tools of analysis and insights that are pertinent for its application. The discipline covers location – what the particular geography of an economy implies for its future development. The economy itself can be that of a rural area, a town, a large city, a nation-state, or a well-integrated multi-state regional economic and trading association. Economic geographers claim that the same set of principles apply to these different locations; if they did not, however, they would not have a discipline. These principles relate to density – both of the economy and the people that inhabit a particular economic space – distance and development. One of the important principles of the new discipline is that with development, economic and population densities increase. According to a 2009 report by the World Bank that focused on economic geography, "density goes from smoothly spread out to quite uneven as a country develops. Urbanization is thus synonymous with a tendency toward greater agglomeration within a country. A country's urban share is a good proxy for the proportion of its population living in areas of high density and, therefore, for the 'bumpiness' in its economic geography".[26]

Applying the concepts of economic geography to South Asia, we should begin with the location of nation-states. In several respects, South Asia is different from other world regions. At its heart is a large country that shares borders with almost all of the states in the area. India has common borders with Bangladesh, Bhutan, Nepal and Pakistan. Only a narrow strip of water separates it from the island state of Sri Lanka. If we use the South Asian Association for Regional Cooperation (SAARC) definition of South Asia, then only Afghanistan and the Maldives are some distance from India. Three of the eight countries of the region – Afghanistan, Bhutan and Nepal – are landlocked with access to the sea either through India or Pakistan. Pakistan, the second largest country in the region both in terms of the size of its population and the size of its economy, has as many physical borders as India: Afghanistan, China, India and Iran. Unfortunately, a number of these borders are difficult – thick in terms of economic geography – and their thinning would bring many economic rewards.

The two largest South Asian economies are seriously deficient in energy, which has produced frequent brown-outs and mandated load-shedding. These have brought discomfort to the affected populations and have damaged the economies. Yet the two countries are located within easy distance of the world's largest reserves of oil and gas. Both India and Pakistan share borders with countries that have large deposits of gas available. However, largely for political reasons, Pakistan has failed to tap Iran and India has been unable to reach an agreement with Bangladesh for the supply of natural gas.

The Iran-Pakistan-India pipeline (IPI) is an interesting case study in geopolitics. Negotiations for building the 2,600-km pipeline began in 1994 with the goal of supplying 60 million cubic meters of gas daily to Pakistan and India, eventually increasing to 150 million cubic meters. The project was to cost US$7.6 billion. India imports 70 per cent of its oil and gas. For almost half a century Pakistan was self-sufficient in natural gas, with the giant Sui field in Balochistan and smaller ones in Sindh meeting total domestic demand. However, largely owing to lack of investment in exploration for new fields and partly owing to a sharp increase in domestic demand for gas, serious shortages developed, beginning in 2010. The IPI project was stalled, with India pulling out of the project ostensibly because, in their view, Pakistan was demanding an unreasonable fee for transmitting the gas. Many observers believed that the Americans had pushed India into taking that decision. In June 2009 the *Financial Times* reported that the Iranians had succeeded in interesting Russia's Gazprom in investing in the project, building the 900km of pipeline passing through the Pakistani territory. "Analysts say Gazprom is interested partly because it seeks a way to channel Iranian gas away from Russia's traditional markets in Europe".[27] The Iranians have already completed the pipeline to their border with Pakistan. On 29 May 2010 Iran and Pakistan signed yet another agreement to build the pipeline and have it become operational by 2014. If the pipeline does begin to supply gas by that time, Pakistan will have three of its four borders providing the country with important economic returns.

Politics often get in the way of using location for economic advantage in South Asia. Some of the countries in the region have been unwilling to grant transit rights through their territories for conducting inter-country trade. One example of this is Pakistan's refusal to permit the flow of goods and commodities from India to Afghanistan and beyond to the countries of Central Asia. The country is doing this even though transit of Indian goods through the Pakistani territory would bring high rewards. In addition to the transit fees that Pakistan could charge, it would also create a large number of jobs in the services sector. Pakistan would be able to put to use the spare capacity it has in the motorway system, which was built at great cost to the country. Using it for transit would help to pay for that cost.

Bangladesh has also been reluctant to grant transit rights to India to reach the seven states in the country's north-east, forcing New Delhi to use the narrow strip of land called the "chicken neck" around the Bangladeshi territory. The Bangladeshis would like to gain access to Nepal through Indian territory so that the Nepalese could use their port for trade rather than be forced into using the crowded Indian port of Kolkata in West Bengal.

Returning to urban agglomeration, South Asia is likely to see significant changes in the distribution of its population in the next few decades. Table 6.5 provides some revealing insights into the development of the large cities in the region. Thirty years ago South Asia's large cities were not very big compared with other urban centres in the world. Kolkata, then the largest, ranked ninth in the world. Mumbai, the second largest, was 15th. In 2007 the South Asian cities made remarkable strides in the league of the world's megacities, with South Asia having four of the world's 10 largest cities; by 2025, half of the largest 10 will be in South Asia. Most remarkably, Dhaka will have 22 million people by that time, ranking number four in the world. Mumbai, with more than 26 million people, will be the largest South

Table 6.5 Urban agglomeration

	Population (millions)			*Rank*			*Average annual rate of change (%)*		*Population residing in agglomeration, 2007, as % of*	
Urban Agglomeration	*1975*	*2007*	*2025*	*1975*	*2007*	*2025*	*2005–2010*	*2020–2025*	*Total population*	*Urban population*
Bangalore (India)	2.1	6.8	59.7	67	36	31	2.2	2.0	0.6	2.0
Chennai (India)	3.6	7.2	10.1	34	35	26	1.8	2.0	0.6	2.1
Chittagong (Bangladesh)	1.0	4.5	7.6	174	56	46	3.6	2.7	2.9	10.7
Delhi (India)	4.4	15.9	22.5	23	6	3	2.5	1.9	1.4	4.7
Dhaka (Bangladesh)	2.2	13.5	22.0	65	9	4	3.3	2.5	8.5	32.0
Hyderabad (India)	2.1	6.4	9.1	70	40	36	2.0	2.0	0.5	1.9
Karachi (Pakistan)	4.0	12.1	19.1	26	12	10	2.4	2.4	7.4	20.7
Kolkata (India)	7.9	14.8	20.6	9	8	8	1.7	1.9	1.3	4.3
Lahore (Pakistan)	2.4	6.6	10.5	56	38	24	2.5	2.5	4.0	11.2
Mumbai (India)	7.1	19.0	26.4	15	4	2	2.0	1.9	1.6	5.6

Source: Department of Economic and Social Affairs, Population Division, United Nations.

Asian city and the second largest city in the world. While these are significant changes in the distribution of population, what will be even more important is the extraordinary growth of secondary cities, a fact that we have already discussed. As indicated above, we expect some 100 cities with an average size of 2 million people to develop into major economic centres strung along the new network of highways being built in India and Pakistan.

Conclusion

The aim of this chapter was to demonstrate that in addition to using what are now regarded as the standard determinants of economic growth and change, the South Asian states would do well to factor other variables into the development equation. Capital accumulation and its allocation to the more productive users will remain important factors of growth. Following the work done by economists such as Robert Lucas and Paul Romer, the state must also give appropriate consideration to improving the economy's knowledge base. This would involve the development of both ordinary and sophisticated skills, as well as research and development. However, there are other considerations that must inform the making of public policy. We have focused in particular upon the need to learn from both country and regional experiences. That, as discussed at some length in this chapter, has happened to some extent in South Asia but not on a systematic basis. At the same time the South Asian state must continue to evolve in the direction in which it has been going by not interfering with the working of the private sector but keeping a watch over it; by surrendering more power to the governments at the sub-national level; and by giving a high priority to organizing the countries in the region so that they actively support each other's development.

Considerable attention was given to demographic change in South Asia. This is the second place in this book where we have focused on demography as an important contributor to economic change. It was first discussed with reference to the developed world, where the recent decline in the rate of fertility has already resulted in a reduction in population size. This has introduced a new dynamic in the economic equation. One argument advanced in this book is that these two different demographic experiences in the developed and developing world will interact with one another through migration from developing to developed countries, and outsourcing of work from the developed to the developing world. There is resistance to these trends in rich countries; in the case of the former for cultural reasons and in the case of the latter for economic reasons. Ultimately, though, sheer economic sense will prevail. This is the first time in human history that populations in some parts of the world are declining not because of war, disease and pestilence but because of the changes in human behaviour. Wars end, cures can be found for diseases and pests can be eliminated, but human behaviour is very hard to change. There is no prospect of changing fertility behaviour in developed countries. Gradually there will be recognition that economies and societies will retain dynamism in rich countries only by interacting with the world's poorer parts.

We have given some, albeit passing, attention to geography as a determinant of economic change and development, while recognizing that the discipline of economic geography is still in its infancy. Interpreting geography to include not only the location of countries but also the distribution of populations within individual countries, we have drawn two important conclusions that the area's policymakers would do well to keep in mind while designing the economic futures of the nations for which they have responsibility. The first is that mostly for political reasons, the countries have not taken advantage of their geographic location. They have been unable to shed the burden of history – this is the subject of another chapter in the book – which stands in the way of drawing full advantage from location. What is required is a thinning of the borders rather than their thickening. The second important conclusion is that we will see a new trend in the distribution of urban populations in two South Asian countries – India and Pakistan. While the major cities will continue to grow even in these two countries, there will be an even greater increase in the population living in the secondary cities. Factoring their growth into the development equation will mean the adoption of a different growth model from that followed in the past.

7 A multilayered world: Regional integration as a determinant of sustained national growth

Introduction

One of the themes developed in this work is that regional integration will help South Asia to find a place for itself in the rapidly changing global economy. Without integration the full advantage of globalization will not be realized and South Asia, compared with other world regions – in particular those in the emerging parts of the world – will be left behind. This chapter advances this argument by first providing the theory behind the effort needed to bring the countries in the region to work together and become collaborators and not just competitors. This is important for South Asia because of the weight of history that has produced a great deal of intra-regional conflict. The chapter then goes on to examine the efforts that have been made in the region to move towards integration. At best, the efforts have resulted in the creation of weak institutions of regional integration. The chapter then examines the performance of two regional associations in different parts of the world to draw some conclusions from their experience for South Asia. It concludes with how India, the area's largest country, must provide leadership to get the region moving to claim the space it should have in the changing global economic order.

The theory behind the effort

The creation of the World Trade Organization (WTO) put trade theory to the test. Its structure and operations were meant to lend substance to the beliefs of trade theorists, who argued that unconstrained trade increases global welfare. According to this belief, it is in the interests of all participants in the system to give equal treatment to all, discriminating against none. This non-discrimination aspect of multilateralism was applied also to foreign producers of the products that were manufactured at home. If favours were granted, they could be challenged in the WTO, which could establish "panels" – a sort of court – to give judgments that had to be respected.

That notwithstanding, the WTO treaty allowed some discretion to the policymakers to take limited action if the economies they managed were in great stress. According to Jagdish Bhagwati and Arvind Panagariya, two trade economists of great repute, "we know that several of the 'legal' provisions that allow protectionism were accepted to help liberalize. You will not liberalize unless you have an exit strategy for when the going gets tough. But the danger, of course is that if countries used the exit provisions indiscriminately, they could undermine the liberal trading system itself".[1]

Emphasis on regional integration on the grounds of economic efficiency flies in the face of trade theory, or so the purists believe. Jagdish Bhagwati, the Indian-born American economist, is the most articulate exponent of the view that regional integration distracts from economic efficiency rather than contributes to it. He has called it the spaghetti bowl approach to trade.[2] Bhagwati and the economists who agree with his point of view focus on the "rules of origin" provisions in the regional and free trade arrangements (RTAs and FTAs, respectively) that have proliferated in the world in spite of the creation of the WTO. The WTO requires equal tariff rates to be applied to all imports, regardless of their country of origin, as long as the countries are members of the WTO. However, RTAs and FTAs reduce and eliminate tariffs only on specific items imported from specific countries. This interferes with economic efficiency in many different ways – it prevents, for instance, external investment based on economic efficiency.

The emphasis, Bhagwati and other purists believe, should be on removing constraints to trade on a multilateral basis, the approach that was followed by different rounds of negotiations undertaken under the aegis of the General Agreement on Tariffs and Trade (GATT). "Uruguay" was the final round of the GATT process, which resulted in the creation of the WTO, following the Marrakesh Treaty signed in the Moroccan city in 1995. The WTO should have been created as part of the international economic and financial infrastructure put in place by the victors of the Second World War, but politics has a way of interfering with good economics. The WTO's creation was to be followed by another round of trade negotiations to remove the wrinkles that remained in the multilateral system. The most prominent of these was in the flow of trade between developing and developed countries in which the latter had used a combination of subsidies and tariffs to deny the former benefits from trading the products in which they had clear comparative advantage. This was the case, in particular, for agriculture, where large subsidies given by the governments in the European Union (EU), Japan and the United States to small segments of their populations kept agricultural prices and hence incomes low in the world's poorest countries. This was all to be sorted out by the Doha round of negotiations launched in the capital of Qatar in November 2001, but the farming communities in the developed world, while small in number, proved to be much too powerful politically to allow the creation of a level playing field. The Doha discussions went nowhere and the negotiations were stalled.

We should go back to the origins of the system that emerged as the Second World War was drawing to a close. The victors met in Bretton Woods in July 1944. The conference was held in a small resort town in New Hampshire, a state in the north-east corner of the United States, to create a new global economic order. The effort was led by the British economist John Maynard Keynes, who had studied the Great Depression and whose public policy suggestions had been adopted by President Franklin Delano Roosevelt of the United States. As such, Keynes had great influence on the thinking of the conferees at the meeting. The war was still not over; Germany was still to formally surrender and Japan had yet to be bombed into submission. However, Keynes and his associates were persuaded that no time should be wasted in designing a new international system that would serve a number of purposes. It would prevent countries from adopting “beggar my neighbour” policies in moments of economic crisis – and such a moment was coming as the war was ending. It would leave a great number of financial issues unresolved, including the settlement of the debt that the victorious European nations owed to the United States. There was the issue of reconstructing Europe and Japan after the war. Keynes and his associates had learnt from the experience of the policies pursued after the First World War that it was short-sighted to put the burden of the war on the defeated nations. It was important, instead, to help them to reconstruct and join the community of nations.

The Bretton Woods conferees also invited the large, non-developed nations to attend the meeting. India came, although it was still a British colony and Winston Churchill was reluctant to let go of the jewel in his nation’s crown. China also attended, although there was a deep on-going conflict between Mao Zedong’s communists and Chiang Kaishek’s Kumintong party. The Russians had little interest in lending their support to the creation of an international economic order that they knew would be dominated by the capitalist powers. The attendance of these countries had the conferees focus their attention on the development of the parts of the world that were about to be released from the grip of colonialism. Finally, the attendees at the meeting were anxious to create a trading system that would not allow the types of disruption that had characterized the conduct of international trade before the Second World War.

At the meeting Keynes advocated a strong role for the state in managing national economies, as well as minding the international trading system. He had three concerns: that policymakers might resort to protectionism as an easy way of dealing with trade imbalances whenever they occurred; that difficulties with external payments also often resulted in the adoption of a protectionist stance; and that the world's underdeveloped nations would need external savings to quicken the pace of economic advance. Each of these concerns needed an institutional response at the international level.

At the Bretton Woods meeting, the participants were unable to agree to the establishment of a multilateral trading body that would not only promote and facilitate international trade but also regulate it. Regulation meant the surrender of some national sovereignty which the conferees were reluctant to do. While the countries were unwilling to do this in the area of trade, they agreed to it in the domain of finance, thus going on to establish the International Monetary Fund (IMF) to watch, and if need be to intervene, in the evolving international financial system. They also established the International Bank for Reconstruction and Development (IBRD) to provide funding for the countries that had been devastated by the war. These countries did not have the creditworthiness at that time to access the markets for obtaining the capital they needed. The IBRD was also to assist the states that had begun to gain independence from colonial rule after the Second World War ended. The IBRD was to develop into the World Bank Group as the demands for development funds increased and changed in scope. The International Development Association (IDA) was added as an affiliate to the IBRD in 1960. It was funded by grants from the world's more developed countries and was directed to provide interest-free loans to poor nations.[3] The World Bank Group also created the International Finance Corporation (IFC) as an instrument for making loans to the private sector with guarantees provided by the government.

However, it took half a century of effort to create the WTO and even after its creation, multilateralists did not win their argument. "Although countries continue to implement the commitments made as a part of the Uruguay Round, in the past few years interest in regional and bilateral trading agreements has surged", wrote the authors of a book sponsored by the World Bank.[4] Why were so many countries defying economic theory and opting for a sub-optimal approach to international trade? This question has been debated by economists for decades and the most convincing answer comes from political economy rather than mainstream economics. If the world was organized in the way conceived by Adam Smith and David Ricardo, states would do well to operate as individuals rather than collective entities. In reality, however, the world is differently ordered. Large countries have found it easier to have their own way even when a dispute resolving mechanism exists within a body such as the WTO. Protectionist sentiment takes hold of the making of public policy whenever countries are in economic stress. This happened most recently in the United States, the country most committed to open economies and free trade, as imports from China overwhelmed the American markets and also its industrial structure. Hundreds of thousands of jobs were shipped overseas to take advantage of low wages in a number of emerging economies. The Administration of President Barack Obama found it difficult to fully check the protectionist sentiment in Congress as it sought to legislate its way out of the deep recession of 2008–09. The large stimulus package it was able to get through Congress had some "buy America" provisions that were resented by the country's trading partners. The reaction to this came in the form of similar provisions in the government procurement policies adopted by such important trading partners of the United States as China.

Given the close relationship between domestic politics and international trade, it is not surprising that of the three legs to the stool that is global economic order, trade remains the weakest. The World Bank succeeded in its mission to provide both relatively cheap money to the developing world and also useful advice. Its success spawned a number of regional banks, notably the Asian Development Bank and the Inter-American Development Bank. The IMF survived the collapse of the Bretton Woods system of fixed exchange rates anchored in gold and the American dollar. It was given a large dose of additional capital by the G20 in its meeting in London in April 2009, when the Great Recession of 2008–09 was at its deepest. In May 2010 it became a critical player in the massive financial support package put together by the European nations to save the Greek economy from meeting a tragic end. As an analyst wrote after the Greek deal was signed, "as a part of the agreement last weekend with the European Union, Mr. Strauss-Kahn [the IMF Director-General] has somewhat audaciously secured a prominent role in what is likely to be one of the more formidable challenges of the coming decades, persuading European countries and perhaps his native France, to pare back their debt-ridden finances if they want the markets to continue to lend them money at attractive rates". However, these institutional successes did not rub off on the WTO, which continued to struggle to implement its mandate to move international trade towards a multilateral system in which all member states participated equally. It had increasingly to face the challenge presented by regional trading arrangements.

Size matters in trade. To acquire some mass when the world trading system is dominated by weighty players, it helps to work with regional partners, to pursue common interests in the international trading arena. This approach has worked. However, in the case of the more successful regional trading arrangements, the initial impulse came from politics rather than from economics. This was certainly the case with the creation of what was later to become the EU. Tired and beaten by constant wars in Europe, some French and German leaders decided to work on creating common economic interests that would go beyond the pursuit of raw nationalism. They started modestly by creating an organization to supervise trade in coal and iron. The organization delivered good results and ultimately evolved into the EU, which currently has 27 member states. The most extraordinary feature of the EU is that its continuous expansion occurred not by conquest, but by those who were outside the arrangement begging to be let in. Turkey is the largest country that has not been admitted into the EU. Its exclusion is not because of economics, but for cultural, political and social reasons. A number of EU members feel that allowing a large Muslim country into the arrangement would make further integration difficult.

While the initial motive for creating successful regional economic and trading arrangements may have been political, their survival and evolution was mostly for economic reasons. The example of East Asia serves as a good illustration for this view. There is agreement among historians that trade played a vital role in the remarkable development of the East Asian economies, particularly for the countries that have won two somewhat different epithets: "miracle economies" and "tiger economies", the former because these countries succeeded in achieving unimaginable goals and the latter because they had run so hard and so fast, overtaking a large number of other developing countries. Initially the tigers were on their own, aggressively using the state to promote production of exports and placing them in the international market. Later, as they industrialized and the size of the larger industrial sector required even bigger markets, the East Asian countries began to look to one other as potential trading partners. It has been hard for those economists wedded to the pure form of capitalism to accept that the state played such an important part in producing the East Asian miracle. However, the World Bank settled this argument by publishing its report identifying and analysing the factors behind the growth of the East Asian economies. It highlighted the role that the state had played in making the export-led model of growth succeed.[5]

Globalization – the process that allowed relatively free movement of capital, trade and information across national frontiers – was meant to create a new economic reality. As the name given to this process suggests, countries around the globe were expected to come together and begin to work as the constituents of one economic order. As Thomas L. Friedman wrote in his bestselling book published in 2002, globalization had produced a "flat world" in which capitalism had triumphed.[6] After a struggle that lasted for several decades, capitalism won out over socialism and communism as the most efficient and effective way to manage economic affairs.

Globalization did reshape the world economy, but only to a limited extent. This was for at least three reasons. First, the world's smaller nations found that they needed economic mass to deal with the countries that had a larger weight in the global economic system. Second, capitalism may have triumphed, but it had a number of flaws of its own, including not enough concern for the less advantaged countries in the world and for the world's poor.[7] Third, multilateral institutions were needed to regulate global transactions that went beyond the flow of goods and commodities. This was particularly the case for financial transactions where national regulatory systems did not serve the purpose. Their absence led to the deep crisis of 2008–09.

The first development that went counter to globalization was the organization of hundreds of arrangements involving a limited number of states. Some countries came together because of geographic proximity, some because they shared common history, and some because of shared culture and religion. Geography was the most common reason for the organization of economic and trading arrangements. By the end of the 20th century the global economy had acquired another layer by dividing itself into a number of economic trading blocs between the nation-state and a non-discriminatory multilateral system.

Trade and the state

Economists since the days of Adam Smith and David Ricardo, the pioneers of the discipline, have believed in the rationality of the individual. They argued that each person behaves in a way that is in their own best interest. They also thought, naively it would now seem, that when these individual actions were put together the larger interest of the community and the society would be well served. Some called it the social utility of greed. However, it took a while before economists journeyed from the micro to the macro, from the behaviour of individuals and firms to that of the entire economy. The term "macroeconomics" first appeared in 1945, coined by Jacob Marschak to explain how national economies worked. Much of his work was based on that of John Maynard Keynes who, a decade earlier, had questioned the rationality assumption as applied to both individuals as well as markets.[8]

However, some of the work done by Keynes and his followers was forgotten once mathematics invaded the domain of economics. Rationality was easy to model mathematically; irrationality less so. This line of thinking and this way of doing economic work eventually led to the development of the "efficient markets hypothesis", or EMH in the jargon of economists. In 1978 Michael Jerden, the American economist, boldly declared that, "there is no other proposition in economics which has more solid empirical evidence supporting it than the EMH".

An important by-product of this way of theorizing was to reduce the role of the state in the making of economic policy. A belief developed that individuals, firms and markets should be left to their own devices, allowed to do what was best for them. The result of this would be good not only for these components of the economy but also for the entire economy. This was an attractive way of thinking and also elegant since it could be embedded in sophisticated economic models. Such an approach was also attractive for what I would call lazy governments – or soft states, according to Gunar Myrdal in *The Asian Drama* – the governments that do not have the intellectual equipment or political pressure to use public policy to guide the working of firms and the markets and the behaviour of individuals.

There were many areas of economic activity where the governments could and should have intervened but chose not to, since economic theories supported such a stand-off approach. Trade was one such area. Activist governments in East Asia took a deep interest in trade, in particular international trade, but lazy governments largely stayed away from this area. Some of these were in South Asia. Pakistan was one such country where the government chose to do little to influence the content of exports and the direction in which they were sent.

Economies are like complicated living organisms, however, and what happens in one part of the body can have a deep impact on other parts. Even weak and lazy governments make fiscal policy and what they do with the structure of taxes deeply affects the pattern of trade. Export promotion may not become an important objective of government policy but whether a country creates an important space for itself or not depends to a considerable extent on fiscal policy. In East Asia, for instance, by combining tax policy with some direct intervention the state was able to create an impressive amount of space in the global markets for domestic producers.

Some other areas of public policymaking also influenced the pattern of trade and its importance for the economy at large. Industrial policy was one such government endeavour that had important consequences for what a country did in international trade. Lazy governments produce lazy economic actors. It was easier to continue to support the established order through tax and industrial policies. Doing anything different meant exposing the economic actors and governments to risk. Innovation may produce attractive returns for those who succeed and for the economy as a whole, but the road to success is often paved with many failures. This is one reason why lazy governments prefer the status quo.

If the state is to get actively involved in promoting trade, what should be done? Good trade policy has at least four components. It must be based on good understanding of the international market place. There are profound changes occurring in the way countries trade, the products they produce, and the relationships they develop with other nations. Understanding all this requires careful analysis and the production of current data and information on many aspects of international trade. Second, the state must be aware of what the economy is capable of producing. If there are opportunities available in the international marketplace, can they be successfully exploited by the firms engaged in production and marketing. If there are major gaps between opportunities and capabilities, what kind of tax, industrial and other policies could be adopted to bridge them? Third, to be effective, the making of public policy must not be jerky. This means that the various actors in the economy must become familiar with the public policy milieu in which they are operating. Once a broad framework has been established, changes in public policy must be at the margin. Fourth, there should be broad public support for the approach being adopted. Economic policies work well when the citizens have some say in their formulation, when they are understood by the citizenry and when the citizens have the means to watch over their implementation.

The South Asian effort

South Asia followed the trend towards creating a regional trade association but, as we see below, it did it in a half-hearted way. In 1986 seven countries of the region agreed to form the South Asian Association for Regional Cooperation (SAARC). This was done at the urging of the then President of Bangladesh, General Zia ur Rehman. His government did a lot of preparatory work before the countries of the region could be persuaded to subscribe to the SAARC idea. In 1980 the president wrote a letter to all the heads of state indicating why he believed it was important for South Asia to have a formal arrangement for addressing common issues. He followed up his letter with visits to all the capitals. The countries of the region agreed, but reluctantly. It took them six years to endorse the idea, when they met in Dhaka in 1986 for the first SAARC summit. They agreed to a charter with the following objectives: (a) to promote the welfare of the peoples of South Asia and to improve the quality of their lives; (b) to accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential; (c) to promote and strengthen collective self-reliance among the countries of South Asia; (d) to contribute to mutual trust, understanding and appreciation of one another's problems; (e) to promote active and mutual assistance in the economic, social, cultural, technical and scientific fields; (f) to strengthen cooperation among themselves in international forums on matters of common interest; and (g) to cooperate with international and regional organizations with similar aims and purposes.

President Zia ur Rehman wanted SAARC to launch the process that would ultimately lead to the creation of a free trade area in South Asia. It took 18 years for this process to begin. It was at the SAARC summit in Islamabad, held in January 2004, that it was agreed to begin work on the launching of the South Asia Free Trade Area (SAFTA). The Islamabad declaration was nothing more than the beginning of a process for the eventual creation of a free trade area.

The first step towards some kind of a trading arrangement was taken on 11 April 1993 with the signing of the SAARC Preferential Trading Arrangement (SAPTA), which entered into force on 7 December 1995. The aim was to promote and sustain mutual trade and economic cooperation within the region through exchange of concessions on tariffs. The agreement did not have much effect on increasing or facilitating trade among the countries of the region. This was particularly the case with trade between India and Pakistan. At the 12th summit, held in Islamabad on 6 January 2004, the heads of the SAARC states agreed to move beyond a merely preferential arrangement, deciding to set up SAFTA. This was to come into force on 1 January 2006 after a good deal of preparatory work was done by the various state agencies. The launch needed formal ratification by the seven governments involved, but Pakistan failed to comply in time, delaying the initiation until 1 July 2006. According to the agreement, India, Pakistan and Sri Lanka – the relatively more developed countries of the region – were to follow a different timeline to the remaining four countries, which were regarded as relatively less developed. These three were to reduce their tariffs to 20 per cent by 2007, for the first phase, and to zero by 2012. The remaining countries were allowed to reach the zero stage in three more years. These reductions were not to apply to a list of products approved by the countries; however, since the so-called negative lists were long, much of the intended effect of the agreement was not achieved.

I carried out a study on SAFTA for USAID in 2005–06. Washington's interest in the matter was related to its desire to bring peace to South Asia, which had been long torn apart by strife. It had been active in a similar way in encouraging the South East Asian countries to create an institutional framework within which they could resolve their differences. The main purpose of the study was to underscore the benefits that the smaller countries of South Asia could draw from the arrangement and also why such an arrangement was beneficial for India, by far the largest economy in the area. The preparation of the study took me to five South Asian capitals – Colombo, Dhaka, New Delhi, Islamabad and Kathmandu. I also met with a number of senior leaders in the capitals I visited, including President Pervez Musharraf of Pakistan and Manmohan Singh and Shaukat Aziz, prime ministers respectively of India and Pakistan. The only places where I found some enthusiasm for SAARC and SAFTA were in Dhaka and Kathmandu. Dhaka continued to remain interested because SAFTA, after all, was the result of a Bangladeshi initiative. Nepal was interested largely because it housed the SAARC secretariat. However, there was palpable lack of enthusiasm and absence of interest in Islamabad and New Delhi. Why have SAARC and SAFTA – two ideas for regional cooperation – not worked? Are there lessons that the countries in SAARC could draw from the experiences of other parts of the world, in particular from South East Asia? Some answers to these questions can be found in the gradual and pragmatic development of the Association of South East Asian Nations (ASEAN). The experience of the EU also has some relevance. We will discuss these two in turn before drawing broad conclusions for South Asia.

SAARC and SAFTA have not lived up to their expectations of bringing together the countries of the region to work with one another rather than against one other to realize the area's considerable potential. This has happened for political reasons. As discussed elsewhere in the book, the burden of history carried by these countries has been hard to off-load; suspicions abound, which makes moving forward difficult. At the centre, of course, is the long-enduring tension between India and Pakistan, which has resulted in both countries looking in other directions – towards other regions – for developing economic and trade links. India has shown much greater interest in developing closer links with the countries to its east rather than those to its north. It has sponsored another regional association, BIMSTEC, which is essentially SAARC without Pakistan, but including Myanmar and Thailand. It is also keen to enter into a formal relationship with ASEAN. Similarly, Pakistan has been turning its attention to the Muslim nations to its north-west and is also working to develop even closer relations with China, with which it has signed a free trade arrangement.

The Association of South East Asian Nations (ASEAN)

ASEAN was formed on 8 August 1967 by five countries – Indonesia, Malaysia, the Philippines, Singapore and Thailand. It is now an organization that includes 10 countries – the original five and later, after the end of the war in Vietnam, three countries of Indochina, Cambodia, Laos and Vietnam, as well as Brunei. Myanmar was recently admitted, mostly for geographical reasons. The Association's aims include the acceleration of economic growth, social progress, cultural development, the protection of peace in the region and the provision of opportunities for member countries to discuss their differences peacefully. On 15 December 2008, 41 years after coming into existence, the ASEAN members met in Jakarta to launch a charter they had agreed upon a year earlier in November 2007. This turned the organization into a legal entity with the aim to create a single free trade area for the region, encompassing by then 500 million people.

Historians do not agree as to the original motivation for the five founding members to associate themselves in a supra-national organization.

According to some, it was Bangkok that wished to form a broad coalition of nations in its neighbourhood in order to balance the American influence on the country. Thailand was an important part of the United States effort to contain the spread of communism in Asia. According to others, it was in fact the United States that was behind the move. It wanted the non-communist countries of the region to work together to resolve their differences and to present a solid front to block the advance of communism. After all, Lin Bao, then president of China, had in 1965 urged the people of Asia to rise against their rulers and to bring the masses to power. There may not be a consensus among scholars as to the motivation of the leaders that created the original ASEAN but there is agreement as to what made it possible for the organization to develop. It was the attitude of Indonesia, the largest country in the association in terms of the size of the population as well as the size of the economy, which made ASEAN become an effective regional enterprise. While it was prepared to be treated as an equal, the smaller countries were, at the same time, prepared to treat Jakarta as the first among equals.

The pragmatic response of several generations of leaders has guided the organization's evolution over time. The original agreement has spawned a number of other institutions and forums in response to the changes in the external economic and political environment in which the region has been operating. The evolution of ASEAN has proceeded in many different directions. Rather than continuing to bring in new members, as the EU has done, the organization has preferred to develop associations using effectively an "ASEAN plus" mechanism. ASEAN plus three is not an association, but a discussion forum of the countries of the association that bring them together with China, Japan and South Korea. The East Asia Summit (EAS) – another discussion forum spawned by the association – is a meeting of the ASEAN 10 along with Australia, China, India and New Zealand.

What were the political dynamics that motivated the member countries not only to remain involved, but to engineer practical changes for making it more effective? While the original motivation may have been political in terms of creating the conditions that would prevent the spread of communism, that threat has disappeared. Now the member countries find that an association that transcends national interests makes it easier to deal with the growing competition between two global powers, America and China. By working closely, the 10 members of the South East Asian region have acquired the mass to deal with the economic and political world in which weight counts.

The European Union (EU)

There are important lessons to be learned from the Greek tragedy that unfolded in the summer of 2010. This is particularly the case for Asia, which has for years looked to the process of economic integration in Europe as an interesting model to be studied for bringing about regional economic cooperation. That said, a consensus has developed among Asian policy analysts that economic, political and social situations in Asia do not match those in Europe. Regional cooperation in Asia, therefore, had to be a much slower and more deliberate process than the one pursued by Europe in the second half of the 20th century.

The EU evolved at a pace and in a scope that could not have been envisioned by its founding fathers half a century ago. The first step in the integration of Europe was aimed at preventing another war on the continent that had been devastated twice by bitter conflict. France and Germany spearheaded the move by creating a common coal and steel community, bringing under European control two products vital for any war effort. That was a modest start to a much larger scheme. The EU now has 27 countries as its members, of varying size and at different levels of development. Having given membership to so many countries, the Europeans have allowed some of the older participants in the enterprise to develop additional mechanisms for further integration. A group of 16 nations within the larger union has given up national currencies in favour of the euro, the common currency. Some of the countries have done away with the need for passports to cross their borders, with travellers needing only a form of identification to go from one country to another.

Politics more often than economics were behind the race to integrate Europe. Initially it was the fear of the Soviet Union and the encroachment of communism on the European mainland that prompted those in the western part of the continent to band together. There was considerable comfort in presenting the expansionary Soviet Union with a united front. The EU expanded to the south and south-west of the continent in order to prevent the spread of communism. As the countries in the Iberian Peninsula and those along the Mediterranean cast off autocratic rule in favour of a democratic structure, the European core felt it necessary to embrace them quickly, to stop slippages from occurring. It was mostly for this reason that Spain, Portugal and Greece were admitted into the union. It is interesting that at this time all three are feeling extreme economic stress, which is proving hard to manage because of the constraints imposed by membership of the EU.

The EU's expansion to the east also happened largely because of politics. As the Soviet Union collapsed and several countries in Eastern Europe emerged from behind the Iron Curtain, the core group once again offered EU membership to secure their independence. Poland, Hungary, the Czech Republic, Slovenia and several other countries moved in as members. Poland's inclusion was especially significant, since under the Soviet Union the defence agreement among the countries in the east of the continent was known as the Warsaw Pact, after the country's capital.

In hindsight, the mistake the Europeans made was to marry economic objectives with political motives. While it was considered politically prudent to bring into the EU the countries on the fringes of Europe, these countries had to accept stringent economic conditions to obtain membership. It turned out to be a process in which policymakers did not pay much attention to economic criteria, however, resulting in the Greek tragedy in the case of Athens. No matter what roadblocks were erected, Greece kept moving towards disaster. An estimated US$1 trillion package of support provides in mid 2010 was meant to prevent the worst from happening: the beginning of the unravelling of the union.

Europe's plight can be traced to 1981, when Greece, still recovering from the aftermath of military rule, was rushed into the EU 14 years ahead of several more developed countries. Greece beat the much wealthier Austria, Finland and Sweden to the European stage. That was not the only lapse. In January 1999 11 countries locked their currencies – the first stage in the creation of the euro, the common currency – after agreeing to a tough set of conditions. These included budget deficits that must remain below 3 per cent of the country's gross domestic product (GDP); national debt that must not exceed 60 per cent of GDP; and an annual rate of inflation that must remain below 3 per cent. Countries such as Greece did not make the grade, but were still admitted.

Athens persisted, even resorting to cooking the books of its accounts. It also became ambitious. In 2002 Greece was among those countries that gave up their currencies to adopt the euro. When the new currency notes were being printed, Yannos Papantoniou, then the Greek finance minister, implored his counterparts that the euro notes and coins that circulated in the country should also carry wording in the Greek alphabet. The Germans insisted that the lettering could only be in Latin. According to Jurgen von Hagen, professor of economics at the University of Bonn, when Greece was admitted into the euro club, "there were clear indications that Athens was forging the data, especially data on deficits, to make their public finance appear more benign than it really was. But European governments did not want to pay attention. For political reasons they wanted Greece in". Greece came in, but since the beginning it has been a difficult member.

Membership of the EU, and a shared currency with such economic power houses as France and Germany, meant that Greece could borrow cheaply. It did that copiously, particularly to finance the 2004 Olympic Games in Athens, the city that had first held the sports competition. The bills came due for payment in 2010 and the country has had to go hat in hand to Germany, France and the IMF for a massive bailout, the cost of which will have to be paid by all countries of Europe, which may not prove palatable for the citizens of larger nations.

This story has obvious lessons for Asia, which is also engaged in a complicated exercise to integrate its many economies into regional associations. Two lessons should be learned from the European experience. Regional integration should be guided by economic considerations rather than by politics. A neat arrangement that encompasses a diverse group of countries is not necessarily preferable to one that evolves, perhaps untidily over time and on the basis of experience. The Asians, ever pragmatic, have allowed regional associations to grow and evolve, not according to some grand design, but to reflect the needs of the time. Attached to ASEAN now are a number of arrangements that have allowed several countries to bind themselves to the core depending on their varied interests. This is the way to go.

This approach has worked well for East Asia. In South Asia, however, attempts at regional integration have largely stalled for political reasons. The two largest economies in SAARC have so many political differences that they have found it difficult to push forward such efforts as SAFTA. As was demonstrated in April 2010 at Thimphu, Bhutan, there was so much interest in the meeting between the prime ministers of India and Pakistan on the sidelines of the SAARC summit, that little attention was paid to regional matters. In Europe, politics pushed regionalism faster than it should have gone; in South Asia, politics is having the opposite effect. However, the fact remains that South Asia needs serious regional cooperation as much as Europe did in the immediate post-Second World War period. While South Asia should move in that direction in a measured way – a lesson to be learned from the European experience – it must begin the journey with serious intent.

Making SAFTA an effective organization

There is a lesson in the ASEAN and EU experiences for India. While it is a more dominant economy in South Asia, compared with Indonesia in Southeast Asia, it has to lower its profile in order to provide comfort to the region's smaller countries. At the same time, the region's smaller nations and economies have to treat India as by far the most prominent player.

While India is rising – its GDP increased at close to 9 per cent a year before the world went into the Great Recession of 2008–09, slowed a bit because of the global recession and picked up again with finance minister Pranab Mukherjee promising in his 2010–11 budget speech a 10 per cent increase a year in GDP to be achieved in a couple of years – it will find it difficult to achieve the economic superpower status to which it aspires. I will suggest in Chapter Eight that the best India can hope to achieve over the next decade and a half is a growth rate averaging 7 per cent a year. This is at least for two reasons. First, it has not yet found a way to broaden the prosperity achieved by a quarter of the population across the remaining three-quarters. As Joseph Stiglitz writes in his most recent book on globalization, India is indeed shining "on the lives of some 250 million people [but] for the other 800 million people of India, the economy has not shone brightly at all".[9]

The other reason why India has been held back from achieving its ambition is that it is an island of relative stability in a highly restive part of the world. There is an on-going conflict in Pakistan involving the rise of Islamist extremists who are challenging the writ of the state. Thousands of people have perished in the conflict to which there is no end in sight. This conflict has been seen by some – including Hillary Clinton, the United States Secretary of State – as posing an existential threat for the country. The militants and terrorists operating from within Pakistan are not only endangering the survival of the Pakistani state, but have also extended their operations beyond the country's borders. In November 2008 10 members of the group *Lashkar-e-Taiba* held Mumbai hostage for three days and killed almost 200 people. In May 2010 Faisal Shahzad an American citizen of Pakistani descent attempted to set off a car bomb in New York City's Times Square.

The future of Afghanistan, not strictly an Indian neighbour, remains highly uncertain in view of, particularly, the United States' declared intention to withdraw its troops from that country beginning in July 2011. Nepal, to India's immediate north, remains unsettled and in considerable turmoil. The powerful Maoist movement that earlier showed some willingness to work with the established groups to stabilize the country called a strike in April 2010 that paralyzed Kathmandu, the country's capital. As Manjushree Thape, a Nepalese, wrote in an article published in May 2010, "we Nepalese are still baffled about how to be part of the modern world [...] For this we are still, seemingly forever, waiting".[10]

Bangladesh, to the east, is still struggling to stand on its own feet, although it has made some progress since the return of democratic rule in January 2008. It now has the second highest rate of GDP growth in the South Asian mainland after India. Then there is Sri Lanka, to the south, not strictly a part of the South Asian mainland but the narrow body of water that separates it from India is narrow enough that it casts a shadow on its neighbour. Although the military was able to put down the long-enduring Tamil insurgency in early 2010, discontent among the members of this large minority remains. That the Tamils are a large community in India complicates matters. What complicates them further is the country's drift towards authoritarian rule. The little kingdom of Bhutan, where the monarch has willingly surrendered most of his royal powers, is the most stable country on India's borders.

Even India has had to deal with armed rebels in its midst, whose ranks are being swollen by the discontent occasioned by growing inequality. Known as Naxalite-Maoists, this challenge to the Indian state was first thrown down in the eastern village of Naxalbari. The areas in which insurgents draw their support from Dalits (formerly known as "untouchables") and Adivasis are sometimes referred to as the Red Corridor. In 2006 Prime Minister Manmohan Singh called the group's activities "the single biggest challenge ever faced by our country". Two years later the prime minister said the country was "losing the battle against Maoist rebels".

India has enough military strength to first contain and then overcome the challenges it faces at home. Its leadership recognizes that the high rate of economic growth that it has demonstrated the ability to achieve will not trickle down fast enough to handle growing discontent inside its borders and among its own people. The government is committed to helping the lagging rural sector. It was worried enough about creating new jobs for new entrants to the workforce to launch an employment guarantee scheme for rural areas. It is the external challenges emanating from its immediate neighbourhood that need to receive the attention of the policymakers in New Delhi.

What, then, are the options available to India, by far the largest country in South Asia by the size of its population and the size of its economy, to achieve the status of an economic superpower? This question has several answers. The most obvious is to work to bring stability to its neighbourhood. It should not be tempted to go it alone, since it will be continuously distracted by instability and uncertainty all around its borders. To deal with its neighbours, though, India will need to cast off some of the old approaches and work towards a new strategy aimed at producing a working economic entity in South Asia to which it and its many neighbours are fully committed. A move in that direction is not taking place. The most important initiative in this respect is SAARC, created a quarter century ago. As shown by the Bhutan summit of April 2010, greater attention is given to the politics between the prime ministers of India and Pakistan than to the work of the summit itself. A concerted effort needs to be made by South Asia to better integrate the regional economies. India must take the lead in this effort and use the SAARC/SAFTA mechanism as the foundation.

8 South Asia

Future growth scenarios with or without integration

Introduction

In this, the final chapter, we will bring together the various themes explored earlier in order to answer one question: Given the situation in South Asia as the second decade of the 21st century begins, what does the future look like for the region?

One way of answering the question is to do a simple quantitative exercise to figure out how well the region might do by following some of the policy directions suggested in this work. We could estimate the increase in the rates of economic growth that would result from a reorientation of the policies in the major countries in the region and compare it with that which would be the result if there were no change in the direction in which the countries have been going for the last six or so decades. The reference here, of course, is to the inability of the states in the region to work together for common economic good. The difference between the two would provide a quantitative estimate of the benefit that would accrue to the region by a change in the stance of public policy with respect to regional integration.

We believe that the most important change in the direction of public policy would be "the thinning rather than the thickening of international borders" – the World Bank's phrase in its 2009 *World Development Report*[1] – by having the countries in the region work closely with one another. This would result in softening the very hard borders that currently separate these countries, but would require the countries to shed the burden of history that they have carried, which has made it exceedingly difficult for them to work together for the collective good of the people of the area. Lingering hostility among some of the countries of the region – especially between India and Pakistan, the two largest – has taken a heavy economic toll. One example of the price that has already been paid is the long-enduring Kashmir dispute. In an earlier work I developed a simple model to estimate the cost that Pakistan had already incurred for staying engaged in the Kashmir dispute since 1947.

According to this analysis, Pakistan's economy would be 2.4 to 3.4 times its present size had it not turned Kashmir into such an important national cause.[2] This does not factor in the cost of the rise of Islamist extremism in the country because of the encouragement that various administrations – both military and civilian – have provided to the *jihadists* to fight against India in the state of Kashmir.[3]

India, too, has suffered, but not as much as Pakistan. The Administration of President Barack Obama has indicated, in spite of protests by the Indian government, that unless New Delhi takes steps to resolve the dispute, it will not be able to find the place it deserves in the evolving global political and economic systems. Although the Indian government was able to remove even implicit references to Kashmir in the terms of reference for the engagement of late Richard Holbrooke as President Obama's special representative on Afghanistan and Pakistan, this position was reiterated by several high-ranking American diplomats, including Robert Burns, a ranking official of the State Department during a visit to New Delhi.

There are other costs that the region has incurred because of the difficulties among the various countries. Pakistan lies in the way of land trade between India and Afghanistan and the countries to the north in Central Asia; Bangladesh has been reluctant to provide natural gas to India, fearing that the move would be politically difficult to sell to the country's citizens. Bangladesh has also not granted India transit rights to the latter's eastern states, leaving New Delhi no other option but to use the "chicken neck" around the former to gain access to Assam in the east.

All this may require the formation of a viable set of regional institutions aimed at improving cooperation in the fields important for achieving economic progress and social advance, but regional cooperation is not the only area where the states need to work together. They also need to factor in a number of other advantages that the region has over other developing nations. Among them are two of special significance – location and demography. Demographic changes that have occurred in the past few decades have created windows of opportunity for all countries in the region, which should be exploited. There are also considerable advantages of location given the growing demand for exchanges of various products and commodities among the economies in the South Asian neighbourhood.

In any such effort three countries – Bangladesh, India and Pakistan – will have critical roles. The last two have a long record of hostility against one another, which has compromised efforts made in the past for the region to define a common view and a common strategy for improving the lives of the citizenry. Any look at Asia's future must start with a short description of the situation in India and in the countries on its periphery. We should then see how the various segments of Indian society look at their own future and whether they believe that it is important to work with the states in the region to bring the country greater stability and sustained economic progress, or whether India could simply ignore the region and go it alone. It is the author's belief that without economic, political and social stability in the region the country could also stumble. It would be extremely difficult to keep turbulence confined to places outside the borders and not have it seep into the country itself. If proof were needed of this proposition, we need go no further than the attack on Mumbai by 10 gunmen who took a boat from Karachi, Pakistan, penetrated the security perimeter of the city and held it hostage for three days. Almost 200 people were killed in this attack in November 2008.

Then there is Pakistan. For many decades Pakistan saw itself as India's competitor on the global scene. It was also obsessed with the belief that India wished to destroy it – to break it up as it helped to do in 1971–72 when Indian troops moved into what was then East Pakistan, defeated the Pakistani army and created the circumstances that led to the emergence of the independent state of Bangladesh. In the early 2000s the people and policymakers in Pakistan must come to terms with the fact that India is now a rising global power with policy interests that go beyond its immediate borders. At the same time, Pakistan has stumbled badly – economically, politically and socially.

The remainder of this chapter is divided into three sections. In the first we will answer the question about whether South Asia can be treated as an emerging economy. If the answer is "yes", then some of the public policy choices in the earlier chapters of this work do not assume the emergency implied here; if the answer is "no", then the countries in the region need to move quickly so that the area is not left far behind other developing parts of the world. If that were to happen, it would become even more difficult than is the case today to catch up. Public policy choices are the subject of the second section, in the context of one sector – industry – chosen purely for illustrative purposes. The third section provides three scenarios in order to estimate how individual countries and the region could gain by adopting a regional approach to development.

Is South Asia emerging?

If by "emerging" we mean a geographic entity – a state or a region – that has achieved political and social stability and sustainable economic dynamism, then the term cannot be applied to all of South Asia; it can only be used for India and even in the case of that country, only to a limited extent. Over the last five years, from 2002 to 2007, the Indian economy has finally shaken off its sluggish past when the country did not run but lumbered. It was not a tiger, but was perhaps on the way to becoming an elephant. Gross domestic product (GDP) grew at an average rate of close to 9 per cent a year, compared with just 3.5 per cent a year in the 40-year period after independence. This was termed the "Hindu rate of growth" by the late Indian economist Raj Krishna. Income per head of the population grew by less than 2 per cent a year and the incidence of poverty increased. In more recent years, per head income has grown by more than 7 per cent per annum and the incidence of poverty has declined significantly. Some cities and states in the country have begun to show signs of prosperity. The size of the middle class has increased significantly, with some 200 million people, perhaps, falling into this category. The middle class has begun to exert its influence on many aspects of Indian life, developing a taste for consumption and thus creating a large market for luxury goods. Indian film-makers and writers have developed audiences and readers outside the country's boundaries, and Indian themes are becoming widespread, with 2009's *Slumdog Millionaire* winning the largest number of Academy Awards, including that of best movie of the year.

Foreign investors have begun to take note of the country's economic potential, looking at it as a market into which they could move and also as a supplier of trained human resources in a world that is experiencing demographic declines in several areas. Large quantities of foreign capital have arrived in the country, some of which went into reserves, which increased to an impressive level. In 1991 the then finance minister Manmohan Singh had to take gold with him to London and Tokyo to borrow money to keep the country afloat and save it from going bankrupt. That is now a distant nightmare. The country now boasts the world's fifth largest foreign exchange reserves. The IT sector has continued to show great strength, making a significant contribution to exports. Some other sectors of the economy have also developed remarkably well, among them health services and pharmaceuticals. India has become an important destination for what came to be called "health tourism".[4]

Can this progress be sustained, however? The country faces many problems, which will have to be resolved before it can achieve the status of an economic superpower. The country has been working hard to achieve that goal, but a number of problems remain. In its issue that gave a significant amount of space to the elections of April–May 2009, *The Economist* provided a revealing summary of some of the problems that the country will need to address. "India is a land of bright promise. It is also extremely poor", stated the magazine in its lead article. "About 27 million Indians will be born this year. Unless things improve, almost 2 million of them will die before the next general election. Of the children who survive, more than 40 per cent will be physically stunted by malnutrition. Most will enroll in a school, but they cannot count on their teacher showing up. After five years of classes, less than 60 per cent will be able to read a short story and more than 6 per cent will be stumped by simple arithmetic".[5]

That the country faces many challenges that can be overcome only by accelerating sharply the rate of economic growth, was illustrated by a report issued in 2010 by McKinsey Global Institute.[6] It focused on the challenges posed by the country's rapid urbanization. According to the report, by 2030 590 million Indians would be in cities and 70 per cent of India's new jobs would be in urban areas. A staggering US$1.2 trillion in infrastructure development would be required to accommodate these new arrivals. That would mean building 2.3 million square feet of roads, and 7,400 kilometres of railroads and subways.[7] Already the country's large cities are groaning under the crush of population. According to one observer, "Bangalore, India's high-technology hub, is strangled daily by traffic that has already eroded its image. Mumbai, the commercial capital, is riddled with over-crowded slums. Calcutta is a swampy mess with corroded roads and a severe shortage of decent housing".[8]

Nonetheless, the epithet "emerging" can be easily applied to India, but not to the rest of South Asia. India at this time has a very troubled neighbourhood, with the most troubled country on its borders being, of course, Pakistan. Its economy is in free fall. *The Economist* special issue mentioned above estimated the country's GDP growth rate at only 0.6 per cent for 2009, compared with 5 per cent for India.[9] However, the government issued a somewhat higher estimate of GDP growth. The *Pakistan Economic Survey 2008–09*, published a couple of weeks before the budget for the year was announced, estimated a GDP growth rate of 2 per cent for the year ending 30 June 2009.[10] When the final figure is calculated, it could even be lower. This means that there will be a significant increase in the number of people who are absolutely poor. The incidence of poverty is most likely to increase by 10 per cent, from 50 million to 55 million. In its annual report for the year 2010, the Lahore-based Institute of Public Policy declared that Pakistan was standing at the edge of an economic abyss. To pull back, it would need concerted action on a wide front.[11]

Pakistan's political system is showing signs of life, but even here it has a long way to go before it can become stable. On 19 April 2010 President Asif Ali Zardari signed into law the 18th amendment to the Constitution, making the prime minister chief executive of the state and responsible to parliament along with his cabinet. President Zardari gave up – albeit with some reluctance – the powers he had inherited from his military predecessors, General Zia ul Haq (by way of the 8th amendment) and General Pervez Musharraf (by way of the 17th amendment). The 18th amendment removed those powers from the Constitution and also granted the provinces a considerable amount of autonomy. The 7th National Finance Commission award, announced a few weeks before the passage of the 18th amendment, increased the flow of resources to the provinces. The amended Constitution gave provinces the authority to use these resources for social and economic development.

These positive moves notwithstanding, the country is faced with what its senior officials have called an "existential threat".[12] In the spring and summer of 2009 the leaders of Pakistan showed a lack of resolve in terms of dealing with the threat that Islamist extremists were posing to the country's integrity as a state. Islamabad first endorsed an agreement signed by the government of the North West Frontier Province (NWFP) with the group operating in Swat and then, when it became clear that the group had no intention of abiding by the terms of the agreement that called for its disarmament, the political leadership ordered the military to launch an all-out offensive against the militants. The operation began in mid-May and it was six weeks before the military could claim that it had overcome the stiff resistance offered by the terrorists. In the process, some 2.5 million people were displaced. The cost of looking after the internally displaced people and the total cost to the economy was estimated by the government at 2 per cent of GDP.[13]

The Swat-Malakand operation was followed by one in South Waziristan, which had become the centre of activities of the group that went under the name of *Tehrik-e-Taliban in Pakistan* (TTP). Its leader, Baitullah Mehsud, had launched a number of terrorist attacks in some of the major cities of the country, the most daring of which was the one on the army's general headquarters in Rawalpindi. Mehsud was also alleged to have master-minded the assassination of Benazir Bhutto on 27 December 2007. He was killed in August 2009 by a missile launched by the United States from an unmanned aircraft. As it had done in Swat, the army succeeded in overcoming the Taliban in South Waziristan.

For several decades Sri Lanka was India's other troubled neighbour. The government there celebrated in mid-May 2009 the triumph of its military over the Liberation Tigers of Tamil Eelam (LTTE). The rebel leader, 54-year old Vellupillai Prabhkaran, was killed in the operation. His fight against the Sri Lankan state and his quest for an independent country for the Tamils had cost the lives of more than 100,000 people. The victory scored by the military after nearly 30 years of struggle could bring stability to the country, but the administration of President Mahinda Rajapaksa remained controversial. At the 19 May 2009 meeting of parliament in which he declared victory over the rebels, 20 opposition chairs in the 225-seat chamber remained empty. They belonged to the Tamil National Alliance, the largest group of parties representing the Tamil minority, elected in the north and east of the island. Without full reconciliation with the parts of the Tamil community that were prepared to operate within the political system, the Sri Lankans will achieve neither political stability nor sustained economic progress. Some members of the Tamil community – in particular those among the diasporas spread across the globe – have vowed to fight for their rights.

Bangladesh is also struggling to find its feet. There are prospects of positive change after the country was returned to the elected representatives of the people in the elections held on 27 December 2007. For two years Bangladesh was governed by a caretaker administration that first attempted to factor out established mainstream parties from the political system, only to work out an arrangement with them to transfer power. This was achieved in January 2008, when Sheikh Hasina Wajed returned as prime minister to head the coalition dominated by the Awami League.

In many ways Bangladesh has surprised the international community. At the time of its birth in December 1971, it was dependent entirely on foreign assistance for its survival. The then United States Secretary of State Henry Kissinger called the new country an international basket case. Now it is the second best performing country in South Asia after India. According to Nicholas Kristof, a columnist for the *International Herald Tribune* who takes a keen interest in Asia, soon after achieving independence, "Bangladesh began climbing a virtuous spiral of investing in education, of girls in particular. It now has more girls in high school than boys, according to Unicef. This focus on education has bolstered the economy, reduced population growth rates, nurtured civil society and dampened fundamentalism. Educated girls formed the basis of a garment industry, making shirts for Americans. This brought in currency, boosted employment and provided an economic lifeline to the country. Those educated girls went to work for poverty-fighting organizations like BRAC and the Grameen Bank".[14]

Nepal is also struggling mightily to define itself after having shed the monarchical system of governance, which had gone awry. However, it is finding the going hard. Reconciling the various disparate elements in the country is proving to be a more difficult task than was originally anticipated. The Maoists are still not fully satisfied with the political dispensation that is on offer. The attempt to write a constitution for the country following the departure of the monarchical system proved to be a more cumbersome process than was anticipated by most participants.

India's periphery, therefore, remains unsettled, with some parts of it in serious turmoil. This raises an important issue. Can India go it alone and run away from the rest of South Asia, or does it have to help the countries around its borders to become stable? This study presents the view that the Indians would do well to pause and reflect on how South Asia in peace and stability would help it to achieve the superpower status. Without this, the country could well stumble. In an effort to secure its periphery, India has an important role to play.

There is intense debate in India and sharp difference among the various segments of society about India's role in the South Asian region and its place in the larger community of nations. This debate was provoked by three different developments. The first of these was the decision by the first administration of Prime Minister Manmohan Singh to sign an agreement with the Administration of United States President George W. Bush that gave it the status of a nuclear power, even though the country had not signed the Nuclear Non-Proliferation Treaty (NPT). This agreement specified some obligations for India which, for the more nationalist Indians, were a serious encroachment on their country's sovereignty. The second development was the decision by the Administration of President Barack Obama to deal with the insurgency in Afghanistan by developing a broad regional policy. This came to be known as the AfPak approach, embracing both Afghanistan and Pakistan. Initially Washington, as already indicated, would have liked to include India within the ambit of the new policy. The Indians resisted the effort, however, apprehensive that this would involve the United States in working out an approach to the long-enduring Kashmir problem. They had always resisted Pakistan's effort to internationalize the dispute. As a result of intense pressure from New Delhi and the powerful Indian lobby in the United States, even an implicit reference to India was dropped from the job description drawn up for Richard Holbrooke, the Special Representative appointed by the Obama Administration to work on Afghanistan and Pakistan. The third development was the recognition that China was on the way to becoming a major economic and political power, particularly after the United States stumbled badly during the financial crisis of 2008–09. There was some talk of the world being organized around a "G2" – the United States and China – rather than around the G7 (the group of the world's richest countries) or around the G20 (the group that includes the rich countries as well as the large emerging economies including India).[15] As discussed below, India's role will be determined by its economic performance and the shape that the international system takes: whether the system becomes multi-polar or bipolar. For those Indians who strongly believe that their country should play an active role in the world, sights are raised towards distant horizons. There seems to be little interest in the neighbourhood. However, there will be a price to pay for this way of thinking.

The argument advanced in this work is that the emergence of a multipolar world is better aligned with Asia's interests. This can only happen if three developments take place simultaneously: India recognizes that it must pay much greater attention to the countries around it borders; that the countries in India's neighbourhood are prepared to accept New Delhi's leadership;

and that China and India, each with its own sphere of influence, work with rather than against each other. A case for this approach can be made on economic grounds. A later section in the chapter makes a start in this direction by quantifying the benefits that would flow to the countries of the South Asian region by working within a collective framework.

The quantification is based on two sets of assumptions. According to the first scenario, each of the constituent parts of South Asia will keep going their own way without a fundamental change in the direction taken in the past. If they take any interest in the countries in their region, it will be to advance their own interests and not to be concerned with the welfare of their neighbours or to determine how the neighbours could directly or indirectly promote their own development. The second scenario – more accurately two scenarios – assumes that the countries in the South Asian region will focus public policy much more clearly on regional integration based on the comparative advantages that individual countries have in the region and that institutional arrangements can be put in place that will further the region's economic development.

There is a significant difference in the benefits that accrue to the region and to the countries in the region if public policies pursue the second set of objectives. According to our calculations, South Asia's combined GDP would be 40 per cent higher in 2025 if the maintaining the status quo approach to public policymaking were abandoned by the countries in the area in favour of a more regional approach.

A regional approach to South Asia's economic development: The case of the industrial sector

Translating for the various sectors the recommendation that South Asia would greatly benefit from adopting a regional approach is beyond the scope of this work. Instead, we will focus on one sector and that, too, for illustrative purposes in order to show how public policies should be shaped to draw the most benefit from a regional approach. We will use the sector of industry for this purpose and employ the cases of India, Pakistan and Bangladesh to underscore the important point that different public policies will need to be adopted in different countries to draw the most benefit.

It is now recognized by economists and policy analysts that industrialization – its pace, scope and content – responds to public policy. The policymakers' focus should be on three aspects of structural change in the sector of industry. As industrialization gathers pace, what should industries produce? Where should industries be located? Should industrialization be used to lift the more backward regions of the country, as was attempted during the period of President Ayub Khan (1958–69) in Pakistan? Where should the products of industrialization be sold? The last question leads to another issue: how much emphasis should be placed on export promotion as an objective of industrialization?

Economists have also begun to recognize that since countries have different histories and different structural characteristics, appropriate country policies will differ and evolve differently. This is called "path dependence" – dependence on what has happened in the past. There is no "one size fits all" public policy approach to industrialization. In the case of India, the grounds for industrialization were laid during the period of Jawaharlal Nehru, when the state was allowed to ascend to the commanding heights of the economy. At the same time the private sector was constrained by the development of the "licence raj". This was a system of controls that brought the government into most aspects of the process of decision-making by private enterprises, including the location of industrial units, their size, and the lines and quantities of products they could manufacture. In the belief that the best way to increase the welfare of the poor was to strictly regulate the labour markets, a series of laws and regulations were introduced that gave little space to entrepreneurs for hiring, retaining and firing their workers. At the same time, the state invested heavily in large-scale industry.

This approach to industrialization had a number of consequences. Two of these were particularly important. The first yielded a positive result. The approach pursued lent scale to the industrial sector. Once the economy was opened to the private sector and to the world outside, some of the large state-owned enterprises in sectors such as energy and mining were able to develop a significant presence on the world scene, helping India gain access to the resources it needed to continue with industrialization. The second consequence was the opposite of the first. Industrial policy of the Nehru era also developed strong vested interests that presented a challenge to the state in modernizing industry and commerce. India, for instance, in spite of encouraging foreign direct investment, has not allowed investment by large foreign retail firms such as Wal Mart in the country. Small retailers carry too great a political clout to allow the entry of large firms into the sector.

In Pakistan's case, the initial direction of industrialization was influenced by the trade war with India that broke out in 1949 over the issue of the rate of exchange between the currencies of the two countries. When trade with India stopped, Pakistan was forced to industrialize quickly by emphasizing the production of basic manufactures. Since the Pakistani state at that time was weak and short of funds, it relied on private initiative to lead the industrialization drive. This had profound consequences for the development of the structure of the industrial sector. Unlike India, Pakistan focused on consumer industries and on private initiatives, while India put the public sector at the commanding heights of the economy and invested heavily in heavy industry.

The other significant historical influence on Pakistan's industrial development was the decision by the administration of President Ayub Khan to spread the ownership of industrial assets by using the government's licensing mechanism for inviting newcomers and encouraging them to locate the sanctioned units in the country's underdeveloped areas. This policy also had profound consequences for the structure of industry, particularly of textiles. By sanctioning new units for no more than 12,500 spindles, the country developed an industry that did not have the scale to become competitive. It also restricted most weaving activities to cottage industries. The structural consequences of Prime Minister Zulfikar Ali Bhutto's nationalization of large-scale industries are another historical fact that needs to be factored into the understanding of the character of the Pakistani industrial structure.

Bangladesh's remarkable economic and social progress was the result of a set of circumstances entirely different from those of India and Pakistan, the two other large economies of South Asia. The first push towards industrialization was the consequence of the splitting of the quota allowed to Pakistan by the West under the Multifiber Arrangement (MFA). Bangladesh was awarded one-half of Pakistan's share. This was done in order to provide the new and highly impoverished country a means for survival other than receiving large doses of financial assistance. However, the country did not have an industry that could make use of the quota. The vacuum was filled by foreign investors, mostly from East Asia, who, having fully utilized their own quotas, were looking for opportunities available in the countries that had not met theirs. Foreign investment poured in and very quickly Bangladesh developed a vibrant ready-made garments industry. As Kristof pointed out in the article quoted above, the development of this industry had many positive consequences that could not have been predicted when the investment was being made.

What this quick overview of the development of the industrial sectors in the various countries of South Asia tells us is that there are complementarities in the industrial systems that can be exploited if a framework for economic integration can be developed. India's large-scale industrial enterprises could use the small enterprises in both Bangladesh and Pakistan as suppliers, which would fit into the structure of production that is developing in other parts of the world. This is a theme that has appeared repeatedly in the work done by the United Nations Industrial Development Organization (UNIDO) and published in its annual *Industrial Development Reports*.

Analytical work done at UNIDO has established a strong relationship between industrial sophistication, structural change and growth. The organization's "research findings confirm that diversifying and moving up the production sophistication ladder in industry are important drivers of development".[16] However, sophistication need not imply the production of a large number of final products in a number of different sub-sectors. With the changes in the international industrial structure that have resulted from the remarkable development of information and communication technologies, the production process has been decomposed into a series of tasks which can be apportioned according to the comparative advantage of various production centres. For countries such as Pakistan that missed out on the initial phase of industrialization that produced a number of economic miracles, particularly in Asia, it may be more appropriate to concentrate on building a task-based industrial economy. Researchers who have studied the development of this approach to industrialization and have compared them to structures that produce total products, have concluded that the concentration on tasks is less sophisticated than the one where industries concentrate on start-to-finish production. Even when an entire product is produced in one location – men's shirts in Bangladesh, for instance – there is still some reliance on imports. The garment producers in the country, for instance, buy buttons from China, which are most probably produced in Qiaotou, often called the button capital of the world.

The next issue is of location. Manufacturing industries and service activities tend to concentrate in the areas in or close to major cities. According to UNIDO, "the economic literature on high and middle income countries provides persuasive evidence of the existence of agglomeration economies [. . .] industrial agglomeration is also important for developing countries. Productivity is higher if manufacturing firms cluster together".[17] Cluster economics has become an important subject of study ever since the pioneering work done by Michael Porter of Harvard University. Bangalore is the most obvious example of a cluster. The IT industry in that city grew out of the presence of a world class Indian Institute of Technology in the city, as well as it being the location of some advanced defence-related manufacturing. Pakistan has some examples of clusters, the development of which was not induced by public policy but by organic growth. Sialkot, the home of sports goods and surgical industries, is one example of a cluster; Gujranwala (electric motors and electric fans), Gujarat (furniture) and Kasur (leather) are other examples.

As indicated, the development of clusters in Pakistan was not the outcome of public policy directed at them; it happened naturally. For the government to help the industries located in the clusters, it would need to provide help to upgrade technology, provide market information, and also introduce them to new sources of finance such as private equity and venture capital funds. The most important contribution the state could make is in the area of knowledge development. Some of the more successful clusters in the developed world are located in close proximity to the institutions of higher learning. It was the presence of Stanford University and the Berkeley Campus of the University of California that resulted in the development of the software industry in Silicon Valley. These different paths to industrialization provide the context within which partnership could develop among the various industrial sectors of South Asia.

South Asia's economic future with or without economic integration

Disregarding the current problems in Europe, the fact remains that regional integration helps countries achieve rates of economic growth that would not be possible if they acted alone. This is the case, in particular, in South Asia where economic progress – India's remarkable performance in the last couple of decades notwithstanding – is being held back by intra-regional conflict. This is where the European experience becomes relevant. The initial European dream was to create a political structure that would also have strong economic foundations. With such a working organizational structure, future conflict would become practically impossible. The dream was realized. Although some historians tell us that scholars should "never say never", it does seem unlikely that Europe will ever see a conflict on its soil of the type that twice devastated the continent in the last century. Economic union has played a large part in realizing this level of comfort.

This was also the dream that drove Zia ur Rehman, Bangladesh's second president, to convince the heads of state in the South Asian region a quarter century ago to work towards greater regional cooperation. His was the spirit behind the creation of the South Asian Association of Regional Cooperation (SAARC), but the potential of SAARC has yet to be realized, in part because the countries of the region are not convinced that this is the way to go. Sometimes, however, simple mathematics help to clear the mind and this is what we will attempt to do here. Our purpose is to develop a simple macro-econometric model to make the case that there are enormous economic rewards available by improving trade and economic links among the eight countries of the SAARC region. Before providing the results of some simple calculations, I will take a slight detour to provide a quick overview of the current economic situation in Pakistan; indicate how the global economy is evolving and what South Asia's role could be in it; and what could India and Pakistan could do to take advantage of the opportunities that are opening up in the global economy.

The future of the Pakistani economy

Pakistan today is passing through an extremely difficult period because of a perfect storm that has gathered around it. The country is dealing with extremism and terrorism, which have stubbornly persisted and have continued to take a heavy toll on the economy and society. Several shortages have developed in such vital goods and services as electricity, natural gas and water, which are hurting industrial and agricultural output. The quality of governance has deteriorated to the point where people have lost faith in the state's ability to provide even for their most basic needs. All these developments have affected the state of the economy. The GDP growth rate in 2009 was perhaps less than 2 per cent; this year it will probably be no more than one per cent. This is about one-third of the rate of growth being currently recorded by India. However, that has not always been the case. From 1947 to 1988, a period of 41 years, Pakistan's GDP increased at an average rate of 5.5 per cent a year, 1.5 percentage points higher than India's growth rate. As Surjit Bhalla estimated in an essay contributed to a volume honouring Montek Singh Ahluwalia,[18] the average industrial growth rate in Pakistan in 1965–2005, a period of 40 years, was 6.5 per cent a year, compared with India's 5.3 per cent. Pakistan achieved a maximum of 10.4 per cent increase in industrial output during this period. India's maximum was only 6.9 per cent. The point of making these comparisons is that nations and economies have their ups and downs; there is nothing permanent about the trends they show at any given time.

If Pakistan manages to navigate out of the perfect storm, it could see acceleration in its rate of growth – it could, according to our simple model, reach 8 per cent by 2025 – provided it could settle its relations with India. Peace with India and strong economic ties with the large neighbour could add almost US$200 billion to Pakistan's GDP, increasing it from US$375 billion in 2007 to US$571 billion a year. This translates into an increase of US$850 per capita by 2025. India's GDP could increase by US$1.5 trillion and its GDP per capita by US$1,140.

Pakistan has potential in many areas. It has a large and young population, which could become an economic asset rather than a social and political liability, depending upon the choices made by those who make public policy. A large population can deliver considerable benefits in a world that is seeing the population's rapid ageing. Then there is the large and well-endowed agriculture sector, which is working way below its considerable potential. It is not always recognized that Pakistan has the largest contiguous irrigated area in the world, which could produce significant amounts of high value-added exports if there were the right set of public policy with respect to the efficient use of water, development of marketing infrastructure and development of appropriate technologies.

Pakistanis also have some well-honed skills that could be used to produce parts and components for the large industrial sectors of China and India. Finally, there is Pakistan's geographic location, which could turn the country into the hub of international commerce provided relations improve with some of its neighbours, in particular with India and Afghanistan. This potential could be realized if South Asia would begin to work as a cohesive regional economy.

Global economic changes

Analysing the on-going changes in the global economy is a vast subject that has been assessed in several detailed enquiries. This has been the subject of a series of *World Development Reports* published by the World Bank since the dawn of the present century. We are at this time going through another period of what economic historians call "catch-up". Asia is catching up with the more advanced regions of the world and the centre of the global economy is shifting from the Atlantic to the Pacific.[19] In this change, China is in the lead; rather unexpectedly, it has been able to improve its position in the global economy by taking the right set of decisions to deal with the situation created by the Great Recession of 2008–09. China's lead in the global economy is partly the result of the active role it has played in developing the new structure of industrial production which builds on the Japanese "just in time" system, but has been taken far beyond the original design. In producing finished products, China imports parts and components mostly from the countries in its neighbourhood. This has meant developing strong trading and economic relations with the countries in which the suppliers are located. South Asia does not have such a system of production, but it could develop one with greater economic cooperation and integration.

The other major change occurring in the global economy is related to demography. As already indicated, the populations in developed countries are ageing rapidly; their demand for services is increasing. These have to be supplied by mostly younger people and so, over time, these countries will begin to rely heavily on the more populous parts of the world, some of which are in South Asia. India has already carved out a niche for itself in the service sector. Bangladesh has put its women to work in one of the world's largest ready-made garment industries. Pakistan, one of South Asia's more populous countries, is lagging behind.

The roles India and Pakistan can play in the changing world economy

In indicating the roles that India and Pakistan could play in the changing world economy, I will focus on just two things. First, Pakistan has to change its stance from a competitor of India and become a collaborator with its large neighbour in many fields. Economics – particularly trade – is one of the more important areas in which it should be prepared to work with India. It has to recognize that India is South Asia's anchor economy, which, at this time, accounts for 82 per cent of total regional product. At the same time, India has to realize that it can only gain the status of an economic superpower if it works with the countries in its immediate neighbourhood. It should not be tempted to leap-frog them to form distant associations with groups such as the Association of South East Asian Nations (ASEAN) and the European Union (EU). No large economy has succeeded without first developing strong regional associations. This is true for the United States, China and South Africa, and must and will be the case for India.

If India and Pakistan could work together in the field of economics and trade, they would see a considerable and palpable impact on the structure of their economies. This would be more true for Pakistan than for India, which is to be expected since the size of the former's economy is only one-eighth of the latter's. There would be a number of fundamental changes in the structures of both agriculture and industry in Pakistan, as these two sectors begin to supply the larger and rapidly growing Indian markets. The Pakistani motorway system, currently more advanced than that of India, could become integrated with India's planned system of highways called the "golden quadrilateral". The electrical grids could connect, with trade in power becoming an integral part of inter-state commerce. The two countries might finally be able to build the gas pipelines connecting them to the Middle East and Central Asia.

Benefits from regional association in commerce

In spite of the effort made over the last quarter century to bring about more meaningful economic integration of the South Asian region, not much has been achieved. Regional trade as a proportion of the total has increased a little, but compared with other world regions it remains almost insignificant. By how much is the area losing out through not turning a sufficient amount of political attention on integration and cooperation? One way of answering this question is to use trade as the driving force for accelerating economic development. Using trade as the basis and historical GDP-trade elasticities for making projections, it is possible to develop some scenarios for the future. We do this purely for illustrative purposes. The three presented here are based on assumptions about the extent of integration, as well as the degree of reorientation of trade with significantly more trade going to Asia in general and South Asia in particular.

According to the first scenario (Table 8.1), the countries in the region continue to focus the direction of international trade and its content on distant trading partners. We call this the base case. For India, the United States and the EU remain the most important markets for its exports and the most important source of its imports. The same is true for Pakistan. Even

Table 8.1 Scenario I (the base case)

	GDP (US $ billions)		*Population (millions)*		*Per capita income (US$)*	
	2007	*2025*	*2007*	*2025*	*2007*	*2025*
Bangladesh	68	195	159	195	431	1,000
India	1,177	3,978	1,125	1,382	1,046	2,878
Nepal	10	24	28	38	357	632
Pakistan	143	375	162	230	883	1,630
Sri Lanka	32	78	20	22	1,600	3,545
Total	1,430	4,650	1,494	1,867	957	2,491

Notes: The base case assumes the following GDP growth rates: Bangladesh 6.0%; India 7.0%; Nepal 4.8%; Pakistan 5.55%; and Sri Lanka 5.0%; 2007 is the base year.

Source: The author's calculations based on the data for 2007 from World Bank, *World Development Indicators*; United Nations, *World Population Prospects.*

though China-India trade is likely to grow at a faster rate than overall trade, increasing Beijing's share in New Delhi's international trade, India has not become a partner in the China-centred system of production that is taking shape. According to this scenario, the growth of India's GDP is sustained at the rate of 7 per cent a year in the 18-year period between 2007 and 2025. This is well below the 10 per cent growth target that finance minister Pranab Mukherjee set for the country in his budget for the year 2010–11, but it is in line with the detailed scenarios developed by McKinsey in the report referred to above (see note 6). The size of the Indian GDP increases more than three-fold and income per capita grows 2.75 times. India's share in the combined GDP of the region increases from 82 per cent to 86 per cent.

Bangladesh will be the second most rapidly expanding economy according to this scenario, with a rate of increase in GDP averaging 6 per cent a year. Nepal does the least well, with a rate of growth at 4.8 per cent. Pakistan's performance lies somewhere between that of India and Nepal. Growing at 5.5 per cent a year, the size of its GDP increases 2.6 times, but its share in the South Asian total output declines from 10 per cent in 2007 to only 8 per cent in 2025.

The second scenario is based on the assumption that the South Asian countries take greater cognizance of the importance of international trade as a contributor to growth and also of the move of the centre of the global economy to the Pacific from the Atlantic. What this means is that the countries of the area pay greater attention to the changing structure of the global production system, which will be largely centred on China. New Delhi's policymakers, taking note of this development, are already deeply engaged in building better economic relations with the ASEAN group of countries. They are also participating in the Asian Economic Summit, an

Table 8.2 Scenario II

	GDP (US$ billions)		*Population (millions)*		*Per capita income (US$)*	
	2007	*2025*	*2007*	*2025*	*2007*	*2025*
Bangladesh	68	202	159	195	431	1,034
India	1,177	4,473	1,125	1,382	1,046	3,236
Nepal	10	25	28	38	357	658
Pakistan	143	445	162	230	883	1,927
Sri Lanka	32	82	20	22	1,600	3,696
Total	1,430	5,227	1,494	1,867	957	2,800

Notes: Scenario II assumes the following GDP growth rates: Bangladesh 6.2%; India 7.7%; Nepal 5.0%; Pakistan 6.5%; and Sri Lanka 5.3%. 2007 is the base year.

Source: The author's calculations based on the data for 2007 from World Bank, *World Development Indicators*; United Nations, *World Population Prospects*.

arrangement that includes 10 countries of the ASEAN region as well as Australia, China, Japan, New Zealand and South Korea. This change in strategy – of focusing more on Asia for expanding international trade – adds to the rate of growth of all South Asian countries. India's GDP is 12 per cent higher compared with the base case scenario, but its share in regional GDP in 2025 remains the same at about 86 per cent (see Table 8.2).

The third case builds on the second by assuming that South Asia manages to develop stronger economic contacts among the countries in the area. Compared with the status quo situation in the first scenario, the combined GDP of the region is considerably larger, as is income per head of the population – both by as much as 40 per cent. The incidence of poverty declines significantly and better services are provided to the citizenry. South Asia is also better integrated with the rest of Asia. In terms of rates of growth, the largest gainer is Pakistan, followed by India. Pakistan's GDP growth according to the third scenario is 2.4 percentage points higher compared with scenario one, while India's is two percentage points higher. In the case of Pakistan, income per capita of the population in the third scenario is 52 per cent higher, while that of India is 40 per cent greater (see Table 8.3).

The impact on poverty and quality of life will be pronounced if the third scenario is played out. This is why economic structures will be profoundly different in this case, particularly in the countries on India's borders. Pakistan, for instance, will be able to develop the agricultural sector to take advantage of the huge Indian market. This would have happened had the countries not severed their trade relations soon after gaining independence from British rule. At that time, close to two-thirds of Pakistan's imports came from India and about the same proportion of its exports

Table 8.3 Scenario III

	GDP (US$ billions)		*Population (millions)*		*Per capita income (US$)*	
	2007	*2025*	*2007*	*2025*	*2007*	*2025*
Bangladesh	68	239	159	195	431	1,223
India	1,177	5,551	1,125	1,382	1,046	4,016
Nepal	10	26	28	38	357	692
Pakistan	143	571	162	230	883	2,479
Sri Lanka	32	88	20	22	1,600	3,957
Total	1,430	6,475	1,494	1,867	957	3,468

Notes: Scenario III assumes the following GDP growth rates: Bangladesh 7.2%; India 9.0%; Nepal 5.3%; Pakistan 8.0%; and Sri Lanka 5.7%. 2007 is the base year.

Source: The author's calculations based on the data for 2007 from World Bank, *World Development Indicators*; United Nations, *World Population Prospects*.

went to that country. These proportions declined to about 5 per cent when the two countries declared a trade war in 1949 on the issue of the rate of exchange between their currencies. This is where the proportions have remained, in spite of the launch of the South Asia Free Trade Area (SAFTA) initiative in January 2004. With the rebuilding of economic and trade contacts, other sectors could also get aligned. Pakistan could become an important supplier of auto parts to the rapidly developing Indian automobile industry, while India could become the main provider of iron ore to the steel industry in Pakistan. Bangladesh could get better integrated in the much larger textile sectors of the two larger economies, India and Pakistan. However, to realize the third scenario, there would have to be exercise of a considerable amount of political goodwill, which has been in short supply now for many decades. Table 8.4 provides GDP growth rates based on these three scenarios for the five larger countries of South Asia. These represent, of course, some heroic assumptions, which is why it is so important to emphasize the illustrative nature of this exercise.

Table 8.4 GDP growth rates, 2007–25 (% per year)

2007			
Scenarios	*I*	*II*	*III*
Bangladesh	6.0	6.2	7.2
India	7.0	7.7	9.0
Nepal	4.8	5.0	5.3
Pakistan	5.6	6.5	8.0
Sri Lanka	5.0	5.3	5.7

It is also essential to underscore that in identifying the determinants of growth for any economy it is important to include a number of variables – to undertake what economists call multivariate analysis. The scenarios we have built for this exercise use only one variable as the driver of growth – international trade. We use its historical elasticity to gauge the quantitative impact on growth rates. However, even if trade were to be the most important determinant, for it to play that role it must be supported by a whole host of other developments. These include well-functioning physical infrastructure – roads, railways and ports – that take goods from the point of production to the point of shipping. Even today, in spite of the development of air cargo, 90 per cent of trade moves by ships. Equally, producers participating in trade must have a steady and reliable supply of water, electricity and other sources of energy; they must have access to capital at reasonable rates to expand their supplies; availability of human skills in order to be able to compete in international markets; labour laws that don't interfere with the hiring and firing of workers; and availability of information about the markets that the producers and exporters are hoping to reach. There must also be good governance, so that rent-seeking behaviour on the part of the agents of the state whose assistance is needed does not eat into the profits that traders are hoping to make. To achieve all this means an active and well-intentioned state.

All this notwithstanding, some analysts have argued that of the many determinants of growth in the emerging markets that still have large sectors of agriculture – as is the case with all South Asian economies – weather may be one of the more important. India's Surjit Bhalla points out that, "surprisingly, rainfall (lagged plus current) alone explains as much as 60 percent of the variation in the growth of agricultural output [...] The model for GDP growth also works well: 40 percent of the variation of GDP growth is explained by rainfall alone".[20] He goes on to suggest that the levels of interest rates as administered by the Reserve Bank of India, the country's central bank, and the rate of inflation are much more important determinants of growth of the Indian economy than capital accumulation or the movement of workers from less to more productive parts of the economy.

Notwithstanding all the caveats we have mentioned above, easing of tensions among the countries of South Asia, especially between India and Pakistan, would have many positive consequences for the region. Our calculations showed that trade alone would add about 2 percentage points to the rate of growth of the region. As the Europeans have discovered, easing trade restrictions produces a number of other beneficial consequences, such as increasing tourism and cultural contacts, contributing to knowledge accumulation as networking increases among researchers working in various laboratories and research institutions. Some of the positive outcomes cannot be fully appreciated ex ante. That said, three of these are worth reflecting on.

Greater intra-regional trade in South Asia would have a significant impact on the structure of the economies of the smaller countries as they developed links with large enterprises in India. This would lead to more labour-intensive activities as producers in Pakistan began to supply parts and components to India's large industries, or as textile producers in Bangladesh get to work for India's and Pakistan's rapidly developing fashion industry. Second, the grant of transit rights by both Bangladesh and Pakistan to India would develop some components of the service industry, including warehousing, servicing of vehicles, hotel businesses, insurance and other related activities needed to move goods and commodities over long distances. Third, by linking the various infrastructural networks such as electricity grids and gas pipelines, the countries in the region should be able to meet one another's occasional deficits while creating markets for electricity, gas and possibly water. The positive economic consequences of opening up to one another would be enormously significant. There would also be positive outcomes on the political side, but that is an entirely different subject better dealt with by those who have grater competence in that area.

Notes

1 Prologue

1 Niall Ferguson. 2004. *Empire: The Rise and Demise of the British World Order and the Lessons for Global Power*. London, Allen Lane.

2 Professor Tan Tai Young has argued in his work on the Punjab that the governing process "which developed in sharp contrast to, and because of, the failure of political institutions, was the increasing concentration of state power in the hands of the Punjabi-dominated bureaucracy army". This had happened because of the importance the British rulers had given to the Punjab as a recruiting ground for their army. "As British recruitment policies came to be informed by the 'martial races' doctrine, only a select group from the Punjab mainly Sikhs, Muslims, and to a lesser extent, Dogras and Hindu Jats were eligible for recruitment, while all other groups of Punjabis not considered of sufficient 'martial' material were automatically excluded." Tai Yong Tan and Gyanesh Kudaisya. 2000. *The Aftermath of Partition in South Asia*. London, Routledge Studies in the Modern History of Asia, pp. 205–07.

3 Roy Harrod. 1951. *The Life of John Maynard Keynes*. London, Macmillan.

4 Alexander Gerschenkron. 1962. *Economic Backwardness in Historical Perspective: A Book of Essays*. Cambridge, MA, Harvard University Press.

5 This change in the Bank's policy stance did not go uncontested by some of the more traditional staff at the institution. Under Hollis Chenery, the Bank's Chief Economist, they authored a book that laid out the thesis that without growth no policy aimed at helping the poor would work. See Hollis B. Chenery, Jack Duloy and Montek Ahluwalia (eds). 1975. *Redistribution with Growth*. New York, Oxford University Press.

6 Samuel P. Huntington. 1968. *Political Order in Changing Societies*. New Haven, CT, Yale University Press.

7 The name The Washington Consensus was given to this set of policies by the economist John Williamson who then worked at the Institution of International Economics, now the Peterson Institution.

8 Joseph Stiglitz. 2002. *Globalization and its Discontents*. New York, W.W. Norton.

9 Samuel Huntington. 1998. *The Clash of Civilizations and the Remaking of the World Order*. New York, Simon & Schuster.

10 The term is borrowed from Thomas L. Friedman who popularized it in his bestselling work, *The World is Flat: A Brief History of the Twenty-first Century*. New York, Farrar, Strauss and Giroux, 2002.

2 Challenges and opportunities

1 Joseph Stiglitz. 2006. *Making Globalization Work: The Next Steps to Global Justice*. New York, Allen Lane.

2 Manjushree Thape. 2010. "Waiting in Nepal", *International Herald Tribune*, 7 May, p. 6.
3 Manmohan Singh quoted in *Armed Conflicts Report – Andhra Pradesh*. Ploughshares. ca. Retrieved 13 July 2009.
4 news.bbc.co.uk/2/hi/south_asia/8256629.stm.
5 The "What if…?" approach to historical analysis has been adopted by several contemporary historians, among them Robert Cowley and Niall Ferguson. See Robert Cowley. 2001. *What If: 2: Eminent Historians Imagine What Might Have Been*. New York, Putnam Adult, and Niall Ferguson. 2000. *Virtual History: Alternatives and Counterfactuals*. New York, Basic Books.
6 I have applied the "catch-up" thesis to Asia in a two-part working paper published in early 2010 by the Institute of South Asian Studies, National University of Singapore. See Shahid Javed Burki. 2010. "Asia in the 'Catch-Up' Game Part 1", Working Paper No. 106, and "Asia in the 'Catch-Up' Game, Part 2", Working Paper 107, 10 May.
7 John Strachey. 1888. *India*. London, Kegan, Paul, Trench, pp. 2–5.
8 This was the year when the Indians rose up in arms against the British. The rebellion was confined to the north-eastern part of the territory that the East India Company, owned by stockholders in London, now possessed in the South Asian subcontinent. It was centred around Delhi, the capital of the fast-fading Mughul empire and the province now called Uttar Pradesh. The British called the uprising The Great Indian Mutiny; the Indian historians called it *The First War of Independence*.
9 This was the year the British departed India leaving the government in the hands of two successor states. Pakistan attained independence on 14 August 1947, a day earlier than India. The earlier date for Pakistan was to accommodate the travel schedule of Lord Louis Mountbatten who was to administer the oath of office to the officials of the two new governments.
10 There is a vast literature – and it keeps growing since the subject continues to fascinate historians of many persuasions – about the Indian independence movement. It covers many different perspectives. Much has been written about and by the major leaders involved in the struggle on the Indian side to end the colonial rule. Mahatama Gandhi is the subject of hundreds, if not thousands, of books. Jawaharlal Nehru, the other leader prominent on the Indian side wrote about his struggle himself and is also the subject of a number of biographies. See Jawaharlal Nehru. 2004. *An Autobiography*. New Delhi, Penguin Books. Gandhi and Nehru, as well as Muhammad Ali Jinnah, are the subjects of the trilogy published by Stanley Wolpert, the American historian. See: *Gandhi's Passion: The Life and Legacy of Muhatama Gandh*i. New York, Oxford University Press, 2001; *Nehru; A Tryst with Destiny*. New York, Oxford University Press, 1996; and *Jinnah of Pakistan*. New York, Oxford University Press, 1999. Another autobiography worth noting is Mualana Abul Kalam Azad. 1964. *India Wins Freedom*. Bombay, Orient Longmans. Azad was the most prominent Muslim to oppose the idea of creating a separate homeland for the Muslims of British India. Several historians have written on the pain caused by the way India was partitioned and the hate with which it was done. Once again a good book that covers this aspect is from Stanley Wolpert. 2008. *Shameful Flight: The Last Year of the British Empire in India*. New York, Oxford University Press.
11 Much has been written about the Pakistan movement and how, within a short period of time, Muhammad Ali Jinnah was able to persuade the British to leave the reins of one part of British India in his hands. At the same time, he was able to convince Mohandas Gandhi and Jawaharlal Nehru, two towering heroes of the Indian independence movement, to accept the idea of partitioning the Indian "motherland" and agree to live with two parts of the Muslim state of Pakistan on either side of independent India. The first full account to appear in print of the movement that created Pakistan is Khalid bin Sayeed. 1964. *Pakistan: The Formative Phase*. London, Oxford University Press. Chaudhi Muhammad Ali, Pakistan's finance minister in 1951–54 and briefly the country's prime minister, was a senior official in the colonial government. Once the British declared their intention to leave India, Ali was deputed to help the government in

yet-to-be-born Pakistan get organized. He reflected on his experiences in a book, Chaudhri Muhammad Ali. 1967. *The Emergence of Pakistan*. New York, Columbia University Press. Later, Ayesha Jalal. 1985. *The Sole Spokesman: Jinnah, the Muslim League and the Demand for Pakistan*. New York, Cambridge University Press, presented a revisionist theory according to which Jinnah did not really want to create an independent homeland for the Muslims of British India but used the Pakistan campaign in order to achieve a better deal for his community in independent India. However, the Hindu leaders called his bluff and gave him what he himself described as a "moth eaten" Pakistan.

12 As is the case with the Indian independence movement and the creation of Pakistan, the long struggle by the Muslims of Bengal to create an independent state for themselves has also attracted a great deal of academic interest. One analyst, Iftekhar Ahmed Chowdhury, calls the 1905 division of Bengal into two provinces Mark I Bengali partition. Then Bengal was divided into two provinces, a predominantly Muslim entity in the east that also included the territory of Assam, and a mainly Hindu province in the west. However, the partition was not accepted by the Hindu community and was annulled seven years later in 1911. The creation of Pakistan in 1947 with two wings, one in the east, the present day Bangladesh, and one in the west, today's Pakistan, was Partition Mark II. The emergence of Bangladesh in 1971 was Partition Mark III. See Iftekhar Ahmed Chowdhury. 2009. "The Roots of Bangladeshi National Identity: Their Impact on State Behaviour", ISAS Working Paper No. 63, 10 June.

13 Sunil Khilnani. 1997. *The Idea of India*. New York, Farrar, Straus and Giroux, p. 4.

14 Paper presented at

15 The term is borrowed from Fareed Zakaria. 2008. *The Post American World*. New York, W.W. Norton.

16 See, for instance, the important contribution made by Zakaria in his recent book, *The Post-American World*, Op. Cit., pp. 59–76.

17 Kishore Mahbubani. 2008. *The New Asian Hemisphere: The Irresistible Shift of Global Power to the East*. New York, Public Affairs, p. 9.

18 Daniel H. Meadows, Jorgen Randers, Dennis L. Meadows and Wieham H. Behrans. 1972. *Limits to Growth*. Washington, DC, Potomac Associates.

19 See Lester Brown. 1970. *Seeds of Change: The Green Revolution and Development*. New York, Prager.

20 Thomas L. Friedman. 2008. *Hot, Flat and Crowded: Why we need a green revolution and how it can renew America*. New York, Farrar, Straus and Giroux, p. 29.

21 UNIDO. 2002. *Industrial Development Report 2002/2003: Comparing through innovation and learning*. Vienna.

22 See, in particular, UNIDO. 2005. *The Industrial Development Report, 2005: Capability for Catching Up: Historical, empirical and policy dimensions*. Vienna.

23 *Ibid.*

24 World Bank. 1997. *World Development Report: The State in a Changing World*. Washington, DC.

25 A great deal has been written on what is generally referred to as Bush's Iraq war. On 27 June 2009 typing "Bush's Iraq War" into Google produced 32.9 million items in 22 seconds. Among the more useful contributions to the subject are the four books written by the journalist Bob Woodward while President George W. Bush was still in office. See his *Bush at War*, 2002; *Plan of Attack*, 2004; *State of Denial*, 2006; and *The War Within: A Secret White House History, 2006–08*, 2008. All these books were published by Simon and Schuster of New York. See also Thomas Ricks. 2006. *Fiasco: The American Military Adventures in Iraq*. New York, Penguin Press; and Frank Rich. 2007. *The Greatest Story Ever Sold: The Decline and Fall of Truth in Bush's America*. New York, Penguin.

26 For the way the Pakistani military has evolved its thinking since the country's founding in 1947, see Shuja Nawaz. 2008. *Crossed Swords: Pakistan, its Army and the Wars Within*. Karachi, Oxford University Press. Other works have also appeared analysing the

role of the Pakistani military in the country's politics and economy. See Ayesha Siddiqa. 2007. *Military Inc.: Inside Pakistan's Military Economy*. London, Pluto Press; and Mazhar Aziz. 2009. *Military Control in Pakistan: The Parallel State*. London, Routledge.

27 The story of the emergence of the Taliban as a political force that was able to use a fierce ideology to turn a ragtag army of young students into a conquering force that occupied all of Afghanistan (including Kabul, the country's capital) save a small bit of land in the north-east that remained under the control of a group of warlords who called themselves the Northern Alliance, is well told in several books, including Ahmad Rashid. 2000. *The Taliban: Islam, Oil and the Great Game*. London, I.B. Tauris; and Steve Colls. 2004. *The Ghost Wars: The Secret History of the CIA, Afghanistan and Bin Laden from the Soviet Occupation of Afghanistan to September 10, 2001*. New York, Penguin.

28 The boundary was named after Sir Mortimer Durand, Foreign Secretary of the British Indian government, who drew it on the map to divide the areas over which the British administration operating out of New Delhi had established some control and the areas that clearly were still under Kabul's influence. The line was demarcated in a treaty signed in 1893 with the Afghan ruler, Amir Abdur Rehman Khan. It stretches over a distance of 2,640 km (1,610 miles).

29 In a study prepared for the United States Institute of Peace and published in 2007, I argued that a different approach could set the stage for the eventual solution of the Kashmir problem but it would need the recognition that both Pakistan and India – Pakistan much more than India – had suffered enormous economic losses for continuing to keep the issue alive. See Shahid Javed Burki. 2007. *Kashmir: A Problem in Search of a Solution*. Washington, DC, United States Institute of Peace.

30 Somni Sengupta. 2009. "Tamils nightmare run for the Indian coast", *International Herald Tribune*, 6 May, p. 12.

31 Joe Leahy, "Sri Lankan conflict intrudes of final round", *Financial Times* , 14 May 2009, p. 5.

32 Iftekhar Ahmed Chowdhury, "Hasina's Visit to India and Emerging Indo-Bangla Relations: Implications for the Region", Institute of South Asian Studies, National University of Singapore, Brief No. 149, 18 January 2010.

33 The study was published by USAID in October 2005. See *South Asian Free Trade Area: Opportunities and Challenges*. Washington DC.

34 This incident is covered in some detail by Strobe Talbot, who as Deputy Secretary of the United States State Department assisted President Bill Clinton in these deliberations. See Strobe Talbot. 2007. *Engaging India: Diplomacy, Democracy, and the Bomb*. Random House.

35 The term was coined by the late Indian economist K.N. Raj.

36 Among the books written by the Harvard Development Advisory Service, the most widely read was by Gustav F. Papanek. 1967. *Pakistan's Development: Social Goals and Private Incentives*. Cambridge, MA, Harvard University Press.

37 Hedley Bull. 1977. *The Anarchical Society: A Study of Order in World Politics*. London, Macmillan.

38 Gideon Rachman. 2009. "Indian democracy has an ugly side", *Financial Times*, 19 May, p. 11.

39 Anwar Iqbal. 2009. "Beat extremists you can", *Dawn*, 21 June, p. 1.

40 See Amartya Sen. 2006. *The Argumentative Indian: Writings on Indian History, Culture and Identity*. London, Penguin.

41 United States-Pakistani relations have attracted a fair amount of academic interest. It was the subject most recently of Dennis Kux's 2001 book, *The United States and Pakistan, 1947–2000: Disenchanted Allies*, Baltimore, MD, Johns Hopkins Press.

42 Pakistan's reasons for taking that route are well spelt out by Field Marshal Muhammad Ayub Khan, the country's president at that time. See his *Friends Not Masters: A Political Autobiography*, London, Oxford University Press, 1969. This policy stance was opposed by Ayub Khan's own foreign minister who, having resigned from his position in 1969, when the military government was celebrating its "decade of development", went on to

put forward his own theory of foreign policy for a relatively small nation such as Pakistan. The approach he advocated was much closer to the one Prime Minister Nehru had followed in India. See Zulfiqar Ali Bhutto, *The Myth of independence*, Karachi, Oxford University Press, 1969.

43 For a discussion of the significance of this visit see Harsh V. Pant. 2006. "Saudi Arabia woos India and China", *The Middle East Quarterly*, Fall, pp. 45–52.

44 The story of those negotiations is told in great detail by Strobe Talbot. See note 34.

45 Ahmad Hasan. 2009. "Army briefs politicians: Mingora besieged, to be secured soon", *Dawn*, 16 May, p. 1.

46 Ravi Velloor. 2009. "Congress Party played its cards right", *The Sunday Times*, Singapore, 17 May.

47 A good representative of this line of thinking is Andrew Bacevich. 2008. *The Limits of Power, The End of American Exceptionalism*. Metropolitan Books.

48 Richard Cohen. 2009. "In a nuclear minefield", *The Washington Post*, 19 May.

3 Reshaping the global economy: The dawn of the Asian century?

1 Fareed Zakaria. 2008. *The Post-American World*. Norton, New York, W.W. & Company.

2 Among those who argue along these lines is Martin Wolf, who writes a widely read weekly column in the *Financial Times*. Also see his recent book, *How to Curb Financial Crisis in the 21st Century*. In an earlier book, Wolf laid a case for the virtues of globalization to make a case against those who were concerned about the adverse consequences of this development. See *Why Globalization Works*. New Haven, CT, Yale University Press, 2004.

3 Alexander Gerschenkron. 1962. *Economic Backwardness in Historical Perspective: A Book of Essays*. Harvard, MA, Balknap Press of Harvard University.

4 Ezra Vogel. 1979. *Japan as Number One: Lessons for America*. Cambridge, MA, Harvard University Press.

5 World Bank. 1993. *The East Asian Economic Miracle: Economic Growth and Public Policy*. New York, Oxford University Press.

6 Shahid Javed Burki. 2010. "Asia in the 'catch-up' game", Institute of South Asian Studies, National University of Singapore Working Paper No. 106, 9 April; and 2010. "Asia in the 'catch-up' game", Institute of South Asian Studies, National University of Singapore Working Paper No. 107, 10 May.

7 Martin Wolf. 2009. "Seeds of its own destruction", *Financial Times: Future of Capitalism*, 12 May, p. 9.

8 The World Bank's report covered eight countries, not the usual four: Hong Kong, Singapore, South Korea and Taiwan, and four additional ones – Indonesia, Japan, Malaysia and Thailand.

9 The best articulation of Alan Greenspan's views is in his autobiography. See Alan Greenspan. 2007. *The Age of Turbulence: Adventures in a New World*. New York, The Penguin Press.

10 The broad approach followed by this group is described in some detail in two collections of essays written by its members and a number of economists associated with them. See Isher Judge Ahluwalia and Ian Little (eds). 1998. *India's Economic Reforms and Development: Essays for Manmohan Singh*. New Delhi, Oxford University Press; and Shankar Acahrya and Rakesh Mohan (eds). 2010. *India's Economy: Performance and Challenges*. New Delhi, Oxford University Press.

11 *The Washington Consensus* did not go unchallenged within the institutions that contributed to its development. I was among those who resisted its application first to China, for which I had operational responsibility in 1987–94, and later for the countries of Latin America and the Caribbean. I, along with several other economists, most notably Joseph Stiglitz who was the World Bank's Chief Economist in the late 1990s, resisted the pressure to advocate rapid transformation of public policy in the countries for which we had responsibility. Stiglitz went on to write a scathing criticism of *The Washington*

Consensus after he departed from the Bank. See Joseph Stiglitz. 2002. *Globalization and its Discontents*. New York, W.W. Norton.
12 George F. Will. 2009. "Capitalism goes out of tune", *The Washington Post*, 10 May, p. A19. I should point out, though, that Will was sceptical about the wisdom of allowing too prominent a role to the state in economic matters. He and other conservative commentators did not give up on "Reaganism" and became very critical of President Barack Obama's economic policies that clearly favoured an active state.
13 Ian Bremmer. 2009. "State Capitalism Comes of Age: The End of the Free Market?", *Foreign Affairs*, July–August.
14 "Lessons learnt for capitalism's future", *Financial Times*, 12 May 2009, p. 13.
15 Francis Fukuyama. 1992. *The End of History and the Last Man*. New York, Free Press.
16 Amartya Sen. 2009. "Adam Smith's market never stood alone", *Financial Times: Future of Capitalism*, 12 May, p. 12.
17 "Rebuilding the banks: A special report", *The Economist*, 10 May 2009, p. 3.
18 The reference here, of course, is to Bernie Madoff, who ran a ponzi scheme that defrauded hundreds of high net worth individuals and rich institutions of tens of billions of dollars. Some of those who invested in the funds managed by Madoff claimed to have a considerable amount of financial expertise. Madoff was exposed by his two sons, tried in a United States court and sentenced to jail for several years.
19 Paul Kennedy. 2009. "Read the big four to know capitalism's fate", *Financial Times, The Future of Capitalism: The Big Debate*, 12 May, p. 20.
20 Gary Becker and Kevin Murphy. 2009. "Do not let the 'cure' destroy capitalism", *Financial Times*, *The Future of Capitalism: The Big Debate*, 12 May, p. 13.
21 Ibid.
22 In quoting from Smith, I have not gone to the original works, as they are not usually read even by the historians of economic thought. Smith is by far the most quoted but least read in the original of the old masters. Most of my quotations come from the very helpful guide to Smith by P.J. O'Rourke. 2007. *On the Wealth of Nations*. New York, Atlantic Monthly Press.
23 Kishore Mahbubani. 2008. *The New Asian Hemisphere: Irresistible Shift of Power to the East*. New York, Perseus.
24 Kishore Mahbubani. 2009. "Lessons for the West from Asian capitalism", *Financial Times: The Future of Capitalism: The Great Debate*, 12 May, p. 32.
25 Geoff Dyer. 2009. "Little leaps forward", *Financial Times*, 28 May, p. 7.
26 David Shambaugh. 2009. *China's Communist Party: Atrophy and Adaptation*. University of California Press.
27 Geoff Dyer, op. cit., p. 7.
28 "Briefing: India's election", *The Economist*, 23 May 2009, p. 25.
29 See, for instance, Shahid Javed Burki. 1988. *Pakistan: A Nation in the Making*. Boulder, CO, Westview Press.
30 Muhammad Ayub Khan. 1967. *Friends Not Masters: A Political Autobiography*. New York, Oxford University Press.
31 Gunar Myrdal. 1967. *The Asian Drama*. New York, Twentieth Century Fund.
32 Pervez Musharraf. 2006. *In the Line of Fire; A Biography*. New York, Free Press.
33 Albert O. Hirschman. 2004. *Exit, Voice and Loyalty: Response to Decline in Firms, Organizations and States*. Cambridge, MA, Harvard University Press.
34 Alan Greenspan. 2009. "We need a better cushion against risk", *Financial Times: The Future of Capitalism: the Great Debate*, 12 May, p. 38.
35 Mahbubani. "Lessons for the West from Asian capitalism", op. cit., p. 45.

4 History's many burdens

1 The "What if…?" approach to historical analysis has been popularized by some modern historians, most notably Niall Ferguson. His edited book that uses this method contains a

collection of articles by historians who were asked to write on what would have happened if events such as the defeat of Hitler in Europe or the assassination of President John F. Kennedy had not happened. See Niall Ferguson (ed.). 1997. *Virtual History: Alternatives and Counterfactuals*. London, Macmillan.

2 Shahid Javed Burki. 2007. *Kashmir: A Problem in Search of a Solution*. Washington, DC, United States Institute of Peace.

3 The most recent addition to the court was Sonia Sotomayor, a judge from one of the appellate courts. While there was a virtual consensus that President Barack Obama had chosen his nominee well – a woman of Latin American origin with a distinguished academic and legal record – her hearings before the Senate Judicial Committee became highly contentious.

4 In the late 1960s and early 1970s the American economic historians who were inclined to look at their country's economic history from the perspective of the left began to emphasize the exploitative aspect of slavery. They also attributed a significant part of the economic advance made by the American colonies before they came together into a union, to slavery which provided extremely low-cost labour to the owners of capital. Of the many works written from this perspective was Eugene D. Genovese. 1972. *Roll Jordan Roll: The World the Slaves Made*. New York, Random House.

5 A great deal has been written about Nelson Mandela and how he helped shape modern South Africa. See Richard Stengel and Nelson Mandela. 2010. *Mandela's Way: Fifteen Lessons on Life, Love and Courage*. New York, Crown Archetype; Nelson Mandela. 1995. *Long Walk to Freedom: The Autobiography of Nelson Mandela*. London, Bay Books.

6 Farhan Bokhari. 2009. "Baluchistan unrest threatens drive to quell Taliban", *Financial Times*, 15 August, p. 4.

7 This subject has been covered by several academics and analysts in the past. There is an impressive and growing literature on the various aspects of India's foreign policy. The most recent addition to this is Rajiv Sikri. 2009. *Challenge and Strategy: Rethinking India's Foreign Policy*. New Delhi.

8 By laying the blame for India's division on the shoulders of Jawaharlal Nehru, Jaswant Singh, in a book published in 2010, stirred up a political storm in India. He was expelled from the Bharatiya Janata Party (BJP), in the government of which he had served as both foreign and finance minister in the 1990s. He did not blame Mohammad Ali Jinnah for the partition of India on the basis of religion, as is the common practice in most of the histories of the Indian independence movement authored by Indian scholars and politicians. See Jaswant Singh. 2010. *Jinnah: India, Partition, Independence*. New York, Oxford University Press.

9 These have been conveniently assembled into a series of volumes by a team of British historians. For our purpose, one of the more relevant volumes is Nicholas Mansergh (ed.). 1976. *Constitutional Relations Between India and Pakistan: Transfer of Power, 1942–47*. London, Her Majesty's Stationery Office.

10 This incident is covered in Stanley Wolpert. 2001. *Gandhi's Passion: The Life and Legacy of Mahatama Gandhi*. New York, Oxford University Press.

11 For a detailed discussion of this episode see Aloys A. Michel. 1967. *The Indus Water: A Study of the Effects of Partition*. New Haven, CT, Yale University Press.

12 Ramachandra Guha. 2007. *India After Gandhi: The History of the World's Largest Democracy*. New York, Harper Collins, p. 138.

13 One of the more articulate expositions of the idea of India is by Sunil Khilnani. 1999. *The Idea of India*. New York, Farra, Strauss, Giroux.

14 Some of these questions are asked and answered in the collection of essays edited by Niall Ferguson. See Niall Ferguson. 1997. *Virtual History: Alternatives and Counterfactuals*. New Basic Books.

15 There are many books on the subject of Kashmir. Some of them have been written from the perspective of the two countries involved in the dispute. For more even-handed analyses,

see Josph Korbal. 1954. *Danger in Kashmir*. Princeton, NJ, Princeton University Press; Alistair Lamb. 1993. *Kashmir: A Disputed Legacy*. Karachi, Oxford University Press; and Victoria Schofield. 1996. *Kashmir in the Crossfire*. London, I.B. Tauris.

16 Shahid Javed Burki. 2006. *Kashmir: A Problem in Search of a Solution*. Washington, DC, United States Institute of Peace.

17 David Pilling and Farhan Bokhari. 2009. "Zardari's new zeal: FT interview", *Financial Times*, 5 June, p. 9.

18 Salman Masood. 2009. "Terrorism is not a priority for Pakistanis, poll finds", *The New York Times*, 12 May, p. A10.

19 Ibid.

20 Institute of Public Policy, Beaconhouse National University, Lahore, "State of the Economy: Emerging from the Crises", Table 4.7, 2009, p. 76.

21 For an assessment of the statement in India and Pakistan, see S.D. Muni. 2009. *India and Pakistan: The Message from Sharm-el-Sheikh*. Institute of South Asian Studies, National University of Singapore, Brief No. 119, 22 July.

22 M.J. Akbar. 2009. "The statement out of joint", *By Line*, 19 July.

23 Olaf Caroe. 1958. *The Pathans 550 B.C.–A.D. 1957*. Karachi, Oxford University Press.

24 Ahmed Rashid. 2000. *Taliban: Islam, Oil and the Great Game*. London, I.B. Tauris; and Steve Coll. 2004. *Ghost Wars: The Secret History of the CIA, Afghanistan, and Bin Laden, from the Soviet Occupation of Afghanistan to September 10, 2001*. New York, Penguin.

25 In developing this argument, I have leaned heavily on the work underway by Iftekhar Ahmed Chowdhury at the Institute of South Asian Studies, Singapore. See his "The Roots of Bangladeshi National Identity: Their Impact on State Behaviour", Institute of South Asian Studies, working paper No.63, 10 June 2009.

26 Quoted in Chowdhury, *op. cit*., p. 3.

27 The British spent large amounts of money in bringing irrigation to the virgin land of the Punjab, not for development purposes but for creating a granary to feed the perennial food deficit provinces in the north-east of their empire, including Bengal. Some of these provinces had experienced famines that had claimed millions of lives and posed a serious security threat to rule by the British. Chastened by the events of 1857, a number of Royal Famine Commissions appointed by the government in London recommended creating a permanent granary to feed the north-eastern provinces. See Shahid Javed Burki. 2007. *Changing Perceptions, Altered Reality: Pakistan's Economy Under Musharraf, 1999–2006*. Karachi, Oxford University Press.

28 Imran Ali. 1988. *The Punjab under Imperialism, 1885–1947*. Princeton, NJ, Princeton University Press.

29 The British erected in the Margala Hills that now form the boundary of Islamabad with northern Punjab a monument to honour an officer, John Nicholson, who was injured in one of the Mutiny battles and was carried back to Rawalpindi by a Punjabi soldier. The soldier was rewarded with an estate that became the source of future wealth and political influence of the famous Hayat family. One of its members, Sir Sikander Hayat Khan, became the prime minister of the Punjab at the head of a unionist party government that included both Muslims and Hindus. It was his later decision to side with Mohammad Ali Jinnah that was responsible for turning an important segment of the Punjabi Muslim establishment in favour of the idea of Pakistan.

30 Malcolm Darling. 1925. *The Punjab Peasant in Prosperity and Debt*. London, Humphrey Milford, Oxford University Press.

31 Quoted in Yasmeen Khan. 2007. *The Great Partition: The Making of India and Pakistan*. New Heaven, CT, Yale University Press.

32 Chowdury, *op. cit*., p. 4.

33 Some modern British historians have a more benign interpretation of the British rule of India. The most prominent in this group is Niall Ferguson, who makes the case that the British left a rich economic legacy in India that could have been more effectively used by

the successor states of India and Pakistan. See. Niall Ferguson. 2001. *Empire*. New York, Penguin Books.

34 Quoted in Amales Tripathi. 1967. *The Extremist Challenge: India between 1890 and 1910*. Bombay, Longmans, p. 157.

35 This case was presented powerfully by the Bengali economists in the report – in fact two reports – issued by the panel of economists appointed by the Planning Commission to help it prepare the fourth Five-Year Plan, 1970–75. The panel split into two parts on provincial lines and ended up issuing two reports rather than one. The East Pakistan group was headed by Nurul Islam and the group from Pakistan by Pervez Hasan. See Government of Pakistan. 1970. *Panel of Economists Reports*. Islamabad, Planning Commission.

36 This episode is covered in some detail by Henry Kissinger in his memoirs.

5 South Asia may have turned the corner

1 Sunil Khilnani. 1999. *The Idea of India*. New York, Farrar, Straus and Giroux.

2 Ramachandra Guha. 2007. *India after Gandhi: The History of the World's Largest Democracy*. New York, Harper Collins, p. 119.

3 Stephen Cohen. *The Idea of Pakistan*. Washington, DC, Brookings Institution Press 2004, and University Press, 2007.

4 Ayesha Jalal. 1985. *The Sole Spokesman: Jinnah, the Muslim League and the Demand for Pakistan*. New York, Cambridge University Press.

5 Jaswant Singh. 2010. *Jinnah: India, Partition, Independence*. New Delhi, Oxford University Press.

6 The emergence of Bangladesh as an independent state after spending a quarter of a century as part of Pakistan has attracted a fair amount of academic interest. Among the more notable contributions to this literature are: Rounaq Jahan. 1972. *Pakistan: Failure of National Integration*. New York, Columbia University Press; and Sisir Gupat (ed.). 1973. *The Challenge of Bangladesh*. New York, Humanities Press.

7 Shahid Javed Burki. 1980. *Pakistan Under Bhutto, 1971–77*. London, Macmillan.

8 Ishtiaq Ahmed. 1987. *The Concept of an Islamic State: An Analysis of the Ideological Controversy in Pakistan*. London, Frances Pinter Publishers, p. 223.

9 Among the areas most extensively studied in Pakistan's brief but turbulent political history is the making of the Constitution. The most authoritative account of this subject is Hamid Khan. 2009. *Constitutional and Political History of Pakistan*. Karachi, Oxford University Press.

10 There are several accounts of the emergence of the Taliban as a potent force, first in Afghanistan and then in Pakistan. See the two books by Ahmed Rashid: 2000. *Taliban: Islam, Oil and the New Great Game*. London, I.B. Tauris, and 2008. *Descent into Chaos: The U.S. and the Disaster in Pakistan, Afghanistan and Central Asia*. New York, Penguin Books. See also Steve Coll. 2004. *Ghost Wars: The Secret History of the CIA, Afghanistan, and Bin Laden from the Soviet Invasion to September 10, 2001*. New York, Penguin Books.

11 See Ishtiaq Ahmed. 2009. "Pakistan's India fixation can bring the Taliban into power", Institute of South Asian Studies, National University of Singapore, ISAS Brief No.104, 28 April.

12 Iftekhar Ahmed Chowdhury. 2009. *Post-election India: How the neighbors view the elephant*. National University of Singapore, Institute of South Asian Studies, Singapore, Insights No. 68, May.

13 Joe Leahy. 2009. "Sri Lankan leader savours high point after rout of rebels", *Financial Times*, 20 May, p. 6.

14 The two works most often used to understand the rise of the Talban are: Ahmed Rashid. 2000. *Taliban: Islam, Oil and the Great Game*. London, I.B. Tauris; and Steve Coll. 2001. *Ghost Wars: The Secret History of the CIA, Afghanistan, and Bin Laden from the Soviet Occupation of Afghanistan to September 10, 2001*. New York, Penguin.

15 Fareed Zakaria. 2010. "Terrorism's Supermarket", *Newsweek,* 17 May, p. 5.
16 David Ignatius. 2009. "President Obama should stick to his message of outreach to the Muslims", *The Washington Post*, 14 January, p. 19.
17 Samuel P. Huntington. 1968. *Political Order in Changing Societies*. New Haven, CT, Yale University Press.
18 Albert O. Hirschman. 2004. *Exit, Voice and Loyalty: Response to Decline in Firms, Organizations and States*. Cambridge, MA, Harvard University Press.
19 Robin Jeffrey. 2010. "Media and Maoism", Institute of South Asian Studies, National University of Singapore, Insight No. 101, 19 May, pp. 1–2.

6 The South Asian way: A non-conventional approach to the making of economic policies

1 Arthur Lewis. 1954. "Economic Development with Unlimited Supply of Labor", *Manchester School of Economics and Social Studies*, Vol. 22, No. 127, pp. 139–91. Professor was awarded the Nobel Prize in Economics for his work. Lewis re-examined his earlier approach in a lecture given at the World Bank in 1979 which was included along with those of a number of pioneers of economic development. See Gerald M. Meier and Dudley Seers (eds), *Pioneers in Development*, New York, Oxford University Press, 1985.
2 In 1985 I led a team of World Bank staff to write a report on the first 25 years of the IDA, 1960–85. See World Bank. 1985. *IDA in Retrospect: The First Twenty-Five Years*. Washington, DC, World Bank.
3 David Warsch. 2006. *Knowledge and the Wealth of Nations*. New York, W.W. Norton, is a good summary of the way the original exogenous model of economic growth became endogenous.
4 Of the many books the DAS advisers wrote, the most comprehensive and also the most influential was: Gustav F. Papanek. 1967. *Pakistan's Development: Social Goals, Private Incentives*. Cambridge, MA, Harvard University Press.
5 Gunar Myrdal. 1967. *The Asian Drama: An Inquiry into the Poverty of Nations*. New York, Pantheon.
6 Gurcharan Das. 2002. *India Unbound*. New Delhi, Anchor Books.
7 The Pakistani model was described by its principal author, who was the Chief Economist of the Planning Commission when the Second Five-Year Plan was written. See Mahbub ul Haq. 1967. *The Strategy of Economic Planning: A Case Study of Pakistan*. Karachi, Oxford University Press. Haq did a summersault in 1968 just as his book hit the bookstands. In a speech that was to change the shape of Pakistan's political structure and the structure of its economy, he argued that most of the benefits from the growth during Ayub Khan's "decade of development" were captured by 22 industrial and financial households. The speech, referred to as the "22 families speech", helped Zulfikar Ali Bhutto to gain mass following for his Pakistan People's Party.
8 For a detailed discussion of Zulfikar Ali Bhutto's policies and their impact on the economy of Pakistan, see Shahid Javed. 1980. *Pakistan Under Bhutto, 1971–77*. London, Macmillan.
9 I have discussed the pressures on Pakistan at the time of its birth and how these shaped the country's economy for years to come in detail in Chapter Four, History's Many Burdens.
10 I am indebted to my ISAS colleague, Dr. Iftekhar Chowdhury, for this point. See his "The roots of Bangladeshi National Identity: Their Impact on the State's External Behaviour", Institute of South Asian Studies, Insight No.68, 22 May 2009.
11 Supported by Professor Paul Streeten and Mahbub ul Haq, I implemented an ambitious analytical program at the World Bank in 1977–81 aimed at providing the basic needs concept with an operational meaning. The findings of this work were summarized in Paul Street, Shahid Javed Burki, Mahbub ul Haq, Norman Hick and Frances Stewart. 1980.

First Things First: Meeting the Basic Needs. New York, Oxford University Press. The group's findings were also the grounds on which the World Bank put forward a strategy for poverty alleviation in the first *World Development Report* that the institution was to publish on the subject. The Report appeared in 1980. The World Bank has continued the practice of updating its thinking on poverty and basic needs in a *World Development Report* devoted to the subject and published at the start of every decade.

12 For a detailed overview of the Satyam affair, see the *Strait Times, "*India rocked by huge IT fraud", 8 January 2009; and Arun Kumar. 2009. "Analyzing the Satyam Affair: Pointers to Business Fraud in India", *Mainstream Weekly*, 2 February.

13 The circumstances that led to the first coup are described by Pervez Musharraf in his autobiography, *In the Line of Fire: A Memoir*. New York, Simon and Schuster, 2006.

14 One of these economists, Rehman Sobhan, had done a significant amount of pioneering work on the provision of basic needs to the poor in the population. See Rehman Sobhan. 1968. *Basic Democracies, Works Programme, and Rural Development in East Pakistan*. Dacca, Bureau of Economic Research, University of Dacca; and Rehman Sobhan. 1980. *Public Enterprise in an Intermediate Regime: A Study of the Political Economy of Bangladesh*. Bangladesh Institute of Development Studies.

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17 Thomas L. Freidman. 2005. *The World is Flat: A Brief History of the Twenty-First Century*. New York, Farrar, Straus and Giroux.

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19 Mathew Nelson. 2008. "Religious Education in Non-Religious Schools: A Contemporary Study of Pakistan and Bangladesh", *Commonwealth and Comparative Politics*, Vol. 46, No. 3, July, p. 271.

20 Khalid Koser. 2009. "Why Migration Matters", *Current History*, Vol. 108, No. 717, April, pp. 147–53.

21 Seku Mehta. 2005. *Maximum City: Bombay, Lost and Found*. New York, Vintage.

22 See, for instance, the Government of the United States. 2003. *The Report of the 9/11 Commission*. Washington, DC.

23 I developed this point in Shahid Javed Burki. 2007. *Changing Perceptions, Altered Reality: Pakistan's Economy Under Musharraf, 1999–2006*. Karachi, Oxford University Press.

24 Adil Najam. 2007. *Pakistanis in America: Portrait of a Giving Community*. Global Equity Initiative, Harvard University.

25 Sometimes fiction provides a better source for appreciating the consequences of certain public policies for the society at large. For the Zia period, a good source is the novel by Mohammed Hanif. 2009. *The Case of Exploding Mangoes*. London, Vintage.

26 World Bank. 2009. *World Development Report, Geography in Motion*. New York, Oxford University Press.

27 Anna Fifield. 2009. "Gazprom linked to Pakistan pipeline by Iran", *Financial Times*, 12 June, p. 16.

7 A multilayered world: Regional integration as a determinant of sustained national growth

1 Jagdish Bhagwati and Arvind Panagariya. 2009. "Why legal barriers to trade must be kept in check", *Financial Times*, 12 June, p. 12.

2 Jagdish Bhagwati. 1995. "US Trade Policy: The infatuation with free trade areas", in Jagdish Bhagwati and Anne O. Krueger (eds). *The Dangerous Drift to Preferential Trade Agreements*. Washington, DC, AEI Press. See also Jagdish Bhagwati, Daiv Greenway and Arvind Panagariya. 1998. "Trading Preferentially: Theory and policy", *Economic Journal*, 108: 1128–48.

3 I headed a team of World Bank staff in 1985 to assess the performance of the IDA in the first 25 years of its existence as the largest donor to the world's poor nations. See World Bank. 2005. *IDA in Retrospect*. Washington, DC, World Bank.
4 Shahid Yusuf, M. Anjum Altaf and Kaoro Nabeshima (eds). 2004. *Global Change and East Asian Policy Initiatives*. Washington, DC, World Bank, p. 5.
5 World Bank. 1993. *The East Asian Economic Miracle, The State in a Changing World*. New York, Oxford University Press.
6 Thomas L. Friedman. 2005. *The World is Flat: A Brief History of the Twenty-First Century*. New York, Farrar, Straus and Giroux.
7 This point is highlighted by Joseph Stiglitz in his second book on globalization. See (2006) *Making Globalization Work: The Next Steps to Global Justice*. London, Allen Lane.
8 There are many works on John Keynes. The most comprehensive of these remains the three-volume study by Robert Skidelsky. See: 1983. *John Maynard Keynes, Vol. 1: Hopes Betrayed 1883–1920*; 1992. *John Maynard Keynes, Vol. 2: The Economist as Saviour 1920–1937*; 2000. *John Maynard Keynes, Vol. 3: Fighting for Britain 1937–1946*.
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8 South Asia: Future growth scenarios with or without integration

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2 See Shahid Javed Burki. 2007. *Kashmir: A problem in search of a solution*. Washington, DC, United States Institute of Peace.
3 As in so many other things, fiction provides a good insight for some of the important developments in Pakistan. In a novel, an Australian-based writer of Pakistani origin, novelist Azhar Abidi, has one of his main characters sacrifice his life pursuing the Kashmir cause. See: 2009. *The House of Bilqis*. New York, Viking.
4 India's recent economic performance has attracted a great deal of academic interest. Of the several books that have appeared since reforms were earnestly launched, one of the more notable is a collection of essays in honour of Montek Singh Ahluwalia, Deputy Chairman of the Planning Commission. The essays were written by a number of his colleagues who participated in the reform effort. See Shankar Acharya and Rakesh Mohan (eds). 2010. *India's Economy: Performance and Challenges: Essays in Honor of Montek Singh Ahluwalia*. New Delhi, Oxford University Press.
5 2009. "Good news: don't waste it", *The Economist*, 23 May, p. 11.
6 McKinsey Global Institute. 2010. *India's urban awakening: Building inclusive cities, sustaining economic growth*. New York, April.
7 Ibid.
8 Lydia Polgreen. 2010. "In India's capital, pristine trains are a runway success", *International Herald Tribune*, 14 May, p. 3.
9 *The Economist*, 23 May, p. 89.
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11 Institute of Public Policy. 2010. *State of the Economy: Pulling Back from the Abyss*. Lahore, Beaconhouse National University.
12 This became a popular phrase to describe the deteriorating security situation in Pakistan in the spring and summer of 2009. It was used by Secretary of State Hillary Clinton in her Congressional testimony after Pakistan signed an agreement with the Islamist extremists operating in the district of Swat, and it was used by her on 23 May in a briefing to the Western press on the situation in the same district after the military was ordered to launch an all-out offensive against the extremists there.

13 Government of Pakistan. 2010. *Economic Survey, 2010–2011*. Islamabad, Ministry of Finance, p. 23.
14 Nicholas D. Kristof. 2010. "A safer Pakistan", *International Herald Tribune*, 14 May, p. 7.
15 For an analysis of the way in which Asia is "catching-up" with the world's more advanced regions and how that would affect the make-up of the global economic system and the political structure that supports it, see two working papers by Shahid Javed Burki. 2010. "Asia in 'the catch-up' game", Institute of South Asian Studies, National University of Singapore, Working Paper No. 106, 9 April; and 2010. "Asia in 'the catch-up' game", Institute of South Asian Studies, National University of Singapore, Working Paper No. 107, 10 May.
16 UNIDO. 2009. *Industrial Development Report, 2009: Breaking In and Moving Up: New Industrial Challenges for the Bottom Billion and the Middle Income Countries*. Vienna, Austria.
17 Ibid.
18 Surjit Bhalla. 2010. "Indian Economic Growth, 1950–2008: Facts and Beliefs, Puzzles and Policies", in Shankar Acahrya and Rakesh Mohan (eds). *India's Economy: Performance and Challenges*. New Delhi, Oxford University Press.
19 I developed this argument in some detail in a two-part working paper issued by ISAS in April and May 2010. See Shahid Javed Burki. 2010. "Asia in 'the Catch-up Game', Part 1", Working Paper No. 106, 9 April; and 2010. "Asia in 'the Catch-up Game', Part 2", ISAS Working Paper No. 107, 10 May.
20 Surjit Bhalla. 2010. "Indian Economic Growth, 1950–2008: Facts and Beliefs, Puzzles and Policies", in Shankar Acahrya and Rakesh Mohan (eds). *India's Economy: Performance and Challenges*. New Delhi, Oxford University Press, p. 42.

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