

STABILITY AND
GROWTH
IN
SOUTH ASIA

Editor
Sumita Kumar

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Stability and Growth in South Asia
Sumita Kumar (Ed)

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Foreword

The IDSA has been organising an annual South Asia Conference which brings together experts from India and SAARC countries to exchange views on key developments in South Asia. The 6th South Asia Conference on the theme “Prospects for Stability and Growth in South Asia” was held in New Delhi on November 6-7, 2012. The present book, edited by IDSA scholar Ms. Sumita Kumar brings together the papers presented at the conference. Scholars and experts from Afghanistan, Bangladesh, Bhutan, India, Maldives, Myanmar, Nepal, Pakistan and Sri Lanka had shared their perspectives on this theme.

The prospects of political stability and economic growth in the South Asian countries have been examined in the backdrop of the recent transition towards democracy and emerging domestic, regional and global challenges. The purpose of the conference was to assess the prospects of growth and stability in South Asia. Will the recent transition to democracy in these countries, create a possibility of a sustained period of political stability, which would encourage economic growth? Professor S.D. Muni, an Indian scholar observes in his paper that the relationship between political stability and economic growth is highly complex and little explored. There is no direct or automatic relationship between political stability and economic growth in South Asia.

This complex relationship is explored in the book by different scholars from different standpoints.

I commend Ms. Sumita Kumar and her colleagues in the South Asia Centre of the IDSA for having brought out this useful volume.

It is hoped that the book would raise awareness about South Asia’s political economy and would be found useful by scholars, researchers and policy makers alike.

New Delhi
October 2013

Arvind Gupta
Director General, IDSA

Welcome Address by Director-General, IDSA, Dr. Arvind Gupta*

I would like to extend a warm welcome to all. Thank you for participating in the conference.

Our special thanks to the Hon'ble Minister of HRD, Shri Pallam Raju for agreeing to deliver the inaugural address at the Conference despite his busy schedule. We greatly appreciate his constant support in IDSA's activities.

Today's conference is the sixth in the series of annual South Asia conferences the IDSA started holding from 2007. During these years we have been fortunate to have many distinguished scholars, experts, journalists, diplomats from Afghanistan, Bangladesh, Bhutan, Nepal, Pakistan, Maldives, Myanmar, Sri Lanka, and India at the conferences. We hope that such gatherings help in a small way to refurbish the South Asian identity.

We have also published the proceedings of these conferences and placed them on our website for wider reading. The Hon'ble Minister will today release two books on South Asia, produced and edited by our scholars. We have tried to promote a community of strategic affairs experts from neighbouring countries who reflect on the problems of the South Asia.

The previous conferences have tackled a number of themes reflecting on the current state of South Asia and the prospects for the future. The discussions held in the spirit of cooperation have been candid and revealing. Most analysts have agreed that despite numerous problems, cooperation is necessary to tackle common problems. Last year the participants came up with a document on the prospects of Cooperative Security for South Asia, a theme not discussed widely and treated with scepticism.

This year we are examining whether the region will remain stable and continue to grow? The deepening of the global economic recession, the acute economic problems in Europe, with which many South Asian countries are linked closely economically, socially and in many other ways, is a cause of concern.

The countries of the region continue to face the challenge of deepening democracy and improving governance.

*Delivered on 6 November, 2012.

Unemployment and malnutrition remain serious challenges.

The region also faces numerous security challenges.

At the same time, the geopolitical environment is changing rapidly. The international forces are set to withdraw from Afghanistan by the end of 2014. A phase of fresh uncertainties is about to begin.

South Asia is closely linked to the Gulf and West Asia. Millions of our compatriots live there, we receive billions of dollars in remittances from them, and we source vital energy supplies from the region. This vital region is undergoing deep transformation. The developments in West Asia will have major impact on South Asia. What will be the implications for us? The IDSA will be exploring some of these questions in a separate conference in February next year.

Extricating itself from two difficult and hugely expensive wars in Asia, the US is now shifting focus to the Asia Pacific region through its policy of rebalancing and pivot to Asia. The US wishes to reinvigorate its alliances in the region and also find a *modus vivendi* with respect to China. US-China relations will also be reconfigured in the next few years. We need to analyse the impact this will have on the South Asian countries, which are linked both to the US as well as China in complex ways. What will be the policies of the new administration in the US, where Presidential elections are about to be held?

East and South East Asia also play an important role in South Asia's stability. The power equations in Asia are being reset as China rises, carries on with the task of military modernisation and seeks greater presence in the Indian Ocean region. The concept of Indo-Pacific, the Confluence of the Two Oceans, is beginning to be discussed. The Indian Ocean Rim Association of Regional Countries, which held its ministerial meeting in Delhi last week, is trying to seek a more active identity, describing itself as an "apex organisation" in the Indian Ocean region. The geopolitical landscape in the Indian Ocean is beginning to change. What impact will this have on growth and stability in South Asia? We need to discuss these issues in detail.

It is a matter of fact that regional cooperation in our part of the region has not progressed to the extent it has in many other regions including Central Asia, South East Asia, Africa and South America. How does this impact our stability and growth? This is worth pondering over too.

Key to the future of South Asian stability will be in the hands of the youth. The question of human resource development assumes great importance. In this regard, millions of youth in our countries will have to be provided with education, skills and job opportunities to ensure that the region continues to grow and remain stable. We need to harness our vast human potential for peace, prosperity and stability in the region.

The presence of the Hon'ble Minister of Human Resource Development at the Conference today is most relevant. It helps us focus on the human resources issue that is so important for all of us. The South Asian countries can cooperate in this area meaningfully even as we struggle to deal with other problems.

Over the next day and a half we will hear a variety of perspectives on these problems. The last session is devoted to thinking about the future.

We look forward to invigorating discussions in the ensuing sessions.

Inaugural Address by Hon'ble Union Minister of Human Resource Development, Shri M.M. Pallam Raju*

I extend a warm welcome to all the delegates and participants who have come from all the states of South Asia, for the 6th South Asian Conference organised by IDSA. For the sixth consecutive year, IDSA has taken this initiative at the Track-II level to discuss issues of mutual interest and concern among delegates from different countries in the region. This is an important initiative that must be sustained. “Think South Asia”, should be the motto for all of us to connect with one another, and build bridges across artificial divides, that inhibit the process of regional integration.

The theme of this conference, “Prospects for Stability and Growth in South Asia” is quite apt. It underlines the interconnection as well as inter-dependence between socio-political stability and economic growth. The on-going global economic down-turn has affected us all in various ways, and its aftershocks will continue to pose critical challenges for the leaderships in all the countries in the coming days. Such moments call for united action-plans for the future. In conferences like this, perspectives from various countries emphasizing the need for coordinated action to meet common challenges, will certainly show us the way forward in the right direction.

During the last five years or so, we have witnessed a ‘democratic moment’ in the South Asian region. Democracy has taken stronger roots in some countries while in others processes of democratic transition are under way, driven by people-power. The governments in the region are struggling to fulfil popular aspirations for better lives, for greater individual liberty and economic prosperity. While the groundwork has been laid for more representative politics, sustaining the pace of democratisation remains a challenge in many countries in the region. We must work towards reinforcing the processes of change by building more capable institutions, improving governance, tackling the problem of corruption, reaching out to the vulnerable sections of the society, and strengthening the feedback loops.

We must also take into account the desire of our people to connect with each other, physically, culturally and through sharing of ideas. The people of the region

*Delivered on 6 November, 2012.

now want to overcome distrust and hostility to build partnerships based on shared cultures, values, beliefs and aspirations. The governments will have to be responsive to such popular desire for peace and prosperity and intensify interactions at all levels.

The positive environment created by the progress of democracy in the region should not detract from the formidable challenges we continue to face. Poverty, illiteracy, crisis in governance, ethnic conflicts, intolerance, religious extremism, climate change and disaster management remain unresolved and require urgent attention. Our separate experiences in dealing with some of these challenges successfully need to be shared for mutual benefit.

The world's attention is also focused on the region because it is being perceived as the nerve centre of terrorism. Too many innocent lives are lost to terrorism every day. We are all victims of this menace. We need to ensure that double standards in dealing with terrorism are eschewed. The lessons of history teach us that those propagating terror are often the worst victims of it. We need sincere and effective cooperation to root out this scourge. Initiatives taken by the SAARC forum provide excellent frameworks for cooperation to deal with this issue.

Sustaining economic growth is a major challenge confronting us all today. After registering decent rates of growth for the last few years, due to the global financial crisis, we are faced with a situation which compels us to think that there is no choice left before us other than cooperation. The developmental goals that are lying in front of us are humongous.

A glance at the combined performance of the South Asian countries would reveal that for a population of about 1.65 billion, we have a GDP of about US \$ 2.27 trillion and a per capita income of about US\$ 1299, which is marginally above the figures for sub-Saharan Africa, which is about US\$ 1255. The average poverty ratio, defined very liberally by most of the countries, remains above 22 per cent. The external debt situation for most countries remains quite worrisome. The annual rates of growth have declined. Due to rising inflation the food security situation has turned for the worse in most of the countries in the region, with huge number of people below the poverty line.

Due to low level of regional trade and commerce, we are unable to pool our resources together to meet these challenges in a cooperative fashion. There are so many economic complementarities that we tend to overlook, in our desire for unilateral responses to such adverse situations. Sometimes, in times of crises, we are compelled to cooperate briefly, but lose the strand soon after we overcome the crises.

We must remember that we are passing through an unprecedented global financial crisis. Our region cannot be insulated from it. We need to ponder: what has been our collective response to this crisis. There is a need for us to sit together and examine the impact of the crisis on the region and come out with

our own responses. No doubt, we are affected by global trends. At the same time, the importance of regional initiatives cannot be underestimated. The finance ministers and the central bank governors should come together and discuss the crisis at the earliest. I hope this conference will come up with some broad ideas as to how the region can cope with the on-going global financial crisis.

India is a trillion dollar economy and has sound promise of growth at a sustained pace, despite some setback for a couple of years. It can play the role of an economic powerhouse in the region. All countries in the region have an opportunity to link up with the Indian economy and improve their own prospects of growth. I do hope that the trust deficit which comes in the way of cooperation will yield to a climate of change, and the positive side of growing together with India will be appreciated. Sri Lanka, Bhutan and to some extent Bangladesh today, have benefited from deepening their economic cooperation with India. Pakistan and India have taken some significant steps forward to improve bilateral trade. If the tempo is maintained, many analysts predict that the volume of trade between the two countries will reach the US\$ 10 billion mark very soon. This has the potential to boost regional economic integration. The present intra-SAARC trade is only 4 per cent of the region's global trade. There is enormous potential of intra-regional trade and investment that we must not leave untapped.

Looking at the last few SAARC summits, it is encouraging to find that there is greater willingness among the states to engage each other at all levels, in spite of the inhibitions and reservations in certain quarters. India need not be seen as a "big-brother" and this attitude must change. India faces the same problems as others in the region. Our destinies are closely interlinked. There is no escape from that reality. Intellectuals, economists, civil society activists and members of the media who see the larger picture are beginning to bring in pressure on their domestic governments, to jettison isolationist mind-sets and to cooperate more fruitfully amongst ourselves. This is a welcome development.

However, we need not be complacent. We need to institutionalise regional efforts for cooperation at various levels. The ideas being evolved at the SAARC meetings need to be implemented well, to unlock the regional potential for collective development. SAARC ministers for Foreign Affairs, Home, Finance, Transport, Tourism, Commerce, Energy and Environment are now meeting on a regular basis. Such exchanges and communication at ministerial levels should be followed by concrete results. As the Indian Prime Minister emphasised at the SAARC summit at Addu in Maldives in 2011, we should seek, "imaginative ways to create new avenues and sources of growth and investment in South Asia", and seek, "complete normalisation of trade relations in SAARC", which will create "huge opportunities for mutually beneficial trade within South Asia". As he noted, India is aware that it "has a special responsibility that flows from the geography of our region and the state of our economy and market". India is ready to undertake asymmetric responsibilities and push the process of regional integration forward.

This will provide the impetus for regional development and have a stabilising impact on the political systems in different countries.

The relationship between political stability and economic growth is quite well-known. Any initiative for sustainable economic development is likely to have a moderating influence on politics. It will contribute to human welfare and create conditions for peace and stability. Similarly, stability is the necessary precondition for economic growth. Political instability often wards off potential investors and leads to flight of capital and human resource.

South Asia is rich in human and natural resources. Because of its vast youth population, the region has a demographic dividend that it should use to its advantage. We need to improve the quality of education and training to improve the quality of our human resource. India has quality institutions of learning and countries in the neighbourhood should tap into them to enrich their human potential. India is ready to play its role to enhance regional cooperation in this field and open its institutions to students in the neighbourhood. We should all invest in education, undertake a mission for universalization of education and develop as knowledge societies. Only then can we leverage our human resources for building better futures for ourselves.

Our region has vast potential for attracting external investment. Instead of wasting their energies on mutual differences, the states in the region need to focus their attention on strengthening the foundations of democracy, and ensuring transparent governance and inclusive development. Other threats like weak institutions, use of asymmetric means to weaken perceived enemies, interference of armies in politics and the negative role of external actors will have to be taken note of while addressing the issue of political stability. Only then can the vicious cycle of political instability and economic underdevelopment be stopped.

Think Tanks like the IDSA can act as facilitators of change and promote mutual awareness and understanding. By providing a forum for discussion at a Track II level—where academics, experts, strategic analysts and media persons meet and discuss common issues that affect them—IDSA is creating avenues for cross-pollination of ideas and building an atmosphere of trust and mutual confidence.

I am sure, during the deliberations in the conference, many useful ideas for action will come up for discussion. These ideas must be stitched together as policy inputs for governments, like the outcome report of last year's conference on cooperative security framework for South Asia. This will go a long way in connecting the various tracks of dialogue and will be of great value for the policy makers in various countries of South Asia. I wish you all success in your deliberations.

Introduction

Sumita Kumar

In the post-colonial phase, the regions of Asia, Africa, and Latin America have experienced varying degrees of political, social and economic turbulence. The goal of political leadership in all the regions has been the establishment of democracy and achievement of economic growth, in order to provide peace and stability to their people. Of all the regions, South Asia is the one which can be regarded as having achieved a greater degree of political stability and economic growth, except perhaps the Asia-Pacific region, particularly parts of East and South East Asia.

In the last decade or so, the trend in South Asia has been towards greater stability and faster economic growth. This can be said to be true of most countries of South Asia to a greater or less degree, even if there have been upheavals of various kinds on and off. For instance, India has had a continuous rule by the United Progressive Alliance since 2004, although the alliance has had its normal problems. Nepal came out of the clutches of monarchical autocracy and Maoist violence, and set itself on the path of a non-violent struggle for acquiring a modus-vivendi among contending political forces in a democratic framework. Bangladesh despite being faced with the challenges of right wing extremism and threats of military activism, has found it possible to stay on the democratic path. Pakistan has fought a valiant war against the perennial stronghold of the army and the well orchestrated violence of Islamic extremists and managed to keep a democratically elected government in power at least since 2008. The successful war against Tamil separatists in Sri Lanka has enabled the country to pay greater attention to processes of long term reconciliation with the Tamil minority, within the framework of a united Sri Lanka. In Afghanistan, the president has ruled for more than a decade in the most difficult circumstances, and has not allowed the Taliban to capture power. It has gone through an epic struggle to defeat a highly motivated insurgency in the last more than one decade, with the strong intervention of foreign powers, and has ultimately realised the unavailability of reconciliation with the insurgents, so that the country can achieve a modicum of stability. In Maldives, despite the political upheaval which took place in 2011, the political system found it possible to keep standing on democratic legs, in the

hope of absorbing incipient challenges in due course of time. Bhutan, of course has gradually veered towards greater democratisation with full support of the monarchy and has tended to move towards greater long term stability. In Myanmar as well, political liberalisation initiated by the newly elected president in 2011 has led to greater political stability, enabling the most popular democratic leader to participate in the electoral process, and work within the framework of the new constitution.

In the economic field, the South Asian region as a whole has seen upward growth in varying degrees. India's rate of growth was noticeable, and the optimism has not dimmed despite the recent slowdown. The Bangladesh economy has also been doing well with an average growth rate of 6 per cent in the last decade. The growth rate of Bhutan has averaged 8 per cent during the same period. Sri Lanka has recently witnessed a growth rate of nearly 8 per cent, in the post war years. There is no doubt that there have been severe challenges to economic growth in Pakistan, partly resulting from natural disasters and partly a consequence of internal strife. Nepal's economy has also been the victim of political conflicts and contradictions, which are now in the process of being patched up. While the Afghan economy has been adversely affected by the prevailing security situation over the last decade, there have been certain years of high growth triggered by large infusion of foreign aid and remittances. The Maldivian economy has intermittently shown years of negative growth along with certain years of above average growth. The economy slipped a couple of years ago, and could be regarded as one of the reasons of the political strife in 2011. The Myanmar economy showed an excellent average rate of 9 per cent growth during the last 10 years, recording a very high rate of growth during the first five years of the decade, which sharply fluctuated in later years, largely due to political vicissitudes and aggravated by natural disasters.

It was in this backdrop, that it was decided to hold the conference on "Prospects for Stability and Growth in South Asia" in November 2012. The primary focus of this conference was to examine the forces and processes which have led to relative political stability or unleashed trends in that direction in some parts of South Asia. It was also meant to delve into the forces that have stimulated economic growth in some countries, and impeded economic growth in others. The purpose was also to examine how far the positive political and economic trends in the region are irreversible or lend themselves to internal convulsions or external influences. Further, it aimed to look at how far interstate relations within the region tend to lead to stronger intra-regional cooperation, particularly in the economic field. Since the conference, three countries in the region went to polls. After its transition from monarchy, the second general elections were held in Bhutan successfully in May and July 2013, which resulted in victory for the opposition People's Democratic Party. For the first time in the history of Pakistan, one civilian government handed over power to another civilian

government after completion of its full term in office. In Maldives, new dates are being set for the presidential poll, as the first round of voting that took place was annulled. All three examples in different ways signify the maturing of the democratic processes within each country.

There has been a trend towards stabilisation of the political systems of the region in the last few years. Since this apparent stability is of recent origin, the situation has inherent in it the possibilities of future uncertainty at the slightest provocation. For instance, while three coalition governments have managed to serve their full terms in India leading to a semblance of stability, the threat to such stability could arise from the economy as it goes into a downturn. In Pakistan, the smooth transfer of power from one civilian government to another, may give rise to the belief that that the political system in Pakistan is maturing. Yet, challenges to the stability of the country can arise from a multitude of elements like the military, an activist judiciary, the increasing power of the religious extremists, and from the government's own inability to provide good governance. In Bangladesh, challenges to the maturing of democracy arise from the deep dissonance between the two main political parties, and the ineffectiveness of state institutions. In Nepal, even though there have been several significant changes in the political arena, the lack of political consensus and increasing polarisation on the question of federalism, could lead Nepal on the path of instability. In Maldives, the advent of democracy has brought to the fore various challenges like politicisation of the media, ineffective functioning of the parliament, lack of independence of institutions, and the increasing use of religion as a political tool. Myanmar came out of a prolonged period of isolation and sanctions, and the new government has taken important wide ranging reforms, yet stability will hinge on whether the pace of reforms is sustained, on the progress of reconciliation with the armed ethnic groups and how it handles the communal issue. In Afghanistan, as the country prepares for the US drawdown, the uncertainties emerge from whether or not there is successful transfer of power after the presidential elections, the lack of a well trained Afghan National Army, the problem of attrition within the Afghan National Army, the expected reduction in foreign funding, progress in peace initiatives with the Taliban and the role of regional stakeholders. These are some of the observations made by the authors.

Another theme dealt with by the authors pertains to the economic aspects of the region, the trends towards positive growth or the lack of them. Bangladesh witnessed a largely stable rate of growth over the last few years, giving rise to optimism about its future growth trajectory. While private sector production, investment, exports, and the inflow of remittances were the main factors that led to growth, achievement of Bangladesh's growth potential could be constrained by inadequate infrastructure, inability to attract Foreign Direct Investment (FDI) and to increase domestic revenue, and faltering institutions, as well as political instability. While Pakistan was seeing impressive growth rates for a number of

years over the last decade due to multiple reasons, including funding from international institutions at concessionary rates, rescheduling of external debt, and increase in FDI and remittances, this trend slowly petered out. Promoting Pakistan as a regional trading hub could improve its economic future, provided it is able to establish itself as a manufacturing hub rather than just a transport hub. Yet, the economic condition of Pakistan and the region would to an extent be affected by the uncertainty regarding the future of Afghanistan, militancy in the tribal belt with its attendant fallout in terms of sectarian and ethnic strife, and the Baloch insurgency.

Nepal is perhaps one of the countries in the region experiencing the lowest average growth rates, with its inability to attract FDI, increasing merchandise imports, and an increase in trade deficit. Development has been affected by the political uncertainty, lack of locally elected representatives, decreasing capital expenditure, a deteriorating security situation, and lack of effective institutions. Factors which affect growth also include lack of agricultural productivity, and inadequate infrastructure. Even though hydropower, tourism and agriculture are Nepal's development priorities, lack of stability and inter party consensus have affected the optimisation of these resources. While the economy in Afghanistan has been growing at a good rate of growth over the last decade, the economy is hugely dependent on economic aid. Economic development is affected by political uncertainty, terrorism and insurgency, weak institutions, and the lack of policies enabling macro-economic stability. Though Bhutan underwent development and achieved good levels of economic growth, it is highly dependent on external aid, and has been facing a weak balance of payments situation, mounting public debt, high fiscal deficit, and at the same time is limited by a small domestic market, limited exports and markets and inadequate infrastructure. Bhutan recently faced a financial crunch due to a shortage of rupees and the lack of availability of credit. The Maldivian economy has witnessed a stable trajectory of growth over the last many years, with its mainstays being tourism, construction, transport and communications. Issues of concern pertain to reducing the government deficit and improving the balance of payments situation. Growth did slow down after 2005 due to political uncertainties and public unrest. It is obvious that some of the countries have maintained the growth rates of the earlier years, while some countries are facing a downturn. Some have brought out the point that threats to the state, or political instability or uncertainty will impact growth. It is clear from the discussion above that if one looks at the trends in economic growth and the extent to which they are affected by political stability, Nepal to larger extent and other countries like Afghanistan, Pakistan and even Bangladesh to some extent prove the point.

Democratic transition in some countries and democratic consolidation in others, may perhaps not be the only plank with which political stability can be measured. It also pertains to the ability of the government to carry out its agenda

throughout its tenure, without being obstructed by perennial political and social convulsions. Yet, it would be erroneous to assume that there can be any such thing as absolute stability. Relative stability is the norm rather than the exception in most of the countries of the region. As regards the correlation between political stability and growth, it is justifiable to underscore that political stability is only one of the many conditions that promotes economic growth, not the only condition. However, the lack of political stability obviously hampers growth. Some authors have drawn attention to the potential that regional cooperation has for the growth of all the countries. The importance of South Asian Association for Regional Cooperation (SAARC) as a regional organisation has been emphasised in this respect. Hopefully, this volume which is meant to comprehensively explore the dynamics of political stability and growth and the relationship between them will be found useful by scholars and practitioners alike.

I would like to express my gratitude to Dr. Arvind Gupta, Director-General, IDSA, for his encouragement and support in bringing out this volume. My colleagues in the South Asia Centre have provided support in this venture and I am grateful to them. Mr. Vivek Kaushik, Associate Editor, deserves my deep gratitude for his valuable support. I would also like to thank Mr. Rajan Arya, his staff at Pentagon Press, and Mr. Virender Negi for their effort in publishing this book.

PART I

Political Stability in
South Asia

1

Stability and Growth: The Uneasy Couple in South Asia

S.D. Muni

Economic growth is a small, though important, component of development. It is necessary for facilitating and promoting development, but on its own, it cannot ensure development which is a comprehensive and multidimensional phenomenon. If handled casually and chaotically, economic growth may also distort the dynamics of development, and even create sources of conflict and disruption in a given society. Development encompasses the social, material, psychological and spiritual progress of human beings in a given society. It involves social harmony and cohesion, a stable and responsive political order based on the consent and commitment of the governed and an 'emancipative cultural change'. All these social, economic, political and spiritual components have a mutually reinforcing relationship and must be balanced and in harmony with each other to ensure development. South Asia has thrown up unique and impressive paradigms of development in contrast to the European pathways that are based on material prosperity and well being. Gandhi in fact, rejected the material indices of development and modernisation and emphasised the importance of "spiritual development" as a measure of real progress. In contemporary times, Bhutan has discarded the criteria of Gross Domestic Product (GDP) to measure its national growth and development. Instead, it has evolved the innovative concept of the Gross National Happiness (GNH) that includes overall contentment and spiritual harmony for its people as the goal of national endeavour. The United Nations has endorsed and acclaimed the innovative Bhutanese approach and many other countries are trying to learn from it. The challenge before the world and South Asia is to explore the prospects of a constructive relationship between stability and development and not to remain bogged down by the concerns for economic growth.

Stability and Growth: Complex Nexus

There is a complex nexus between stability and economic growth. However, before examining that nexus, it is important that we understand these concepts. Economists have laboured hard to decode the intricacies of growth. They take into account the demand and supply sides of economy to map out growth trajectories. They include factors like infrastructure, human capital, technology, and education for a long term view on aggregate demands and interest rates, consumer confidence, real wages and exchange rates, for assessing short term demands for growth. They accept that commodity prices and weather can affect growth prospects. Very few of them are sensitive to the role of non-economic factors in shaping and influencing growth. Nobel laureates like Amartya Sen, have linked the social situation to economic dynamism while Indian scholars and planners like Kaushik Basu have made critical contributions to the understanding of growth, by linking it to social norms and values.¹ Such economists who look beyond economic factors of growth also accept that political stability can affect growth. This means that stability in our present discussion means political stability, but then how do we see political stability? What does it mean? Stability is not the opposite of change. Smooth and harmonious political change is encompassed within the framework of stability. As against this, political instability would result from frequent executive changes. Similarly, violence, disruptions, mass uprisings and radical transformation of political structures and institutions that disturb peace and public order would also create political instability. Similarly, inter-state wars would also lead to political instability in either or both of the warring states. On the whole it is accepted that political stability means “regularity of political exchanges” but the nature of what we understand as “exchanges” would greatly depend upon the nature, location and characteristics of the players and observers of these exchanges.²

The complexity of nexus between political stability and growth is reflected in the conflicting and qualified assumptions of the relationship between these two concepts. One set of assumptions asserts that political stability stimulates economic growth by creating conditions suitable for the many and diverse factors of growth. Stability invites investments, encourages private sector and ensures smooth transactions of all economic activities like manufacturing, trade, savings, productivity etc. Studies based on mathematical models have been carried out to underline this point.³ The World Bank has regularly supported this assumption. The positive correlation between political stability and growth is also reinforced by the related assumption that political instability is harmful to growth.⁴ Various arguments marshalled in favour of this assumption suggest that political instability precipitates five “D” conditions that impinge negatively on the growth dynamics of a given country. These are: **D**isturbs social peace and order, **D**isrupts economic activity, **D**elays policy processes and policy implementation, **D**eters investments and economic stimuli and **D**istorts priorities and vision of economic growth and

development. These assumptions are constrained by the very notion of stability that is focused upon. Political stability in these assumptions is taken as stability of governance; continuity of a stable executive and a “predictable political environment”. Governance is of course not politics in its entirety. Regarding the relationship between political stability and economic growth the conclusion of a comparative study on some African countries said:

...political stability is no doubt key to growth for a given and highly particular vision of stability ... But while the governance agenda underlying this view is undoubtedly important, it needs to be tempered with an appreciation that other types of politics—the messy, murky, complex and local kind—cannot be wished away, and are remarkably robust.⁵

Many of these studies and assumptions do not even take into account the nature of the political system i.e. whether it is authoritarian or democratic. Some studies on the relationship between democratic systems and economic growth even conclude that “democracy has a negative effect on economic growth”.⁶ The other characteristics of a democratic system like “economic freedom and ethnic homogeneity” may be “beneficial to growth while democracy may have a small negative effect”.⁷

The other set of assumptions do not corroborate the positive relationship between political stability and economic growth. They at best accept that political stability may contribute towards creating conditions for economic growth, but not necessarily. Stability alone does not ensure that growth would take place because there are other factors that are more critical for growth. Some have pointed out that economic growth and stability may have an adversarial relationship; “Growth leads to a rise in the visibility and power of the middle class; a classic catalyst for social and political upheaval”.⁸ There are scholars who have even argued that political stability may be harmful for economic growth as it may breed stagnation. Philip Keefer and Stephen Knack’s study of Latin American countries on the basis of data from *International Country Risk Guide* and *Business Environment Risk Index* suggests that if and when ‘bureaucratic quality and corruption’ as products of political stability adversely bear on security of property rights, economic stagnation is encouraged.⁹ The opposite of political stability, i.e. political instability, contrary to the assumptions identified in the preceding paragraph, may also not harm economic growth. Let us examine some of the South Asian examples for these contrary propositions.

The two main examples of political stability under democratic as well as authoritarian systems are India as a democracy and Nepal when it was as an autocratic monarchy. They are concrete examples of political stability not leading to economic growth. Nehru’s India was politically most stable. There was no change in either political system or political leadership for nearly 17 years, from 1947 till 1964. And the leadership was deeply committed to the welfare of the

people. But the economic growth during this period was the lowest, around 3-3.5 per cent. Economists had caricatured this as the 'Hindu rate of growth'. In the subsequent periods, India has maintained much higher growth, even under frequently changing governments and fragile governing coalitions. For instance during 1989-99, India's growth rate was 6-7 per cent.¹⁰ Later, from 2004 onwards, India has been the world's second largest growing country, maintaining a growth trajectory of 8 per cent and above, except for the past two years when the growth rate has come down. The recent decline in the rate of growth has been a result of various factors including the global economic downturn, slow movement of second generation domestic economic reforms and 'policy paralysis'.¹¹ None of the factors related to the declining growth can be attributed to the factor of political stability. The same coalition is in power, leadership has not changed and there has not been any major threat to governance. There is a persisting left wing insurgency that the government describes as the most serious threat to India, but that has been the case since this government took office in 2004. In Nehru's India also there was no challenge to political stability, despite the pressure of the Tamil separatist movement during the 1950s and the war imposed by China in 1962. Growth was prevented by the nature of economic policies pursued and the lack of international support for India due to the Cold War.¹² There is surely a positive side to Nehru's economic policies, wherein the policies laid the foundations of a scientifically and technologically strong, egalitarian and independent India that had the potential for future development and growth—but here we are discussing economic growth during the Nehru period. It is possible, however, to argue that if political stability during Nehru's India had been disturbed, perhaps the rate of economic growth would have been even lower.

Nepal experienced robust political stability under monarchy from 1960 until 1990. But this period shows a dismal economic performance. Growth rates seldom exceeded 3 per cent under the monarchy. Nepal's huge economic potential in hydro-power and tourism remained utterly untapped. The king used the Nepal state as a rent seeking apparatus to serve his feudal interests. He hardly had any serious consideration for the well being of his people. He was often swayed by advisers who were of the view that the harnessing of the hydro-power potential would lead to Nepal's industrialisation, which would in-turn transform its innocent and loyal rural population into politically conscious and rebellious blue collar workers, who could challenge the very foundations of the monarchical order. Unfortunately for him, the monarchy had to eventually go because of the protests and opposition of a rural insurgency led by the Maoists from 1996 to 2006.¹³ Contrast this with the neighbouring stable monarchy of Bhutan, which by harnessing its hydro-power potential alone, has turned Bhutan into South Asia's second richest country. What is the role therefore, of political stability in autocratic systems in economic growth? The post-monarchy political instability and uncertainty, including the failure to adopt a Constitution have also hindered

economic growth in Nepal. Both these aspects underline the marginal role of political stability in economic growth.

Sri Lanka provides yet another perspective of the relationship between political stability and economic growth. Until the end of the ethnic conflict in 2009 following the military elimination of the Liberation Tigers of Tamil Eelam (LTTE), there was a general perception of the opportunity costs of the war. However, in 2002 and 2003, the worst, war affected North and East regions of Sri Lanka recorded an impressive growth of 12.6 per cent and 10.1 per cent. These regions depended upon fishing and agriculture, the two sectors that continued to do well even in the midst of violence and disturbed conditions.¹⁴ During the three decades of internal conflict since the 1980s, Sri Lanka has recorded an uneven economic growth. From 1991 to 1999, Sri Lanka's overall growth remained satisfactory at more than 4 per cent.¹⁵ In the years preceding the final phase of the war also, Sri Lanka maintained a good growth record at 6-7 per cent. The Sri Lankan economy is driven by three main sectors i.e. plantations (tea and rubber), the garment industry and tourism. All these three sectors have been outside the conflict zone. This however is not to ignore the costs of war in terms of a growing defence budget, the burden of rehabilitation and reconstruction and the almost unaccounted opportunity-cost, which led many Tamils to leave their homes to go abroad in search of safety and livelihood. The end of the conflict in 2009 has reinforced political stability with the unchallenged domination of President Rajapaksa and his ruling coalition. At the end of the war a business corporate like Merrill Lynch predicted that the Sri Lankan economy will boom. This has however not happened. Delivering a lecture at the University of Paradeniya in Sri Lanka on July 12, 2013, Professor Premchandra Athukorala a reputed economist said:

The end of the conflict in Sri Lanka in 2009 generated widespread expectations of a period of sustained economic growth, building on the achievements of the liberalisation reforms sustained over three previous decades. However, recent developments have dampened that optimism, rekindling fears that Sri Lanka's tale of missed opportunities may continue.¹⁶

It is matter for debate whether this pessimism could be set aside and economic dynamism whipped up by the President emerging as a national statesman, who will address the Tamil issue by the horns and resolve it forever, rather than opting to remain a Sinhala leader, who is busy nursing his political constituencies for himself and his posterity to cash on.

Therefore is the equation between stability and growth, high stability-unimpressive growth; conflict and instability-growth, satisfactory? It surely underlines the constraints of seeing a systematic causal relationship between the two aspects of the South Asian reality.

All the three foregoing examples of India, Nepal and Sri Lanka reinforce the assumption set out at the beginning of this chapter: that there is no direct or automatic relationship between political stability and economic growth in South Asia. The tone and tenor of this relationship changes from case to case, depending upon the country and the context. The secret or say, the devil of understanding this relationship lies in precisely working out the specificities of the nature of stability and the character of the growth factors operating in a given milieu. This is a challenge that is better addressed by emerging policy makers and scholars.

Prospects of Political Stability and Economic Growth

South Asian politics has generally remained turbulent. The region's undemocratic polities witnessed a significant resurgence of democracy during the first decade of the 21st century. Most spectacular of them was Nepal, which turned its ten-year old Maoist insurgency into a mainstream political force, and eliminated its 250 year old traditional institution of monarchy in 2008. The people of Pakistan first forced its president, the army chief General Musharraf, to give up his uniform and then give up power by holding elections in 2008. The Maldives ended Maumoon Abdul Gayoom's long-standing one party dominated authoritarian regime, to usher in multi-party democracy in 2008. Bhutan's King Jigme Singye Wangchuk voluntarily turned his absolute monarchy into a constitutional one, by almost goading his people into accepting a multi-party democracy. In 2008, a popularly elected parliamentary system came into existence in Bhutan under a constitutional monarchy. Bangladesh's caretaker government organised a free and fair election in December 2008, which brought Sheikh Hasina Wajid's Awami League party to power with a decisive landslide majority. With these momentous changes, it appeared that South Asia had taken a big leap towards sustainable democratic governance. This has however, not happened and the region is again gripped by political turbulence.

In Nepal, the broad national political consensus, that included the Maoists, who had successfully led the Peoples' Movement (*Jan Andolan-II*) in April 2006, could not be sustained. The elected Constituent Assembly assumed office in 2008 initially for a two year term, but, even after several extensions, failed to give a Constitution to the country till May 2012. Nepal is again preparing for another election to the Constituent Assembly but with much reduced popular expectations and enthusiasm. There are persistent questions whether it would be possible to complete the election process smoothly and whether the country would eventually be able to get a constitution and stable polity. In 2013, Pakistan successfully experienced the first ever smooth transition of power from one elected government to another. This is an obvious sign of political stability according to text book definitions of the orderly change of executive. Pakistan however hardly looks stable because of Islamic extremism, violence and terrorism and serious erosion of critical institutions. The Pakistan Institute for Peace Studies, Islamabad, in its

latest *Pakistan Security Report 2012* discloses that while there has been a declining trend in cross border attacks (0.79 per cent), suicide attacks (29 per cent), and drone attacks (41 per cent); but there is an escalating trend of sectarian violence (28 per cent), target killings (811) and terrorist arrests (1238).¹⁷ These are no indicators of stability. In the Maldives, the democratically elected President Nasheed resigned in February 2012, and his party was thrown out of power in what was alleged by Nasheed to be a coup. This has been followed by protests and counter protests leading to an uncertain political situation in Maldives, until the time that the next election gives a clear political verdict. Nasheed was subsequently slapped with several court cases for his acts of commission and omission during his tenure that even led to his arrest for a day in 2013. Bangladesh is now awaiting the next elections and there is a huge loss of credibility for the Awami League government, which even at the beginning of its term of office had to face a revolt by a section of its security forces. It is only Bhutan which has had a smooth democratic transition, but there has also been an unexpected change of the ruling party. The elections held in July 2013, gave a clear majority to the People's Democratic Party which had only two seats in the outgoing parliament. Afghanistan continues to reel under the pernicious impact of the ten year old war on terror and everyone is keeping their fingers crossed over the extent of the destabilising impact of US withdrawal, not only on Afghanistan and Pakistan but on the whole of the region.

The situation has not been comfortable even in the two, otherwise stable, democratic polities of South Asia as well, namely India and Sri Lanka. The governing institutions have suffered loss of credibility. India has not yet been able to control left wing extremism, though the intensity of this insurgency has been on the decline. The ruling government at the centre and the opposition ruled governments in the states, have come under severe charges of corruption. While the central ministers have been removed and jailed, the president of the opposition, Bharatiya Janata Party, (BJP) had to resign on charges of corruption. The central government has also failed to keep its coalition partners together, and carry out its promised legislative agenda, in the face of stiff opposition and undependable coalition support. Critical policy issues in India seem to be in a state of suspension, waiting for firm leadership and guidance after the scheduled elections of 2014. In Sri Lanka, the Tamil ethnic issue refuses to die even after the end of the Tamil civil war, and new tensions are brewing up between the Sinhalese and the Muslims. The ruling coalition has been deeply divided on the question of the abrogation, or the need for changes in the 13th Amendment to the Constitution, that was made in 1987 to devolve powers to the Tamil majority provinces. What was previously perceived as a vibrant democracy, Sri Lanka today appears to be a dynastic fiefdom, with President Rajapaksa's three brothers holding critical positions in the parliament, and the defence and finance ministries. His son has also entered parliament, perhaps as an attempt to define the line of family

succession.¹⁸ With strict controls on media and the continuing dominance of army in North and East provinces, Sri Lanka continues to give the impression of being a 'national (Sinhala) security state' even four years after the end of civil war.¹⁹

The factors that affect political governance and stability in South Asia are many, and varied. Constraints of space and time do not permit us to study them case by case in detail. Three of them may be highlighted for their out-reach and significance and to provide a comparative perspective. These are: credibility of the core institutions; leadership deficit; and the agenda of power. All the three issues are of critical importance in the dynamics of economic growth, under the conditions of political stability. In various degrees, these are relevant in almost all the South Asian countries. On the question of the credibility of the core institutions, Nepal and Pakistan offer good examples. Nepal's transformational political change in 2006, led to the deconstruction of all the major institutions and the very nature of politics as had existed and functioned hitherto. Since then, Nepal has been governed by an "interim constitution" and past norms and practices. The failure of the first constituent assembly to give a constitution to the country, has left an institutional vacuum in Nepal and the credibility of the entire political class is in shambles. If Nepal fails to hold the next constituent assembly elections scheduled for November 2013, or the new constituent assembly fails to deliver a viable constitutional structure to encompass republican and inclusive democracy, Nepal will slide into deep chaos.

Pakistan has displayed a semblance of political stability in the form of the smooth and peaceful transfer of power from one elected government to another. However, the institutions that deliver good governance and sustain stable polity are all in shambles. An official commission, the Abbottabad Commission, set up in 2011 to investigate the intrusive U.S. Mission to "assassinate Osama bin Laden" on May 2, 2011, has made a strong indictment of the institutional collapse in Pakistan. The commission in its report wrote:

The whole episode of the U.S. assassination mission of May 2, 2011, and the Pakistan Government's response before, during and after, appears in large part to be a story of complacency, negligence, incompetence, irresponsibility and possibly worse at various levels inside and outside the government. Institutions either failed to discharge responsibilities that were legally theirs or they assumed responsibility for tasks that were not legally part of their duties and for which they were not trained. Thus, reflected the course of civil-military relations and the power balance between them. The resulting lapses were sometimes of a serious nature.²⁰

Commentators described even this indictment as an attempt to "cover-up".²¹ If this is the state of institutional credibility in the vital area of security and national sovereignty, then one can imagine how miserable the condition must be, with regard to economic growth. Pakistan could be the worst example of the loss of

institutional credibility in South Asia, but other countries are also not free from this disease. In Sri Lanka, the chief justice of the highest court was impeached most unceremoniously and unconstitutionally for political considerations. In India, there have been strong public protests against institutionalised corruption and the Supreme Court has often reprimanded the executive, for lapses in the discharge of their responsibilities. In Afghanistan, the writ of the powerful president does not run beyond Kabul.

The second serious political constraint arises from the leadership deficit. South Asia's present leadership, in general is lack lustre, devoid of creative vision and lacking in charisma. Sri Lanka's Rajapaksa gathered a bit of charisma as a result of his military victory over the LTTE, but that remained confined to a segment of the Sinhala constituency but is being eroded even among them. In India, while the ruling coalition seems hampered by the dual centres of power, the prime minister and the chairperson of the United Progressive Alliance (UPA), the opposition party the BJP's top echelon is riven by competing power ambitions. In Nepal, the leadership of most of the parties does not seem to be in command of their respective political agendas and party cadres. The Maoists have already split once and are struggling to cope with internal tensions. The Nepali Congress and the Communist Party of Nepal-Unified Marxist Leninist (UML) leaders have often failed to get their parties to endorse the positions, taken in multi-party negotiations. This has been one of the reasons for the lack of consensus in Nepal, on critical national and constitutional issues. In Pakistan, civil leaders cannot be effective unless backed and endorsed by the military leadership.

Lastly, the political dynamic in South Asia appears to revolve around the struggle for power. Aspiring for power is a legitimate preoccupation of political parties, their leaders and activists. But power for the sake of power or personal and/or sectional aggrandisement is not a creative preoccupation. Power must be seen as an instrument for nation building and national politics must be development oriented, keeping the greater good of its people at the top of the agenda. Failure to strike viable power-sharing arrangements has created serious distortions in national agenda, time and again in South Asian countries.

The prospects that any of these three constraining factors, of institutional erosion, leadership deficit and power agenda, that are having an adverse effect on political stability and governance, will be moderated in the foreseeable future appear to be dim. One can hope against hope, that in Pakistan, the new government manages to keep the military from interfering in political processes, and is able to get a handle on how to deal with the monster of extremism and violence. But this is a tall task. One may also hope that the forthcoming elections in Nepal and the Maldives will result in greater institutional stability and a constructive direction. And also, that the forthcoming elections in India and Bangladesh may bring such governments to power, that do not deviate from the developmental agenda of their respective countries.

South Asia's growth dynamic looks a shade better than the spectrum of its political stability. Barring Nepal, Afghanistan and Pakistan, the rest of South Asia has maintained a reasonably satisfactory growth momentum for the past decade or so. The growth trajectory has been adversely affected by the negative global trends in the past couple of years, and the region as a whole has also suffered owing to India's slower economic performance. According to World Bank estimates, 2013 may see a better rate of growth, from 4.7 per cent growth in 2012 to 5.5 per cent in 2013, if the countries of the region can put their fiscal houses in order and "boost private investment". "How countries manage their economies in the face of uncertainties in the global environment will be critical not only for addressing near-term current account and fiscal deficits but also for tackling South Asia's long-term challenges".²² And in terms of the long term challenges, political stability and the related factors of institutional credibility, leadership dynamism and developmental agenda of politics could play a major role. In addition, analysts have also underlined the role of regional cooperation, and the harnessing of South Asia's natural resources, for the collective regional good. What is inhibiting a regional perspective among the countries of the region, according to Dr. Shekhar Shah, Director General of India's National Council for Applied Economic Research (NCAER) is the narrow national approach. He said:

Each country has political compulsions that draw away most of the political leadership...we need to think about the shared future that South Asia has, it (is) the largest concentration of poor people in the world, if we are going to tackle global poverty...this is where the real changes will have to happen.²³

The overall nature of politics will therefore, continue to interfere with the growth mechanism, both at the national as well as the regional level.

Summing Up

We are still far from understanding the real nature of the relationship between political stability and economic growth. The assumption of governmental or executive stability, that includes its smooth and periodic transition as the whole truth of political stability, has proved to be misleading in understanding economic dynamics, at least in the South Asian context. It may be safe to assume that a politically stable government would facilitate economic growth, but one has to go beyond the structure of government and scrutinise institutions, leadership, the nature of political agenda, level of conflicts and social mobility and a host of other related political factors to see how they will shape the factors of growth. If the institutions, leadership and political agenda are not geared to developmental politics, no degree of political, or governmental stability can ensure economic growth.

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2

Dynamics of Political Stability in India

E. Sridharan

Four Major Challenges

Presently there are four broad types of challenges to political stability in India. First, secessionist insurgencies, such as in Kashmir, Nagaland, Manipur and Assam (e.g., ULFA). Second, non-secessionist insurgencies: primarily, the Maoist insurgency, and secondarily, insurgencies which seek to break up existing states, and carve out new states or new regions within states, such as the Bodoland area. Although they are non-secessionist insurgencies, or simply non-secessionist agitations, nonetheless, they are a threat to political stability. Third, communal and ethnic violence, such as Hindu-Muslim riots, attacks on minorities (e.g., attacks on Christians) and the Bodo versus Bengali Muslim riots recently in Assam. Fourth, the nature of coalition government in India, which is the main focus of this paper.

In the first 42 years after independence, from 1947 to 1989, except for the Janata Party interregnum, there was single-party majority in the Indian Parliament: India had successive governments of the Congress Party. One overarching umbrella party ruled India. Further, even the Janata Party, which was an amalgam of four or five smaller parties, was technically a single party. So, there was a system in which there were single-party majority governments.

Decoding Exceptional Coalitions

In contrast, in the seven consecutive elections since November 1989, there have been seven electoral outcomes, wherein no single party has got a majority in the Lok Sabha, thereby necessitating solutions to hung parliaments. Solution to a hung parliament can be either in form of a minority government, which can be a single-party minority government, a minority coalition or a majority coalition. So, there have been essentially minority and/or coalition governments. The minority government can also be a coalition dependent on outside support, like

the incumbent United Progressive Alliance II (UPA II). Since 1989, and especially since 1996 (the 1991-96, Congress government of Narasimha Rao achieved majority through inducements and/or defections in the middle of its term), we have had coalition governments throughout, and all of them have been minority coalitions dependent on outside support. A minority coalition means that the outside supporting parties do not have ministerships in the coalition of parties that form the Council of Ministers. They are in that sense technically outside but supporting. This has been a challenge. Such a coalition has been a new kind of governmental regime in the sense that a challenge to stability can arise anytime by withdrawal of members of the governing coalition or of its external partners. For example, in September 2012, Trinamool Congress withdrew support from the incumbent coalition, which necessitated the leading party to look for outside allies for support: the Samajwadi Party and the Bahujan Samaj Party finally gave their support.

Unlike the international dataset on coalitions, in the 10 coalitions, including the 12-day Vajpayee government in 1989, eight have been minority coalitions, and all have been minority governments, except the second half of the Narasimha Rao government's term. This has been exceptional in the coalition literature. Minority governments, whether coalition or single party, have been only a relatively smaller part of the solution to hung parliament situations in most long-standing democracies. In India, since 1989, all of them were minority governments; eight out of the 10 were minority coalitions dependent on outside support, including the National Front (NF) government of V.P. Singh, the United Front (UF) governments of H.D. Deve Gowda and I.K. Gujral, the Vajpayee government of 1998-99, the NDA government of 1999-2004, the United Progressive Alliance I (UPA I) of 2004-2009 and UPA II of 2009 onwards. Not only in terms of international data have these been exceptional, they have also been exceptional in that they have been among the largest coalitions in the world with six to 12 parties participating in the council of ministers. In most cases, except one or two exceptions in Israel and Belgium, there were two, three or four parties in coalition governments. We have had an exceptional coalition situation since 1996. What challenges does it pose? Has it posed a challenge to Indian democracy at a broader level and to political stability at the governmental level, that is, the level of stability of a particular government?

Accommodative Democracy

If we refer to the literature on Indian democracy, there seems to have developed a sort of a cottage industry on "India as a successful and stable democracy despite lacking the standard preconditions". Although India is largely poor and rural; not developed; not industrialised; has religious, linguistic, ethnic and cultural heterogeneity and so on, yet it has been sustaining democracy for 65 years. Both poverty and extreme heterogeneity are normally considered to be ill-suited to

maintaining or constructing a stable democracy. However, India has been a stable democracy despite that, and there has been considerable literature around it, most of which explains this phenomenon in terms of India's power-sharing system. Different scholars have used different terminology to essentially express the same idea. According to Arend Lijphart, India is a consociational system; Ashutosh Varshney or Aseema Sinha argue that the vote gives the poor the capacity to put pressure on the government, to implement at least, partial anti-poverty programmes and, therefore, meet the needs of the poor to some extent, thereby stabilising the system in a sort of a self-reinforcing cycle. Scholars like Atul Kohli argue essentially that it is a power-sharing system. And by arguing that India has remained a stable democracy despite not having the pre-conditions or having adverse conditions because the Indian system is essentially a power-sharing system, the scholars are emphasising the presence of a federal system, linguistic federalism (after the 1956 reorganisation of states on linguistic lines), clear minority rights and reservation for historically underprivileged groups like Scheduled Castes and Scheduled Tribes. Thus, it promotes inclusiveness and an idea of the nation which is pluralistic, does not entrench or establish any religion and is not majoritarian in a religious, ethnic or linguistic sense. So, because of the power-sharing character of the Constitution, the practice of politics in India so far has been accommodative and not exclusionary, and the political system is institutionally and systemically a power-sharing system.

How does this change with the challenge to political or governmental stability through very large coalitions of six to 12 parties, which have been dependent on outside support in the period since 1996? Is this a threat to the system or is it actually in some ways reinforcing the system? My argument is that it is actually reinforcing the system. If one looks at the data in the period since 1989, as many as 35 parties—large, small and tiny—have had ministers in the government at the centre, 35 parties plus six independents have been participants in the central council of ministers. This indicates an extraordinary level of inclusiveness and gives a voice to a range of small interests. Particularly, when most of these parties are based in a single state, they either articulate state interests or the interests of specific segments within states. So, a very large number of small interests, which earlier might not have had a voice, have actually got accommodated in the central council of ministers in the period since 1989, and especially since 1996. In a sense, despite the size of the coalitions, their minority character and dependence on outside support, the coalition phase has been remarkably inclusive, which can be seen or read to be actually reinforcing the power-sharing character and, hence, the stability of India's democracy. While it is a challenge to maintain the stability of governments, the stability of democracy has actually been reinforced. At least, that is my reading of the coalition phase.

To take the argument further, if one looks at the external supporting parties, there have been 34 plus five independents who have been external supporters,

which overlaps with the first figure I gave. Some of them in a few coalitions have been in the government, while some have given outside support. In addition, there are pre-electoral coalition partners which have not won seats, but whose vote share is important. Therefore, indirectly, they have some say or voice: there have been six which have not found ministerships, but they have been important pre-electoral coalition partners. Further, at any given time, a large number of states are ruled by parties which are not in power at the centre, but are in the opposition (the principal opposition, aligned or not aligned to the principal opposition). So, there is diversity and accommodation of parties at that level too in terms of being in power in the states. The whole coalition period, though it may seem extremely messy and extremely unstable in the sense that there is a mind-boggling range of parties (large, small and tiny), has actually contributed, one can argue, to the power-sharing character of the system, which has been a major factor in sustaining Indian democracy.

Managing Coalitions

Even in the management of coalitions, from 1977-79 onwards (the Janata Party coalition era), there has been a sort of learning process. Parties have learnt how to play the game of managing them, so that the last three coalition governments, NDA (1999-2004), UPA I (2004-9), and the current UPA II, if it lasts its full tenure until 2014, will be three full-term coalitions, and that too very large coalitions by international comparison. This has largely been possible because of an on-going learning process in the sense that certain devices which have been common internationally have been introduced. For example, diverse parties no longer need to be united artificially, which was what the Janata Party did, and then it broke up. Later, the V. P. Singh government kept the BJP and the Left outside the coalition government as external supporters, despite having one-to-one seat adjustments in the election. Further, the two UF governments introduced, what is in the West called a coalition pact. This pact essentially deals with a common minimum programme, or a publicly declared programme, to the effect that a compromise is reached even when the interests of the coalition partners are not coinciding resulting in a public programme. It is a device used internationally to stabilise coalitions. It has been used in India too since 1996 as a coalition management device, and a steering or coordinating committee has functioned intermittently, more in some coalitions and less in others. So, there is a learning process in the management of coalitions that is observable, including a common minimum programme, a steering committee and consultations among party leaders, which would have led to, if 2014 is reached by the incumbent government, three large, full-term coalitions, that too, minority coalitions dependent on outside support.

One can argue that over a period of time, the coalition game is being learnt to be played, and it has also basically reinforced the core power-sharing character

of the Indian system, which, as mentioned earlier, has sustained India's democracy. Therefore, I would basically argue that coalition governments may seem to be rather messy and there are threats to governmental stability; however, coalitions have actually contributed to the stability by reinforcing and further making inclusive the power-sharing character of the political system. Therefore, while management of coalitions remains a challenge to political stability, it is not something which is insurmountable. Despite recent developments, the Indian system has shown that stability in coalitions can be achieved.

But this learning process of stabilising coalitions has happened against a favourable backdrop: the past 20 years have coincided with the post-1991, post-reform high-growth phase. So, it can be said that the process has not been challenged by a serious downturn as yet. (Internationally, it has been observed that coalition governments become unstable when they are hit by economic downturn, and then the problem of how to distribute the burden of fiscal cuts or other resource crunches between coalition partners and important interest groups which would be affected, at least in the short term, arises.) So coalition politics in India has stabilised itself against a favourable backdrop of high growth over the past two decades, and has not been seriously challenged by the downturn. However since 2012, the incumbent coalition government has been facing that kind of challenge while heading into the unfavourable part of the electoral cycle, as the 2014 election approaches. Thus, there is now a renewed challenge to political stability in India, at least in terms of stability of coalition governments as it is now that the downturn has to be managed by a coalition heading into an election in a fairly short period of time.

3

The Future of Democracy in Pakistan

Sushant Sareen

A New Beginning

The successful conclusion of general elections in May 2013, followed by the smooth transition of power from one civilian government to another, a first in Pakistan's sordid experience with democracy, has raised the hopes of many within Pakistan and without, that a paradigm shift has taken place in Pakistan's political system and structure and democracy this time is here to stay. Adding to the sense of optimism is that fact that Nawaz Sharif, whose commitment to democracy and civilian supremacy is no longer in any doubt, has been elected to the office of Prime Minister, his third stint in the top political job in that country. What is more, Nawaz Sharif does not suffer from the disadvantages that his predecessors in the previous National Assembly suffered. He has a very comfortable majority (nearly two-thirds) in the National Assembly and doesn't depend on his ability to manage an unwieldy coalition to survive in office. His party is in power in the province that serves as the centre of gravity of political power in Pakistan—Punjab. The Pakistan Muslim League-Nawaz (PML-N) has also emerged as the single largest party in the restive Balochistan province, where Nawaz Sharif very graciously conceded the office of Chief Minister to a smaller party which is part of the coalition in Balochistan, thereby winning immense goodwill (more outside Balochistan than in that troubled province) and earning kudos for displaying statesmanship. His refusal to bite the bait of robbing Imran Khan's Pakistan Tehrik-e-Insaaf of the opportunity to form a government in Khyber Pakhtunkhwa has also enhanced his standing.

Not only is Nawaz Sharif well placed politically, he also has other things going in his favour. The judiciary, which was unabashedly hostile towards the Pakistan People's Party (PPP)-led government, is both beholden (he was responsible in large measure for the restoration of the chief justice and other judges in 2009) to Nawaz Sharif and friendly towards the new government. Many of the judges

share an ideological affinity with the conservative and right wing PML-N government. The Pakistan Army, despite its apprehensions about Nawaz Sharif's born-again democratic inclinations, is neither in a position nor keen to overthrow a legitimately elected government and take over the reins of power. The media is also not tearing into the PML-N as it did to the PPP. This is partly the result of the right-wing proclivity of many media personnel and partly the result of the legendary media management skills of the PML-N. Finally, there are the militants and jihadists who could destabilise the new government and, by extension, democracy. But despite the massive spike in terror attacks since the new dispensation has taken office, the fact that Nawaz Sharif and his camp followers are perceived to be soft, if not friendly and apologetic, towards the jihadists could result in some sort of an uneasy accommodation between them. Of course, this will at best be a temporary arrangement, and eventually the state will have to either exterminate the terror machinery or else succumb to it. Needless to say, the latter option would mean the death of democracy.

Managing Old Problems

While the peace moves with the Taliban and other sundry Islamist terror groups do not hold promising prospects, challenges and tensions are also likely to emerge and erupt with the military, judiciary and media. Within the first 100 days of the new government, the judiciary has already started interfering in government decision-making. Appointments to some institutions and commercial undertakings have been set aside by the courts, increase in electricity tariff and taxes on gas have been questioned and suspended, development plans and privatisation of state-owned enterprises are also being challenged in the courts. For now, the government is obsequiousness personified before judicial assertiveness and activism. Analysts believe that this attitude could change post-December 2013 when a new chief justice takes office. But if the next chief justice continues along the same path as his predecessor, then the government could enter into a clash with the judiciary. If, however, the Nawaz Sharif government continues to surrender before the courts, then the reform agenda that is so desperately needed, and yet so difficult to implement, will have to be jettisoned.

It is also too soon to write-off the military's role in politics as a thing of the past. Although it is possible that the army will not show its hand openly, it will want to continue to call the shots on issues like relations with India, Afghanistan, and the US, the nuclear programme and policy on terrorism. Over the years, the army has developed the ability to orchestrate situations in which it is able to push the government in a corner, where it is left with no choice but to kowtow to the wishes of the army. Something of this kind may have already started with the spike in tensions along the Line of Control in Jammu and Kashmir. The frequent breakdowns in the ceasefire and the rising incidents of infiltration and cross-border raids are aimed at not only sabotaging Nawaz Sharif's peace overtures

to India, but also weakening him politically among his core right-wing, conservative constituency. The media too has started targeting the government for taking some tough decisions on the economic front, and as things become more difficult, the temptation to muzzle the media will be too great to resist. It is at that time that Nawaz Sharif's credentials as a democrat will be tested. What will also be tested is the resilience of democratic culture in Pakistan.

This is precisely the reason why every time anyone claims that a tectonic shift has taken place in Pakistan and democracy is finally here to stay, it becomes difficult not to quote the noted Pakistani lawyer and constitutional expert Aitzaz Ahsan: "The only thing predictable in Pakistan is the past." If the past is anything to go by, then the future of democracy in Pakistan doesn't seem to be very bright. If anything, it is very uncertain, more so in light of the enormous strain that the latest democratic experiment has had to put up with, since the ouster of the regime of the former military dictator General Pervez Musharraf. But for the considerable flexibility, or if you will pusillanimity, and compromise which President Zardari showed while at the helm of affairs, it is highly unlikely that the democratic system would have survived for as long as it has.

Politico-Military Dynamic

At the risk of sounding facetious, even clichéd, Pakistan can be said to have a two-party system: the military establishment and the civilian political parties. Each normally enjoys a 10-year stint in power (give or take a few years), and interestingly, both call their tenures democracy. Field Marshal Ayub Khan called it 'Basic Democracy'; Musharraf called it 'Real Democracy' and insisted that his rule embodied 'the essence of democracy'. The civilians also called their stint in power 'democracy'. The other thing which is common to both the military version of democracy and its civilian manifestation is that they both exact what the late and much-lamented Benazir Bhutto so evocatively called the 'revenge of democracy' on the people of the country.

In recent times, there has been a lot of hyperbole about how much things have changed in Pakistan and how democracy with its warts and all is here to stay. But if there are two things in which the word irreversible should never be used, it is the Indo-Pak peace process and democracy in Pakistan. Both are eminently reversible and calling them irreversible is nothing short of tempting fate, or worse, the usual suspects (Military, Mullahs and Mujahids backed by the Munsifs or the judiciary which rubber-stamps and sanctifies usurpation of power), who incidentally play the spoiler with regard to both democracy in Pakistan and India-Pakistan relations.

But this is not to deny that some things have indeed changed in Pakistan, and new factors and players have entered the scene. For instance, there is the emergence of an extremely assertive and activist, even interventionist, judiciary.

Then, there is the media which has also become a factor to contend with. More importantly, Pakistan has seen a radically different attitude on the part of the main opposition party, which instead of conspiring with the proverbial 'third force' (read Army) to destabilise the incumbent government has actually played a role in preventing any extra-constitutional intervention. During the tenure of the PPP government, the leader of the main opposition party, Nawaz Sharif, surprised both his supporters and detractors by strongly resisting any and every attempt to become a handmaiden for an extra-constitutional intervention by the military or any other usurper. Now that Nawaz Sharif has assumed the reins of the government, the PPP has been playing the responsible opposition, which opposes the government without doing anything to destabilise it. With no credible political player ready to provide the political fig leaf for an extra-constitutional takeover, it has become much more difficult for the military establishment to overthrow the elected government.

Apart from the fact that the political class has been closing its ranks, the military is also faced with another serious problem that does not allow for direct intervention in the political system. It has been overstretched because of two insurgencies: the Islamist insurgency in the Pashtun belt of Khyber Pakhtunkhwa, Federally Administered Tribal Areas (FATA) and parts of Balochistan by the Taliban and other al-Qaeda affiliates and the Baloch insurgency in the Baloch belt of Balochistan. Moreover, there is as yet no great appetite for military rule among the public. The reason for this perhaps lies in the fact that the civilian interregnum has just about reached its mid-term of 10 years, and despite all the anger and frustration over the dismal performance of the civilian governments—Nawaz Sharif's 'honeymoon' did not even last 100 days before the public disillusionment set in—the army has still not been able to erase the memories of Musharraf's era from the public's mind. The military is also mindful that the international situation is not exactly conducive for a coup maker.

All these positive developments are, however, not as firmly established as many people would like to imagine. Rather they are still somewhat fragile and in a transient stage, and how they ultimately settle down is uncertain. For instance: Will the opposition parties in the future continue to act as responsibly as Mian Nawaz Sharif, who ensured that the Zardari-led dispensation was not destabilised to a point that paved the way for an extra-constitutional intervention? It is important to bear in mind that many people in his own party (including his younger brother Shahbaz Sharif) were not averse to conspiring with the army to see the back of the PPP government. Then there is the question of whether and for how long the army will continue to suffer its image problems and lack of political support. Will the next crop of generals, many of whom are believed to have been quite keen to see the back of the government by means fair and foul, show the same amount of forbearance that General Kayani has done? Will the judiciary's stock continue to be as high as it has been in recent years? Or will the

financial and other shenanigans of judges and their sons sully the image of the judiciary and bring it crashing down to the ground making it impossible for it to play any role in blocking another man on the horseback from usurping power? And will the media continue to be a factor or can it once again be muzzled or at least made compliant? Notwithstanding the Pakistani media's delusions of having become a critical player on the political chessboard, in reality, it has more been played than been a player.

Apart from how effective a role these so called positive developments play in the survival of democracy in Pakistan, there is also a chance and a real danger of their becoming the biggest hurdles for the survival of democracy. The ugly reality of power politics in Pakistan was succinctly summed up by former Prime Minister Shujaat Hussain, who said that all it takes to mount a successful coup is one jeep and two trucks. And when one jeep and two trucks move, one of the first things that is done is that the judiciary is sacked or at least those judges who do not swear loyalty to the new regime.

Of course, the army does not move in just on a whim or a fancy. Invariably conditions exist or are created that allow for the military to take power. Moreover, these conditions are of such nature that it is no longer possible or feasible for the military to pull strings from the sidelines, which they do even otherwise during the civilian phase of democracy. Normally, every military coup is treated with relief and even celebrated when it takes place. In other words, not only is the coup popular, but it is also a measure of the unpopularity of the civilian political class. In that sense, perhaps, it can even be termed a democratic change of power.

It is another matter that within a few months or a couple of years disillusionment sets in. The military regime becomes unpopular and then is ousted either through an act of God, as in the case of General Zia, or through popular uprisings and street protests, as in the case of Ayub and Musharraf, or in the aftermath of a lost war, as in the case of Yahya Khan. The only saving grace for Pakistan is that when the military takes over, it is an institutional action, but the regime which follows is that of an individual, and that is the one of the main reasons for the transfer of power from civilian to military after every decade or so.

In the past, the real danger to a civilian set up was invariably from the military. But now a new source of danger has emerged—the judiciary. A lot of airtime and newsprint has been wasted on holding up the judgement in the Asghar Khan case, as a landmark in blocking the path of the military from intervening in the political process, directly through a coup or indirectly through manipulating elections. But the fact is that such 'landmark' and 'historic' judgements have been passed earlier as well. Only they never stopped the army when it felt that it had to step in supreme national interest. And if and when the army feels, it will move in regardless of what the judges say or do. While the current judiciary

has been very quick to insult and humiliate civilian politicians, it understands the power dynamics in Pakistan very well. It is therefore very circumspect and careful in administering to the generals the treatment that it metes out to civilian politicians.

The head of the Abbottabad Commission, Justice Javed Iqbal, when asked in the Missing Persons (enforced disappearances) case why he didn't summon the heads of the intelligence agencies or the generals who are responsible for human rights violations, said that last time the judges mustered the temerity to do such a thing the generals sent them back home, and therefore no one should expect the judiciary to go down that path again! Even as the judges hurl a lot of empty threats against the generals, there has been absolutely no action taken or order passed against a single serving military officer. But when it comes to humiliating ministers and top non-army officials, the same judiciary does it at the drop of a hat. Clearly, Pakistan's newly independent and empowered judiciary has imbibed the paraphrased Stalinist dictum: "How many divisions do the Judges command?"

Probable Spoilers

The point is that while the danger to the civilian-led democratic order remains very much in place from the military, the judiciary too has become a danger to democracy. The judiciary has broken new and very dangerous ground by sacking a sitting prime minister on charges of contempt of court. In another ruling on the law and order situation in Balochistan, the court practically called for the dismissal of the provincial government by pointing to its failure in maintaining law and order in the province. In such a case, what happens if the federal government resists acting on the basis of such an observation or even ruling by the judges? Will that mean that the President, who has to issue an order for dismissing a provincial government, will become liable for contempt of court and therefore be sacked. As if this was not enough, the Lahore High Court passed an order in the so called dual offices case, and held that Asif Zardari could not hold a party office, as well as be the President of the country. Clearly this judgement was aimed at an individual, a man who is reviled by the right wingers in Pakistan. Shockingly, the judges who are unelected and who are increasingly acquiring the character of a self-perpetuating mafia, wherein they select themselves without any parliamentary oversight—both the judicial commission as well as the parliamentary commission for selection of judges to superior courts have been rendered toothless—have acquired the power to make and break governments. The judicial excesses have ranged from setting the price of sugar to taking Suo Moto notice of an actress carrying two bottles of wine in her luggage, from making the Constitution (e.g., in case of the Judicial Commission) to deciding posting and transfers of officers and from determining salaries of policemen to passing rulings on economic policy making. It is an endless series

of bizarre interventions, which effectively has made the judiciary arrogate to itself the right to make and break laws according to its interpretation of the constitution. Of course, for all their grandstanding, the judges are no less corrupt, nepotistic, politically partisan, averse to any sort of accountability, intolerant of any criticism and, to top it all, as inefficient as any other section of society or an institution of state. Therefore, their ability to put things right is as suspect as that of anyone else.

Apart from the military and the judiciary, there are two other very big threats that any sort of a democratic order will confront in Pakistan. The first is the failure of the political class to provide good governance and solve the problems facing the state and society. This is something that creates a vacuum which has generally been filled by the military and now increasingly is sought to be filled by the judiciary. But the failure of governance is only partly the fault of the political class. The other part of the blame must be shared by the military and the judiciary which played a highly destabilising role in keeping the government unsettled, which has then had an adverse impact on its ability to govern what is not an easily governable country in any case. This, however, doesn't absolve the political class of its glaring failures in managing the economy, law and order, delivering public goods and on practically every other thing. At the same time, it would be unfair to not appreciate some of the good that the political class has done by settling issues that even military strongmen and judicial fiat couldn't do. For instance, restoring the constitution, devolution of administrative and financial powers to the provinces, thereby addressing a long standing grievance of the smaller provinces and making an effort to legislate not always by majority but by consensus. Much of the credit for this should go to Asif Zardari and the PPP, which has tried to break the traditional mould of confrontationist politics by ushering in what they call the politics of reconciliation. One sterling achievement of the PPP dispensation was the enormous tolerance it showed towards the perpetually hostile and often unfair criticism directed towards it by the media. The PPP can also legitimately claim that this is the first government which held no political prisoner (except perhaps in Balochistan where political activists were kidnapped, tortured and finally killed, and their mutilated bodies dumped on the roadsides or in remote areas), or which has not tried to exact political revenge by instituting false cases against political opponents. In a sense, this is what the essence of democracy is.

Aside of the governance deficit, the other very big threat to democracy is from the rising power of religious extremists and the growing intolerance in society. The latter is manifest on issues like blasphemy. The former are manifesting themselves in the rise of organisations like the Taliban and other terrorist and extremist organisations like the Jamaat-ud-Dawa/Lashkar-e-Taiba. Instead of becoming a uniting factor, Islam is probably the most politically divisive factor in Pakistan today. The country is split right down the middle on the issue of how

to handle extremism. There is no clear idea or plan, much less any coherent strategy, in place to fight extremism and radicalism. There is also no clarity on whether democracy is Islamic or un-Islamic with even Islamists divided on this issue. It is true that the Islamists do not get many votes, but it is equally true that they are not looking for votes. They have enormous street power which they use to exercise a veto over everything they don't like. They use it to push through with their demands and, more importantly, control the debate and discourse in the media.

On the eve of the general elections, new schemes and proposals were being floated to change the structure, character and operation of democracy. Most of these proposals were basically aimed at ousting the political class and replacing it with an unelected and unelectable lot, which believes that it knows what is best for the people of the country. For instance, a retired foreign service official, who not surprisingly studied at a top British public school, advocated a restricted franchise system. A top technocrat who was Musharraf's science and education policy advisor wanted an Iranian type council of elders, controlled by the judges, to vet candidates before an election. Other public intellectuals rooted for a presidential form of government because according to them the current parliamentary form is irretrievably broken. There were also proposals for reducing the term of office to four years, which is the average length of time before the public's and the establishment's patience runs out with whichever government is in office. Retired generals came out of obscurity and asked the country to be saved from itself, because the people were incapable of judging what is best for them. Some called for replicating the Bangladesh model, in which a government of technocrats would run things with the help of the judges and generals, to put things back on the rails. Needless to say none of these people were capable of even winning a resident welfare association election. Moreover, none of them would be caught dead hobnobbing with the 'great unwashed', and yet they were so self-assured about knowing what is best for the people and the state. Above everything else, it is this patronising and patriarchal mindset that is the biggest threat to survival of democracy in Pakistan. Furthermore, as the Nawaz Sharif government comes under pressure both for the decisions it takes, and those that it refrains from taking, these pressures will only increase.

The future of democracy, therefore, appears to be bleak. The 2013 elections and the smooth transfer of power in Pakistan from one civilian government to another, while being a necessary first step in the direction of democratic consolidation, is not sufficient for ensuring the survival of democracy. Without fundamental changes in the way people think, the way institutions function, the way government performs, the way politics plays itself and way the new government is able to establish civilian supremacy over the military, a cloud of uncertainty will remain hanging over the future of democracy in Pakistan.

4

Challenges to Democracy and Pluralism in Bangladesh: Structural and Institutional Imperatives

Smruti S. Pattanaik

As is the case with most post colonial states, the consolidation of democracy as a form of government, has been a major challenge for Bangladesh. Weaknesses in the institutional framework coupled with a weak judiciary, a politicised bureaucracy and a patronage based political culture, have led to institutional decay. Rising religious fundamentalism and *mastan* politics have corroded the pluralistic character of the society and politics. The politics is further divided because of the entrenched positions of political parties on different issues, the zero sum game attitude, and the ideological divisions inherent in their perspectives on the creation of Bangladesh, and its early history. The partition of Bengal, the creation of East Pakistan, and the later liberation of East Pakistan and the birth of Bangladesh, have left an indelible mark on the nation's history, and on the debate on the place of minorities in the nation state. The partition of the subcontinent had not only changed the cartography, but had also partitioned the shared history and socio-cultural heritage, into 'ours' and 'theirs'. This political rupture was followed by bloody violence, where people who had lived together for centuries, killed those who became the 'others', in the new construct that emerged after 1947. This violence also gave credence to the enemy discourse, nurtured and sustained by political actors with a vested interest in this narrative. It was based on the belief that religion was a monolithic identity and basis of state formation, which divided the ideological landscape of the state. Assertion of identity based on ethnicity and language posed a threat to this newly constructed entity that was based on religion. Rather than accepting the diversity within the state, characterised by plurality of culture, religious beliefs, sectarian differences; the post-colonial states increasingly developed a sense of insecurity regarding this plurality, and accused those who demanded recognition for this diversity and political autonomy, of following an enemy-driven agenda to break

up the unity of the state. Narratives, that emphasised the homogeneity of religion, also resulted in a centralised state structure, where security of the state became a predominant feature. Within these parameters the democratic right to dissent, freedom of expression and criticism of the government was not tolerated. Democracy and pluralism became a casualty in this conception of a monolithic state, whose reference point became the partition and the two-nation theory. Bangladesh's birth and its journey as a nation state and its attitude towards pluralism, cannot be divorced from these narratives.

Bangladesh was born out of its quest for pluralism and democracy, which was denied in the erstwhile Pakistani state. In view of this background, the question is: How was the Bengalis' quest for secularism—that recognises religious pluralism and democracy—reflected in the state of Bangladesh. While the structure of the society and its ethos are a historical inheritance, the political aspect emerged after its independence. The societal structure and its cultural heritage informed the constitution and institutional framework, that was created to nurture its socio-cultural inheritance. In the context of state formation, it is important to therefore to examine the kind of institutional framework, needed to translate these socio-cultural and political aspirations into reality. What are the challenges to democracy and pluralism in Bangladesh? Are they structural or are they born out of contested politics of Bangladesh where political narratives (Bengali or Bangladeshi) constrain the debate on religious and cultural pluralism? Does the institutional structure of democracy protect the plurality of opinion and the environment to express them? This paper focuses on these issues in the context of political transition in post-colonial countries. It examines them within the structural and institutional framework of the Bangladesh state and democracy.

The creation of Bangladesh and Pakistan “did not resolve questions of national trust and stability of political integration and cooperation”.¹ Rather, it reignited old debates on state and nationhood. The role of political leaders in the liberation war became a highly contested reference point, when they claimed political legitimacy to assume power during the democratic experiment. Terms such as ‘freedom fighter’ and ‘collaborator’, depending on the role of an individual during the liberation struggle, divided the Bangladesh polity. The state that was founded to fulfil the democratic aspirations of the people, soon gave way to intolerance and complete devotion to the political leader, which is the antithesis of democracy and pluralism. The post colonial state became too conscious of its political identity, and the democratic experiment frequently fell prey to dictatorship, in the name of preserving the state.

Structural Basis and Nature of the State: The Quest for Democracy and Pluralism

Democracy cannot function without pluralism, that not only involves the recognition of diversity: of religion, language and culture and the need to preserve them; but also encompasses plurality of opinion, the right to dissent, and a system

that ensures a level playing field to all its citizens. An independent media and judiciary nurture an environment which makes this possible and are also significant in any democracy project. The constitutional structure needs to guarantee the rights of the minorities and prevent discrimination against them, to protect the plural structure of society. No discussion on democracy is possible without a discussion on the societal character of the state, level of political development, the political environment and its institutional structure, to assess, whether these are conducive for the survival of democracy or not.

The structural basis of the state greatly influences the political institutions. Bangladesh is a Muslim majority state. The language of the majority is Bengali. However, other minority ethnic groups also live in Bangladesh, and are mostly referred to as *adivasis* or indigenous people. The concept of indigenous people has become a contested issue in the recent past. Given the politics of language and religion, political parties have tried to shape the character of the constitution according to their ideological preferences. Though majoritarianism is part of democracy, over a period of time, tolerance towards religious and ethnic minorities has eroded, with a growing emphasis on the politics of religion. The context of state formation has informed its democratic basis. Bangladesh was under direct military rule from 1976-1990 and under semi-military rule from 2007-2008.

The State of Bangladesh was created to fulfil the democratic aspirations of the people yet from the beginning the state was not seen to be giving equal treatment, to a section of its citizens. The relationship between the state and its citizens underwent change, and this impinged on democracy. The Chakmas and other indigenous groups, as well as the religious minorities are not treated at par with other citizens by the state. After the creation of Bangladesh, the state instead of recognising the rights of the minority tribal groups, exhorted them to become Bengalis. As 'being Bengali' became the definition of nationhood, the Chakmas and other tribal groups felt marginalised by the new nation state. To quote Mujibur Rahman:

Our ideology is clear. The ideology has inspired us to attain independence, and this ideology shall constitute the basis of this state. Nationalism-Bengali nationalism-shall be the main pillar of this state. Bengali nationalism encompasses Bengal's culture, Bengal's heritage, its land and above all the sacrifices made by the Bengalis.²

Article 6, para 1 of the 1972 constitution, declared all the citizens of Bangladesh as being Bengalis, thereby excluding the tribes of Chittagong Hill Tracts (CHT) from the political definition of the new state i.e. Bengali nation.

While Bangladesh is a Muslim majority country, its language and culture are largely syncretic, and thus bridge the religious gap between the Hindus and Muslims, given their common cultural heritage e.g. the Bengali language which is also the state language (Article 3). Though the Chakmas and other tribal and

religious minorities like the Buddhists have been living in Bangladesh, there have never been any conflicts over socio-linguistic differences. Religious conflicts between the Buddhists and Muslims are a relatively new phenomenon, which are exacerbated by Islamic fundamentalist elements, as witnessed in the violence in Ramu. A greater majority of them aspire for modern democracy. Therefore, it is not surprising that the military rulers have used the excuse of democratic governance to support their takeover.

The state was founded in 1971 on the principles of secularism and democracy, among others. They embodied the struggle of the people of East Pakistan and their quest for democracy, equal rights, preservation of their language and rejection of religion as the sole basis of the state. What was evident to the people of East Pakistan was that, religious affinity was used to deny them these rights and also deny them their political status as majority, by the 'one unit' formula introduced by General Ayub Khan.

Democracy and democratic norms that were a driving force for the forces of liberation have eroded over a period of time—initially, due to the policies of Mujibur Rahman and subsequently due to the military coups that denied the people their democratic rights. The state became intolerant of voices of dissent and tried to homogenise the plurality of opinion. Mujib's regime had already banned religious political parties, in view of their role in the liberation war. The new state concentrated on targeting the radical left groups who were challenging the state structure. It increasingly clamped down on the youths within the Awami League (AL), who were raising questions regarding the nature of the state, and criticising its elitist structure. In 1972 when Shahjahan Siraj, Abdur Rab and other young leaders left the Awami League to form the Jatiyo Samajtantric Dal (JSD), many leftist political activists and retired army officers also joined them. These youth leaders were opposed to Prime Minister Shiekh Mujibur Rahman, and Awami League politics which they felt was bourgeoisie oriented. By 1974, Mujib had become intolerant of opposing views within his government. Absence of political opposition, hindered the creation of the institutional framework that is needed for the success of parliamentary democracy. The Awami League got 307 seats out of 315 seats, in the 1974 elections. As a result, prominent leaders like Tajuddin Ahmad, who had served as the prime minister of the Bangladesh government in exile, were sidelined. Mujib increasingly listened to those who supported his policies and the cabinet ministers were marginal to any decision taken by the government. Between 1972 and 1974, the government hunted down the left wing radicals, arresting and killing them in the name of maintaining law and order. By 1975, Awami League had emerged as an authoritarian political party that did not allow any space for democratic dissent. Democracy and pluralism for which East Pakistan had fought the liberation war, were given a burial in 1975, with the introduction of the fourth amendment to the constitution that over night changed the parliamentary form of government, to a presidential one.

Mujib declared national emergency, extended the term of the parliament, and banned all political parties, all newspapers, except for the four government newspapers. The president had the sole power to appoint the judges of the court, and the local government system was abolished. The governance structure became monolithic with a one party regime, with the creation of BAKSAL (Bangladesh Krishak Sramik Awami League) through Article 117A. The institutional basis of the state was thus weakened.

Most Bangladeshis therefore did not grieve the demise of democracy after the military coup in 1975, and the assassination of its founding father Mujib. The authoritarian character of military regimes, their ideological stances and their tendency to court the religious right, not only impacted the nascent democracy, but also affected the pluralistic character of its society, and its cultural underpinnings.

General Zia-ur-Rahman who took over power after Mujib's assassination, further amended the constitution. The earlier construct of Bengali nationalism and its replacement with Bangladeshi nationalism, led to the formation of an exclusively Muslim state. The foundational principle of secularism was abandoned and the ban on politics of religion was lifted. This created space for religious political parties. According to an analyst "The proclamation neatly excised all reference to 'secularism'.... It was at its best because the amendments did not really change any of the operative clauses of the Constitution. But they did answer an emotional need".³ However, it needs to be mentioned that this emotional need was a response to circumstances, and was propagated by elements opposed to Mujib, who characterised his policies as 'ungodly'. Since 1947, Muslim nationalism and exclusivity were ingrained in the minds of the people, who were not prepared to concede equal status to the minorities, as citizens of the state. The historical reality that East Pakistan in 1947 was carved for the Muslims, and thus belonged to the majority community became the justification for this. The hegemonic state structure earlier based on Bengali identity and later, on Bangladeshi identity, challenged the pluralistic state structure, by marginalising people who did not fall within this framework. General Zia-ur-Rahman also introduced multiparty democracy by abolishing the BAKSAL system.

Both the regimes—Mujib and Zia—did not face any credible opposition to their regimes. During the Mujib period, there was no opposition political party that could have played a critical role in parliament. The parties that were opposed to his regime had gone underground. During Zia's regime, the main opposition party was crippled as all its prominent leaders had either been killed in the August 15, 1975 military putsch or were subsequently assassinated in the infamous jail killing, in November 1975. The Bangladesh Nationalist Party (BNP) regime that General Zia headed, rehabilitated dissenters from the Awami League, political opportunists and those of the religious right, who were united by their hatred for Mujib and India. As a result, when the Fifth Amendment to the constitution

was passed, the AL chose to walk out. The military rulers legitimised themselves through elections, in which the opposition was not provided a level playing field, or were co-opted as partners. This was evident both in the 1978 and 1985 elections, held by General Zia-ur-Rahman and General Ershad respectively.

The military regime not only did immense damage to democracy, as the army emerged as a political force and consolidated its position, it also initiated certain policies that had far reaching implications for society and polity. Apart from introducing the politics of religion, Zia militarised the CHT and encouraged resettlement of Bengalis in Chittagong, to dilute the numerical majority of the Chakmas. This allowed to him to give land to landless Bengalis, and to prevent the formation of an ethnic homeland that could have posed a challenge to Bangladesh's security. It was during his period that the Chakmas rebelled, as they not only they became marginal to the identity of the nation state, but a minority in their traditional homeland. The situation of the Hindu minorities became vulnerable with Islam being declared as state religion in 1988. They were dispossessed of their property by the Vested Property Act. Some in Bangladesh argue that there was no movement against secularism in the country in 1977, nor there was any pressure to make Islam the state religion in 1988.⁴

The military rulers have also played to the gallery, and have projected themselves as preservers of democracy. For example, General Ershad in his address to the nation said:

The important role played by the Armed Forces to protect the democratic process in the country so long are not unknown to you...The main source of this military rule is the nine crore people of this country, so it is deeply related with the amelioration of their conditions...So our aim is to create a healthy political situation and atmosphere here so that there will be no obstacle towards the growth of democracy and that the country and the nation is not plunged into crisis time and again.⁵

The military had always wanted to be a part of the democratic structure or at least be a part of the decision making process. Parties like the BNP have from time to time, projected the Bangladesh army as the champion of democracy and urged it to protect democracy.

After the restoration of democracy, the ideological divide between the two major political parties—the Awami League and the Bangladesh Nationalist Party—characterised by a deep mistrust of each other, created a space for extra-constitutional entities to intervene. The political class's disregard for democratic politics based on institutional integrity, their disrespect for opposing viewpoints, patronage of *mastans* to pursue street politics, and the electoral arithmetic based on permutation and combination of interests, made both the religious political parties, as well as the army relevant to Bangladesh politics. The erosion of constitutional politics that is the essence of democracy, had started in 1975 during the Awami League's rule.

Institutional Framework for Democracy and Pluralism

Constitutional Politics

The Bangladesh constitution adopted in 1972 was based on four foundational principles i.e. democracy, secularism, Bengali nationalism and socialism which became the core values of the new nation. The constitution guaranteed freedom of speech and expression, and equality to its entire citizenry. The politics of religion was banned. The state had a parliamentary form of the government. Soon after its liberation, the state faced structural challenges, as it did not have enough trained bureaucratic staff to help put the administration in place. Severe shortage of experienced bureaucrats made the government restore the jobs of those bureaucrats, who were opposed to the creation of Bangladesh, and had collaborated with Pakistan. Its economic structure was in shambles as it inherited a post war economy with damaged infrastructure. It faced a famine in 1974 and had to deal with the extreme hostility of some of the major powers of the world. But Bangladesh was governed by a leader, with an overwhelming personality. His incarceration in jail in Pakistan, had not allowed him to participate in the liberation struggle. His dominant personality also made other cabinet ministers appear like midgets, and there was no one to challenge his decisions. Thus, Bangladesh started with a fragile structure that was incapable of sustaining democracy and addressing peoples dissatisfaction.

With the emergence of military leaders like Zia and Ershad, and the rigged elections, the institutional structure of democracy, which is a parliament and constitution, was further eroded. During military rule, local government elections were held, not to strengthen democracy, but to create support structures and legitimacy for military rule. Recruitment and the circulation of the elite are important for democratic polities. But in Bangladesh both these processes were based on a patronage structure that perpetuated supremacy of the party leader, rather than nurturing grass root democracy. Political contestation became the hall mark of mobilisation. There is no dialogue between the government and opposition, as both the parties pursue a zero sum game. This undermines constitutional politics.

Even though the opposition boycotted the parliament, the government as per Article 7B has prevented any further amendment to 55 clauses of the constitution, describing these as the:

...basic structure of the constitution. Notwithstanding anything contained in article 142 of the Constitution, the preamble, all articles of Part I, all articles of Part II, subject to the provisions of Part IXA all articles of Part III, and the provisions of articles relating to the basic structures of the Constitution including article 150 of Part XI shall not be amendable by way of insertion, modification, substitution, repeal or by any other means.⁶

Institutional structures, and relations between different institutions and organs of the government are important for the survival of democracy.

Independence of Judiciary

The High Court in 1999, passed an order for the separation of the judiciary from the executive. But the order was not implemented, and the BNP government took 23 adjournments, before finally a decision for the separation of the executive from the judiciary was taken in 2007, when the military backed Care Taker Government (CTG) took over power. The civilian governments in the past had paid lip service to the issue. While article 116 A reads, "Subject to provisions of the Constitution, all persons employed in the judicial service and all magistrates shall be independent in the exercise of their judicial functions;" in reality, the President continues to make appointments to the subordinate courts. As per the court order, the government is yet to set up a separate department to deal with the transfer, promotion and postings of the magistrates belonging to the judicial service. This power of the government, was responsible for the politicisation of lower courts that deals with local crimes, and decide on the bail for criminals. Most of the *mastans* involved in crimes belong to political parties and they benefit from the politically appointed magistrate and get bail easily. The court's order to separate the judicial service, from the Bangladesh civil service, has been opposed by the bureaucrats from the administrative service, who have been occupying the posts of judges in the magisterial court. The powers of the judiciary that were usurped by the executive in 1975 [Article 115 (appointment to subordinate courts) and 116 (control and discipline of the subordinate courts) of the constitution] remains a feature of the present constitution, and thus undermines judicial independence.

Civil-Military Relations

Civil-military relations in an emerging democracy remain an important factor in democratic consolidation. The military is mostly seen as an alternative to democratically elected authoritarian regimes. For example, a series of coups and counter coups that preceded General Zia-ur-Rahman's military coup, did not encounter any public protest, in spite of the fact that one of the factors that led to the liberation struggle was, refusal of the West Pakistan elite to hand over power to the Bengali elites, who had emerged victorious after the elections in 1970. The past history of civil-military relations in the erstwhile Pakistan state, also cast a shadow over Mujib's government, and to a very large extent shaped his attitude towards the military, that was already politicised, due to its participation in the liberation war. The Bangladesh military claimed a role for itself in the political administration of the state, or at least they did not want the military to remain weak, or to be neglected, in the newly emergent state. The

military tried to gain a greater role in the name of strengthening democracy. Reintroduction of the multiparty system gave General Zia the political distinction of being the one that prevented democracy from turning into autocracy. Ershad also nursed the idea of allowing the army a role constitutionally. In an interview to the *Guardian* newspaper in London, Ershad had said, "...if the army participates in the administration of the country, then they will probably have a feeling they are also involved, and they will not be frustrated."⁷ Post the 1990s, the democratic regimes have catered to the military's demand for sophisticated weapons, modernisation and a larger defence budget. Democratic regimes also explored ways and means to keep the military happy, and also inducted some of them into the political parties. Some leaders like Begum Zia have not hesitated to portray the army as a protector of democracy. Weak institutional structures have allowed the military to play a greater role as in January 2007.⁸ It would be instructive to quote General Moeen U. Ahmed, the Chief of the Army Staff who was behind the last CTG regime, to understand the military's view of democracy and governance:

I reckon, Bangladesh will have to construct its own brand of democracy recognizing its social, historical and cultural conditions with religion being one of several components of its national identity ... I perceive that both democracy and security are complementary features of the system now being put in place by the current initiatives.⁹

The various military coups have crippled Bangladesh's institutional structures. To prevent the reoccurrence of coups, the ninth Parliament passed the Fifteenth Amendment. According to Article 7A (1):

If any person, by show of force or use of force or by any other unconstitutional means: (a) abrogates, repeals or suspends or attempts or conspires to abrogate, repeal or suspend this Constitution or any of its article; or (b) subverts or attempts or conspires to subvert the confidence, belief or reliance of the citizens to this Constitution or any of its article, his such act shall be sedition and such person shall be guilty of sedition.¹⁰

Politicisation of Bureaucracy

The politicisation of the bureaucracy that had started during Mujib's regime, got further accentuated as the military captured power. Emergence of vested interests—Islamists, petty bourgeoisie, and the military's institutional interests—eroded the culture of democracy. This led to the further erosion of the state's authority, and gave rise to multiple centres of interest, led by political parties, NGOs, civil society organisations, Islamists and mafias.

Political change in Bangladesh is accompanied by a reshuffle of the bureaucracy, which involves appointment of key bureaucrats to positions that will give the government a control over the administration. Politicisation of bureaucracy also impacts the efficiency of institutions, as the system functions

within the parameter of rewards and punishment for favouring or not favouring a political government.¹¹ Before the elections, the incumbent government places its key bureaucrats into positions that will help it during the elections. As a result, honest officers are either penalised or they are appointed as Officer on Special Duty (OSD) without any specific charge being given to them.¹² The civil bureaucracy further entrenched itself during the military regime, and attained considerable autonomy.¹³ They partnered the military in ruling the country, who sought to protect their institutional interests by allowing the politicisation of bureaucracy, who in turn saw this as a path to enter politics after retirement, or to get plum post retirement positions.¹⁴ Given the politicisation, it is apparent that the bureaucracy makes an effort to ensure that the same government returns to power, seriously eroding the election process.

Functioning of Parliament

The current *Jatiya Sangsad*, which came into being on January 25, 2009, has seen a very poor presence of the opposition. As of June 2013, the BNP had boycotted sittings of the current parliament for 318 working days. In the BNP led eighth parliament, the Awami League stayed away from the House for 223 out of 373 working days. In the seventh parliament led by the AL, the BNP was absent 135 of the 400 sittings.¹⁵ As one can see, this trend of boycotting parliament has been steadily rising over the years. Article 67 of the Bangladesh Constitution stipulates that any MP who remains absent for 90 consecutive days will lose his seat. Participation of voters in the elections has been increasing since the restoration of democracy. In the 5th parliamentary election there was 55 per cent voter participation; in the 7th, 74 per cent of the voters cast their vote; in the 8th parliamentary election there was a marginal increase; and in the 9th parliamentary election the voters turn out was 87 per cent.¹⁶

There were 319 sittings of the House till September 2012, of which the opposition boycotted 266 and attended only 53. The Leader of the Opposition and BNP chief Khaleda Zia was present for only 8 sittings. The opposition last attended the House on March 20, 2013 and then began a fresh boycott, which still continues.

The Parliament has seven standing committees, apart from one each for various ministries, which are constituted by the *Jatiya Sangsad*. Many argue that though the opposition boycotts the Parliament, it regularly attends these standing committees whose business is:

...to examine draft Bills and other legislative proposals; to review the work relating to the Ministry; to inquire into any activity or irregularity and serious complaint with respect to the Ministry; to examine any Bill or other Matters referred to it by Parliament; and to examine any other matter within its jurisdiction.

According to an *Odhikar* report:

775 people were killed and 58,251 injured in political violence across the country in the last four years till December 31, 2012. During the last four years, the number of highest 251 political killings took place in 2009. At least 382 incidents of internal violence in Awami League and 146 in BNP were recorded during the year 2012. Among the political casualties, 37 people were killed and 4,330 injured in internal conflicts of the Awami League, while six were killed and 1,619 were injured in BNP's internal conflicts last year.¹⁷

Disappearances and encounter killings of criminals have been a regular feature. This reflects the fragility of the judicial system and the culture of violence that permeates each strata of society. The country also witnessed violence against minorities by the Islamists in March 2013. There are also several instances of inter and intra party violence of which little cognizance is taken by the party leadership. The violence is spreading to educational institutions.

The Fifteenth Amendment to the Constitution: Restoring Pluralism

In 2011, the government brought the 15th amendment to the constitution, to restore some of the provisions of the 1972 constitution that had formed the basis of Bangladesh's political structure and its constitutional ethos. The most important feature of the Supreme Court verdict of 2010, was declaring the 5th and 7th amendment to the constitution null and void. The amendments are unique in the context of democracy and pluralism, especially those which relate to religion, language and the judicial structure of the state that plays a role in protecting the constitution. It restored the secular provisions of the constitution but also retained its Islamic provisions, thus continuing to give primacy to Islam. Restoration of Bengali nationalism does not give much confidence to the indigenous people who are not Bengalis. The Bangladesh Constitution includes, provisions relating to national culture¹⁸ (Article 23) and the culture of indigenous groups (Article 23 A) which is not considered to be a part of national culture. It retains the exclusive religio-linguistic characteristic of the state undermining the country's plural character. While the plural socio-political dynamics of its society got subsumed in the majoritarian socio-cultural religious ethos, the space for freedom of expression and the independence of other organs of the state was restricted. For example Article 70 that restrains members of political parties from expressing their differences with party policies, continues to be part of the constitution.

Process of Election: Caretaker Government and Election Commission

Elections and political transition are an inalienable part of democracy. In Bangladesh, the mode of political transition has been highly contested. The four

elections after the liberation of Bangladesh took place, when the incumbent governments were in power. However, after the transition to democracy in 1991, the holding of free and fair elections, has become an important issue. Political parties were distrustful of the Ershad regime, and thus the innovative formula of holding elections under a Care Taker Government (CTG) became an imperative. The suspicion and mistrust between the two political parties, coupled with a politicised bureaucracy made the CTG a permanent feature of political transition till the 2008 election.

The CTG is a unique feature of the Bangladesh constitution (Article 58, abolished by the 15th Amendment to the constitution, 2011). This was introduced as the Election Commission was not perceived to be neutral, and there was a fear that the Ershad regime may influence the outcome of elections when democracy was restored in 1990, after a political movement spearheaded by the two political parties. Justice Shahabuddin became the first Chief Advisor (CA) of the CTG that oversaw the transition to democracy. In 1996, the CTG system became part of the constitution, after AL and the Jamaat-i-Islami refused to participate in the sixth *Jatiya Sangsad* elections, forcing the BNP that was elected uncontested, to move the constitutional amendment to institutionalise the CGT as part of the constitution of Bangladesh and declare fresh elections. The CTG system has not furthered the case for the strengthening of the Election Commission. The CTG's relations with the Election Commission (EC) and the armed forces are not clearly laid out, creating apprehension about the Institution. The politicisation of CTG started after the BNP government took a decision to raise the retirement age of the judges, to ensure that the BNP's preferred Supreme Court Chief Justice K.M.Hasan could take the charge as Chief Adviser of the CTG after retirement, as required by the constitution. At the same time, the military backed CTG, which took over power in January 2007, also exposed the loopholes in the constitution. The armed forces emerged as a main force in the Fakruddin Ahmed headed CTG. The army wanted to implement, what it perceived was a blue print for democracy in Bangladesh. The attempt to restructure the political parties through its once touted 'minus two' formula, made it the most controversial CTG in Bangladesh's history. The immense ordinance making powers of the CTG are also problematic, even though these are to be passed by the Parliament once the new government assumes office.

While the government has repealed the CTG in spite of the high court's suggestion to retain it for the next two parliamentary elections, it has not taken any steps to establish an independent Election Commission, that will give other political parties the confidence to participate in the election process. Article 123 (3) of the 1972 constitution, relating to the Election Commission has been restored. The interesting aspect is that while the political parties trust the EC's conduct of local elections, they doubt its credibility where the national elections are concerned.

The Election Commission or the body that oversees the transition must be seen to be an impartial body, to conduct free and fair elections that ensure the political legitimacy of an elected government. Election laws, registration of political parties and timely conduct of elections are an important part of democracy. The plurality of voice and the representation of women, and minority groups are the other essentials. Providing an atmosphere where citizens can vote without fear and reprisal is also a function of the Election Commission.¹⁹ In Bangladesh the Election Commission is not autonomous, and the political parties have always tried to interfere in its functioning. It has been a politically appointed authority. Major changes to the Representation of the People Order (RPO) were made in 2007, to plug the loopholes in the representation law and strengthen the office of the EC. In 2008, the military backed CTG introduced article 91E to the Peoples Representation Act, and empowered the EC to declare any election of a candidate null and void if that candidate had violated election law. In an interesting development, the current EC wants to give back this power.²⁰ Another issue that has affected the independence of the EC is the overtly political nature of the bureaucracy, which does not instil confidence about its role in facilitating a free and fair election.

Challenges to Democracy and Pluralism

Political Parties and Inner Party Democracy

Bangladesh moved from being a multiparty democracy in 1972, to the one party BAKSAL system in 1975, to the reestablishment of a multiparty system in 1977. Bangladesh has a bi-party system of government, with the two political parties having a large alliance of ideological affiliates. Given the strong personalities of the two leaders who have inherited the party mantle, inner party democracy is more of a procedure of reaffirmation now. For example, elections to the post of party president/chairman were introduced by the previous CTG as part of political reform, but the BNP elected Begum Zia as chairperson for life, contrary to the spirit of democratisation. The members of both the political parties are aware that there is no political future without the two leading ladies—belonging to the families of Mujib and Zia—leading the parties, as they carry two important political legacies of Bangladesh. In any case this trend of dynastic politics is also prevalent in other South Asian countries. The Jamaat-e-Islami, whose registration as a political party has been cancelled by a recent High Court verdict, has an elected Amir and is not based on dynastic politics. But the Jamaat has minimal representation of women and minorities in its highest decision making body. Its constitution supports an Islamic state, which is the antithesis of a pluralistic societal culture and in violation of Bangladesh's constitution. The Party also does not believe in equality for its citizens. The Jatiya Party is also divided into many factions. Ershad remains the supreme leader of his faction even though it has various committees and presidium members.

The constitution of AL is that of a democratic party that allows room for debate and discussion, and encourages collective decision making. In reality, it is the party president who takes most of the decisions and dissent is almost non-existent. For example, the leaders those who spoke of inner party reforms within the party in 2007, were sidelined after Hasina assumed office.²¹

Both the AL and the BNP, profess their belief in democracy as per the party constitution. According to the AL constitution:

The fundamental principles of the Bangladesh Awami Leagues shall be Bengali Nationalism, Democracy, Secularism or in other words ensuring freedom of all religions as well as non-communal politics and Socialism, that is to say-the establishment of an exploitation-free society and social justice.

Similarly the Constitution of the BNP professes:

To ensure such a clear and stable social and political system... To establish stable democracy through parliamentary democratic government elected by direct vote of the people based on multi-party politics and bring equitable national progress and development. To set up *Jatiya Sangsad* as the epitome of democratic life and democratic values and preserve the fundamental rights of the people.²²

But the BNP has hardly adhered to its constitution. While there is a mention of democracy in the constitutions of both the political parties, there is no reference to preserving the languages of the minority indigenous people in Bangladesh, or any commitment to preserve their culture.

All the political parties have organisations from the national until the ward level, and the selection for each stage is clearly laid out in their party constitution. The BNP chairman as per the party constitution, is required to be elected every three years. The same is the case with the AL. The election of office bearers of the parties at various levels is not transparent. Money and muscle power play a major role in the process apart from loyalty to the party, and ability to protect the local party turf. Clashes between the party workers at the local level are a recurrent feature.

There is lack of inner party democracy given the predominant position of these leaders. Any criticism of the party leader is not tolerated, and many don't dare to speak contrary to what the party leaders believe in, or go against their decision or criticise them. As a result, plurality of voice within the party is completely lacking. And there is competition among the party members within these parties to have the attention of the leader.²³ Some senior leaders in the AL also resent the role played by the many advisors Hasina has appointed. Some AL leaders are critical of the marginalisation of senior leaders like Tofail and Abdur Razzak who have extensive political experience, and the elevation of inexperienced leaders solely on the basis of their loyalty to her when she was jailed.²⁴ What has further vitiated the culture of democracy is the nomination of businessmen to

contest the elections, a rising trend in Bangladesh politics. Bangladesh, like many other countries does not have provision for state funding of elections, and the sources of funds of the political parties are not transparent, allowing people to buy nominations to contest elections. These businessmen once in power, not only further their business interests at the cost of the people, but also utilise their positions to recover the money they spent on their election. The RPO of 2009 in Article 90 B(iv) reads as follows:

...to finalise nomination of candidate by central parliamentary board of the party in consideration of panels prepared by members of the Ward, Union, Thana, Upazila or District committee, as the case may be, of concerned constituency.²⁵

Though the Election Commission specifies the amount each candidate can spend for contesting elections, most candidates far exceed that limit. As a result, it is difficult for the normal politician to contest elections and thus the present parliament is dominated by businessmen. No individual donation should exceed Tk five lakh per year and Tk 25 lakh per year in the case of a company. This to a large extent has disheartened the grass root level leaders, who spend their time in building the party organisation.

Political parties before the elections also distribute sops to woo voters. For example, on April 23, 2001 AL allocated 100,000 tonnes of extra wheat, and each MP and political leader got 500 tonnes for distribution. Similarly the BNP government allocated Tk 25 lakh to its candidates in each constituency, ahead of the 1996 elections to the 6th parliament.²⁶ The following table reflects how personal preferences and money, rather than experience play a role in the selection of candidates in the elections.

Table 1: Experience of Legislators

Indicator	1970 (CA)	First	Fifth	Seventh	Eighth	Ninth
Gender (Directly Elected)						
Male	100	100	98	97	98	94
Female	n/a	0	2	3	2	6
Profession						
Businessman/industrialist	27	24	53	48	57	56
Civil/military bureaucrat	3	n/a	8	8	8	10
Lawyer	30	27	19	17	11	15
Professional	17	15	14	9	11	7
Politics	5	13	2	4	7	5
Others	19	21	4	14	6	7
Education						
Postgraduate	22	27	38	40	42	37
Graduate	41	42	46	45	47	45
Undergraduate	24	27	16	11	10	15
Others	3	4		4	1	3

Indicator	1970 (CA)	First	Fifth	Seventh	Eighth	Ninth
Parliamentary Experience						
No experience	n/a	34	68	40	29	55
Experience of one term	n/a	57	17	27	28	16
Experience of two terms	n/a	10	7	33	27	8
Experience of three terms	n/a	n/a	4	0	11	3
Experience of four terms	n/a	n/a	4	0	4	2
Experience of five terms	n/a	n/a	0	0	1	0

Source: Ronouq Jahan and Inge Amundsen, "Parliament of Bangladesh: Representation and Accountability", CPD-CMI Working paper 2, 2012, p.29. http://www.cpd.org.bd/pub_attach/CPD_CMI_WP2.pdf (accessed on August 10, 2013).

Elections and Participatory Democracy

While elections in Bangladesh have been marked by a high voter turn out, violence has been an endemic feature. In some cases the minorities are either prevented from casting votes, or asked to cast their votes to particular political parties.²⁷ In the aftermath of the 2001 elections, the minorities were targeted, as they were not believed to have voted for the BNP, which won the election. Some even point out that this violence was for compensating the political activists by allowing them to loot and occupy property of the minorities. *Mastans* have become 'acceptable actors'²⁸ and have emerged as an essential part of democracy in Bangladesh, not only to provide patronage and protect the support base of political parties, but also to settle local inter-party and intra-party disputes.²⁹ Many in Bangladesh refer to this phenomenon as 'mastanocracy'.³⁰

Table 2: Hindu Minority and Ethnic Minority Representation in Parliament Since 1991

Parliament	Total	Awami League	BNP	Others
Hindu Minority Representation				
Fifth	6	5	0	1
Seventh	5	4	1	0
Eighth	3	3	0	0
Ninth	10	10	0	0
Ethnic Minority Representation				
Fifth	4	4	0	0
Seventh	3	3	0	0
Eighth	3	2	1	0
Ninth	4	4	0	0

Ethnic Minorities means Adivasis.

Source: Ronouq Jahan and Inge Amundsen, "Parliament of Bangladesh: Representation and Accountability", CPD-CMI Working paper 2, 2012, p.31 http://www.cpd.org.bd/pub_attach/CPD_CMI_WP2.pdf (accessed on August 10, 2013).

It needs to be noted here, that there is a significant decline in minority population since 1991. There was a decline from 12.5 per cent to 10.5 percent by 2001, and by 2011 the minority population reduced to 9.5 per cent, with the Hindus accounting for most of this decline. The Awami League has taken steps to ensure minority representation, while the BNP is conspicuously lacking in minority representation.

Role of Civil Society

Given the competitive and extreme ideological polarisation in Bangladesh, civil society has emerged as an important player along with the media. In the previous election some civil society institutions participated in a CPD sponsored, “National Dialogue 2007: Civil Society Initiative for Accountable Development”. It also conducted a dialogue in collaboration with media houses like the *Daily Star*, *Pratham Alo* and Channel I before the 2007 election, which was cancelled. There are NGOs—some of which are funded by the Western countries—who have played a role in educating people on elections and democratic values. Moreover, Western countries have sometimes intervened to break the political deadlock without much success. Given the prevailing mistrust and suspicion, the civil society intervention has not been effective, as both the government and the opposition suspects them of being the instrument of the other. Civil society members also have been attacked by fundamentalists for their views on secularism and have often been termed as ‘foreign agents’. It should also be remembered that some civil society members played an important role in the transition to democracy in 2008. The military’s efforts to marginalise political leaders were criticised by them and the media. However, the government has often arrested prominent NGO activists, and those who work in the field of human rights for being critical of its working. The fear of reprisal is always present in the mind of the NGO workers especially those working in the human rights space.

An independent judiciary is essential to support the emergence of pluralist voices. But judicial verdicts in political cases have become almost predictable. The politicisation of government machinery from police to the judiciary, does not instil confidence in civil society. Perhaps the most powerful NGOs—who are well connected internationally—can afford to take a confrontational attitude with the government. The regulation of the media and the cancelling of permits, arrests of editors and trumped up charges against them, has not furthered the cause of democracy and pluralism. In 2001, the BNP arrested Ershad but told him that their government would not press criminal charges against him if he joined the BNP.

The vote share of the two main political parties in Bangladesh has been changing with changing alliances. The Jatiya Sangsad elections show that there is a marginal percentage difference between the two as in the fifth general election, when the two parties polled a similar percentage of votes.

Table 3: Votes Share vs. Seat Share of Major Parties/Alliances

Parliament	Indicators	AL	BNP	JP (Ershad)	JI
Fifth (1991)	Votes (%)	30.1	30.8	11.9	12.1
	Seats (#)	88	140	35	18
	Seat share (%)	29.3	46.6	11.6	6
Seventh (1996)	Votes (%)	37.4	33.6	16.4	8.6
	Seats (#)	146	116	32	3
	Seat share (%)	48.6	38.6	10.6	1.0
Eighth (2001)	Votes (%)	40.2	47.2	7.2	
	Seats (#)	62	216	14	
	Seat share (%)	20.6	72.0	4.6	
Ninth (2008)	Votes (%)	57.1	39.9		
	Seats (#)	262	34		
	Seat share (%)	87.3	11.3		

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Source: Ahmed (2002: 55); Nohlen *et al.* (2001: 525-537); Ahmed (2010: 71); <http://123.49.39.5/result/report4.php?lang=en>. As cited in Ronouq Jahan and Inge Amundsen, *Parliament of Bangladesh: Representation and Accountability*, CPD-CMI Working paper 2, 2012, p.29. http://www.cpd.org.bd/pub_attach/CPD_CMI_WP2.pdf, Sixth Jatiya Sangsad election had 12 days sitting in which bill regarding to CTG passed. Opposition did not participate in the sixth Jatiya Sangsad election

Conclusion

Like any other democracy, the Bangladesh Constitution provided the institutional framework necessary for a democratic polity to function. However the institutional framework has been amended to suit the interest of ruling elites, especially the military which changed the rules to accommodate themselves in power. Since its transition to a democratic regime in 1991, democracy in Bangladesh can largely be characterised as dysfunctional. The only functioning part of democracy is the political transition, through elections. However, the opposition has invariably termed them as rigged. The integrity of institutions has been eroded over the period of time. Bangladesh's unique experience in state formation also influenced the nature of the state and its majoritarian structure. The challenges to democracy have been both structural as well as institutional.

Structurally the state has a majority Muslim population and a syncretic tradition that nurtures cultural components of both Hindu and Muslim religion. The state's history has a background of two partitions that has a significant bearing on politics, and influences the attitude towards minorities and the issue of secularism. Pluralism of religion, language and culture is perceived from the perspective of state formation. Some of them are intertwined with its relations with India. Democracy in Bangladesh has to be seen from the majority-minority perspective. The liberation war and the establishment of a secular state has a bearing on the state structure. This confusion is embodied in the constitutional

structure. The constitution reflects the religion and language of the majority, yet it has provisions for secularism and protection of indigenous language and culture. Though the structural aspect has its bearing in the constitution and institutional structures, weaknesses of institutions can be attributed to politics. A dysfunctional parliament, weak judiciary, politicised bureaucracy, lack of inner party democracy, personality and ideologically driven politics, have significant implications for the state of democracy and also impinge on socio-religious and cultural pluralism. This erodes not only the faith of minorities, but also does not provide space for expression of plurality of opinion. The political parties adhere to the party line of thinking, even though some of their members express different opinions in private.

Absence of a contrarian perspective does not help Bangladesh's prospects for democracy. Parliament is still not the heart of democracy and a culture of constitutionalism is clearly lacking. The *hartal* culture and exhibition of strength on the street, has unfortunately become an alternative to the Parliament. Democracy is functioning as per the winner take all syndrome, and parliamentary opposition is non-existent, a practice that was started by the BNP during the seventh session of the Parliament. The use of law enforcement machinery and institutions like the Anti-Corruption Commission against the opposition has been a norm. Such an atmosphere is not conducive to a democratic culture. Thus Bangladesh is likely to continue to function as a notional democracy—at least for the foreseeable future.

NOTES

1. Lawrence Ziring, *Bangladesh: From Mujib to Ershad: An Interpretive Study*, Oxford University Press, London, 1992, p.95.
2. Parliament Debates, 12 Oct 1972, p. 20, as cited in Amena Mohsin, *Politics of Nationalism* UPL, Dhaka, 1997, p.59.
3. Anthony Mascarenhas, *Bangladesh: A Legacy of Blood*, Hodder and Stoughton, London, 1986), pp.124-25.
4. These views were expressed by Prof Anisuzzaman, Dr Kamal Hossain, Mr. Hasanul Haq Inu and many others. Even some members of the BNP distance themselves from the issue of state religion attributing it to General Ershad. Interviews conducted in 2004, 2007 and 2011 for my research work on "Identity Politics in Bangladesh".
5. "Text of General Ershad's Declaratory Address to the Nation", March 24, 1982", *Defence Journal*, 7(5), 1982, pp.27-29.
6. The Constitution of the People's Republic of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs, http://bdlaws.minlaw.gov.bd/sections_detail.php?id=367§ions_id=41504
7. *The Guardian* October 7, 1981 as reproduced in "Bangladesh Army to Seek Greater Role in Politics", *Defence Journal* (Karachi), 8(5) 1982, p.32.
8. See Smruti S. Pattanaik, "Re-emergence of Military and Prospects for Democracy in Bangladesh" *Strategic Analysis*, 32(6), November 2008, pp.975-995.
9. Moeen U. Ahmed, COAS, 'The Challenging Interface of Democracy and Security', address to an International Political Science Association Regional Conference on "Rethinking Political

- Development: Security and Democracy”, organised by the Bangladesh Political Science Association, Dhaka, April 2, 2007.
10. The Constitution of the People’s Republic of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs, http://bdlaws.minlaw.gov.bd/sections_detail.php?id=367§ions_id=41503
 11. On February 8, 1992, the BNP government promoted 654 officials, between 1991-96, 51 civil servants were forcibly retired without being given any reasons, while several were promoted for supporting the party during its fight for restoration of CTG government. In 2001 BNP promoted 355 officers violating the principle of seniority, 174 civil servants were recruited on contractual basis. Ferdous Jahan, “Public Administration in Bangladesh”, *CGS Working Paper I*, pp.12-13. In 2001 BNP appointed 978 officials as OSD. Same policy is continuing under the current AL government. See M.Abul Kalam Azad, “Retirees Rule administration”, *Daily Star*, March 27, 2001.
 12. OSDs are appointed for following reasons: a) misconduct, b) unauthorised leave for more than two months, c) officers awaiting training, d) pending posting after return from abroad and e) other administrative exigencies. Harunur Rashid, “The OSD Culture in Bangladesh Administration”, *Independent*, 28 March 2013, http://theindependentbd.com/index.php?option=com_content&view=article&id=162009:the-osd-culture-in-bangladesh-administration&catid=139:editorial-post-editorial&Itemid=136. Also see “HC Asks the Government to Explain the Legality of OSD”, 5 June 2012, *New Age*, <http://www.newagebd.com/detail.php?date=2012-06-05&nid=12704#.Ugm82BYmzdk>
 13. Ferdous Jahan, “Public Administration in Bangladesh”, *CGS Working Paper I*, BRAC University, http://research.brac.net/workingpapers/jahan_public_administration.pdf
 14. M. Abul Kalam Azad, “Retirees Rule Admin”, *The Daily Star*, 27 March 2011, <http://archive.thedailystar.net/newDesign/news-details.php?nid=179291>
 15. “Parliament Goes into Last Budget Session Monday”, *Priyonews*, 2 June 2013 <http://news.priyo.com/2013/06/02/parliament-goes-last-budget-session-monday-77650.html>. The fifth parliament constituted in 1991, following the ouster of HM Ershad’s regime, passed three of five budgets with the opposition Awami League-led MPs in the House. The Awami League lawmakers boycotted parliament during the last two budget sessions of that parliament, demanding the caretaker government system. The seventh parliament, constituted through elections in June 1996, passed four national budgets between 1996 and 1999 with the BNP-led opposition lawmakers in the House. However, the seventh parliament had to pass its two last budgets without the opposition. The eighth parliament, constituted in October 2001, passed all its budgets with the then Awami League-led opposition lawmakers in the House, except the last one. Shekhawant Liton, “Boycott feat Beckons JS”, *Daily Star*, 7 June, 2012, <http://www.thedailystar.net/newDesign/news-details.php?nid=237257>
 16. Ronouq Jahan and Inge Amundsen, “Parliament of Bangladesh: Representation and Accountability”, CPD-CMI Working paper 2, 2012, p.14 http://www.cpd.org.bd/pub_attach/CPD_CMI_WP2.pdf,
 17. “Odhikar Reveals 775 Killed, 58,251 hurt in Pol Violence in 4 Years”, *The New Nation*, <http://thenewnationbd.com/newsdetails.aspx?newsid=65571>
 18. This article does not define as to what constitutes national culture. However, a separate provision for the indigenous groups in Article 23A gives the impression that they are not part of the ‘national’ culture.
 19. For details about making EC effective see the article by Mohammad Abu Hena, Former Election Commissioner of Bangladesh, “The Challenge Before the Election Commission”, *Daily Star*, March 17, 2013, <http://www.thedailystar.net/beta2/news/the-challenge-before-the-election-commission/>

20. "EC Wants, 91E to be deleted from the RPO 1972", *New Age*, July 29, 2003, <http://www.newagebd.com/detail.php?date=2013-07-29&nid=59119#.UgtYu22GUUM>
21. These leaders are Amu, Tofail Ahmed, Suranjit Sengupta and Abdur Razzak. Though the military intimidated and encouraged these leaders to rise against Hasina's leadership, the AL remained united. It must be pointed out that the issues raised by these leaders had some resonance within the Party itself though many did not support them openly. Similarly in the BNP, Mannan Bhuyian was encouraged to speak against the leadership of Begum Zia and the lack of inner party democracy which led to a split within the Party. He was sidelined by the leaders who felt that sticking with the Begum Zia would ensure their political future. They are the people who elected Begum Zia for life. From interviews with Presidium members of AL and important leaders of BNP who would like to remain anonymous. Interviews took place between July-September 2007 when the author was a Visiting Fellow at Dhaka University.
22. <http://bangladeshnationalistparty-bnp.org/content.aspx?tablename=webitem2&cid=8&child=null&parentid=null>
23. A senior party functionary of the BNP who would not like to be identified claimed that he is close to the Party Chairman and thus has a credible voice within the party. Interview with a member of highest decision making body of the BNP on April 5, 2012 in Dhaka
24. Interview with two senior members of Awami League who would like to remain anonymous. April 2, 2012 in Dhaka.
25. *Bangladesh Gazette*, February 24, 2009, <http://www.ecs.gov.bd/MenuExternalFilesEng/262.pdf>
26. Enam Ahmed, "Black money in Electioneering", *Daily Star*, 31 January 2004, http://archive.thedailystar.net/suppliments/anni2004/demo_09.html
27. See Smruti S Pattanaik, "Majoritarian State and the Marginalised Minorities: The Case of Hindus in Bangladesh", *Strategic Analysis*, Vol. 37(5), 2013.
28. Imtiaz Ahmed, "Mastanocracy, Violence and Chronic Poverty: Issues and Concerns" in *Chronic Poverty in Bangladesh: Tales of Ascent, Descent, Marginality and Persistence*, (ed.) by Binayak Sen and David Hulme, BIDS, Dhaka, 2004, p.102.
29. According to a Transparency International Bangladesh Report, "53.5 per cent of these members of parliament (MPs) had direct involvement in criminal activities, party leaders and activists at the local level were involved in nearly every instance. Syful Islam, "Report: 97 per cent of Bangladeshi Lawmakers are involved in wrong doing", <http://www.trust.org/item/20121101160000-r24cm/>
30. No. 28.

5

The Political Economy of Sri Lanka's Growth: Focus on Youth Unrest

Anura Ekanayake

Introduction

The narrative of Sri Lanka's economic growth since the 1950s is one of performance well below its potential. In the 1950s, Sri Lanka was only second to Japan in the whole of Asia, and at par with Korea in GDP per capita terms.¹ The memoirs of Lee Kuan Yew describe this potential and the high expectations from Sri Lanka as he saw first-hand in the year 1956, on his way back to Singapore from UK. Of course he goes on to describe how Sri Lanka failed to realise its true potential and lamented, 'It is sad that the country whose ancient name Serendip has given the English language the word "serendipity" is now the epitome of conflict, pain, sorrow and hopelessness'.² It is only with the end of the separatist war in mid 2009 over half a century since Lee Kuan Yew's famous visit that signs of economic prosperity are emerging in Sri Lanka. Needless to emphasise, sustainable economic prosperity requires a careful examination of the 'what' and 'why' of the lost opportunities of Sri Lanka, and charting a course of maximising its current and future potential.

That a protracted civil war in the North and East of the country had much to do with this underachievement in terms of potential economic performance of Sri Lanka is well known. What is much less appreciated is that Sri Lanka was equally troubled by an armed Tamil youth uprising in the North, which had escalated into this full-blown civil war, as well as by two armed uprisings in the South by Sinhala youth during the last 40-year period, collectively holding back the progress of the nation. The associated deprivation and suffering caused by the armed forces who confronted the rebels, their nucleus families, their extended families and entire communities for four decades is immeasurable. What is in the public domain in this respect cannot be more than a mere fraction of what was experienced by those affected. The tragedy is that almost all those who

sacrificed their lives, whether the Sinhala youth, the Tamil youth, the civilians who got caught in the cross fire, or the members of the armed forces, were from the poorest sections of the citizenry.

That the youth rebellions in the North as well as in the South, originated more or less at the same time in the late 1960s even though the Southern one peaked and ended in 1989, whereas the Northern one continued for a further 20 years ending in 2009, is also less well known. The available literature covers the socio-political and historical aspects quite comprehensively, more in the case of the narrative of the armed Northern Tamil youth than in the case of the armed Southern Sinhala youth. The Northern youth rebellion, which rapidly developed into a secessionist movement, has widely been depicted as a primarily ethnic phenomenon while the failed Southern rebellion aimed at creating a 'socialist state' has been seen more from the point of view of class and caste.

If the armed Northern Tamil youth movement for a separate state was fuelled purely by harassment, oppression, unfairness, victimisation and discrimination of the minority Tamils by the majority Sinhalese regime on ethnic grounds, then the simultaneous eruption of an armed Sinhala Youth movement for a socialist state cannot be easily explained. The majority Sinhala regime of the nation could not have simultaneously harassed and discriminated against the Sinhala youth and the Tamil youth at the same time, on purely ethnic grounds. An explanation is also required as to why the Tamil youth rebellion went on for 40 years, lasting for 20 years longer than its Sinhala counterpart, which petered out after continuing for 20 years in one form or the other.

At the very outset of this paper, it must be emphasised, that the Tamil community of Sri Lanka had a wide range of specific grievances, cannot be denied. The question is whether those were necessary and sufficient conditions for such a long drawn out armed conflict. A holistic understanding of the underlying factors and processes leading to four decades of youth rebellion in the North and the South of Sri Lanka and thereby holding back of the progress of the newly independent nation is critical to the mapping of a way forward for Sri Lanka. Given the range of current conflicts and the potential for future conflicts, such an understanding can be of great help for promoting peace and prosperity in the rest of South Asia as well. In fact, South Asia has been recently identified as the most conflict affected region in the whole world.³ This paper is a part of a more ambitious on-going personal undertaking of the author to uncover and understand the full potential of South Asia and the shared destiny of her people. Understanding the nature, severity and the costs of conflict within the region are an essential part of such an undertaking to identify a pragmatic way forward and to realise the full potential of the region.

In the next section of this paper, a brief review of some of the relevant and better-known literature on youth insurrection in Sri Lanka is undertaken. Thereafter, an attempt is made to search for an appropriate theoretical basis to

try to explain the Sri Lankan experience. In the section after that, some key relevant demographic and economic variables such as population, labour force, education, economic growth and unemployment covering the 40–50 year period under review are examined. Thereafter, other factors that determine the feasibility of revolt are discussed. The apparent economic costs of war to Sri Lanka as well as to India, her giant neighbour are looked at next. Finally, the potentially peaceful way forward is explored, based on the aforementioned sections.

A Brief Review of Literature on Youth Uprisings in Sri Lanka

A comprehensive review of the vast extant literature on this subject is well beyond the scope of this undertaking. The compromise resorted to here is to provide a brief categorisation of the literature illustrated by some examples the author is familiar with. The categories of relevant literature are primarily ethnic studies, youth studies, and work focusing on the Liberation Tigers of Tamil Eelam (Northern) or Janatha Vimukthi Peramuna (Southern) or both. These may also be sub divided into those of primarily historical, political or economic nature or some combination of the above. However, it must be stressed that most of the literature cuts across these categories one-way or the other.

An authoritative source for the relevant political history of Sri Lanka from colonial times to the late 1990s is the much acclaimed scholarly work of Prof. K.M. de Silva.⁴ While this work focuses primarily on the Tamil issue, the much later collection of news paper articles in Sinhala language by the senior journalist Victor Ivan⁵, himself a leader of the first Sinhala youth armed uprising, is perhaps the most comprehensive in so far as both Sinhala and Tamil youth uprisings are simultaneously examined and compared.

De Silva points out how the colonial era political aspirations of the majority Sinhala elites and the minority Tamil elites gradually evolved. The former evolved into a position that Tamils of Sri Lanka are a separate nation, and therefore, required separate representation in the legislature on an equal basis with the Sinhalese initially, thereafter as a separate regional entity in a federal structure. Subsequently, they demanded an altogether separate state. In parallel, the Sinhalese elites became increasingly insensitive to minority concerns and resistant to any kind of power sharing along ethnic and or regional lines in an independent sovereign state. Based on primarily a historical analysis of the conflict, De Silva concluded that it is '....much more than a conflict between a majority and a minority, or indeed a conflict between two minorities'.⁶ He goes on to say, 'The conflict is between a majority with a minority complex and a minority with a yearning for majority status, a minority with a majority complex'.⁷ Yet, he identifies the post colonial language policy and resulting changes in access to government jobs, a series of changes in the policies of admitting candidates to the Universities based on regional and linguistic criteria, as specific post

independence developments, which further fuelled what he sees as primarily an ethnic divide.⁸

Ivan⁹ also recognises this 'majority with a minority complex and minority with a majority complex' and finds fault with the majority leadership for their lack of sensitivity to the minority concerns and their desire to gain short-term political advantage with the majority Sinhala community by taking a 'Sinhala only or Sinhala first' line, resulting in disastrous language based politics and policies. At the same time, he is critical of the minority leadership for seeking parity of status going beyond their population ratio and geographic representation. More importantly, he points out that the roots of both minority and majority youth uprisings are similar in that the rebels of both were primarily unemployed educated rural youth from depressed castes of both communities. Further, he asserts that the repression of both were equally brutal, citing the numbers of people killed during the peaks of their revolts, of JVP from 1987 to 1989 and of LTTE from 2007 to 2009. He argues that there was no difference in the manner the armed forces quelled both revolts.¹⁰ The implication of the above is that the causes of the youth uprisings in Sri Lanka cannot be explained by ethnic factors alone and/or state repression alone.

A comprehensive treatment of youth issues in Sri Lanka in the late 1990s is provided by Hettige and Mayer by whom some historical data are considered. They observed, 'The two insurrections of the Sinhalese youth in the South, and the ethno-nationalist or so called Tamil conflict in the North East, have to a great extent their roots in unfulfilled expectations of the young, in a mismatch between aspirations and opportunities of juveniles...'.¹¹ Lakshman's paper in this work examines the employment aspects of the youth unrest and shows that economic growth and job growth were very low, and youth unemployment was very high right through the late 60s until the 90s giving credence to the view that youth unemployment was a crucial factor in the emergence of the youth revolt. Interestingly, he notes that while youth unemployment was more acute in the rural areas, it was relatively higher in the South where the Sinhala youth uprising originated, compared to the North that was the cradle of the Tamil youth uprising.¹²

Work of Balasingham,¹³ Chandraprema,¹⁴ Manikkalingam¹⁵ and Narayan Swami¹⁶ are a few among many, which provide interesting and useful perspectives on the Tamil youth movements over the years. These largely focus on the ethnic and geo political dimensions rather than the economic factors.

Writings focusing on the Sinhala youth rebels are much fewer in number. Two noteworthy sources are Alles¹⁷ and Godahewa,¹⁸ which appear more as sequences of events with some elaboration of the relevant underlying factors.

An interesting feature right across the above literature is the relatively low level of attention given to underlying demographic and economic reasons as against

the very wide-ranging exploration of the ethnic and socio-political reasons for youth revolt. Some key ideas elaborated in this paper, perhaps in a rudimentary form, appeared in the present author's submission in his then capacity as the Chairman of the Ceylon Chamber of Commerce to the Lessons Learned and Reconciliation Commission (LLRC) appointed by the government of Sri Lanka, soon after the end of the Civil War.¹⁹

A Theoretical Framework for the Study of the Youth Revolt

The author has not come across one single study which develops a theory of armed conflict, providing sufficient and necessary socio-economic and political conditions for such to arise, and then to develop into separatism and a protracted civil war or attempted revolution. However, elements of such a framework are evident in bits and pieces of the total body of the available literature on armed conflicts.

The search for a comprehensive theoretical explanation of youth revolt has to be based on the extant theories on revolt in general. Machiavelli's view that rebellion arises out of man's self-interest or greed for political or economic power,²⁰ is perhaps one of the best known and oldest explanations of revolt of the Western World. A more romantic and perhaps therefore, one of the most influential views of revolt is that of Tocqueville who observed that the French revolution was ignited by frustrations caused by an extremely repressive regime.²¹ Those who take this view explain armed uprisings as fighting against injustice or fighting for freedom. Take for example the work of Balasingham on the LTTE with the title 'The Will to Freedom', cited earlier.²² As noted by Paul Collier, '...popular perceptions see rebellion as a protest motivated by genuine and extreme grievance' and rebels are seen as 'public spirited heroes fighting against injustice'.²³

Another highly influential work was the Theory of Relative Deprivation of Ted Gurr to explain 'Why Men Rebel'. Relative Deprivation is the discrepancy between what people feel entitled to have and what they have in reality. When the gap between the two grows large, frustration builds up and leads to violence.²⁴ This is indeed a further elaboration of Tocqueville's idea of fighting against injustice.

While all of the above singly or together may provide the necessary conditions for revolt, what makes them escalate and develop into protracted civil war- in other words the sufficient conditions for revolt, requires further theoretical elaboration. It has been clearly observed that the mere presence of political and/or economic inequality, religious and ethnic divisions, injustice and the resulting sense of grievance is insufficient for revolt.²⁵ The feasibility hypothesis of J. Fearon and D. Laitin, where organisational, military and financial feasibility are required for armed conflict to actually materialise,²⁶ can bridge this gap in explaining the development of injustice (relative deprivation) and the desire ('greed' as per

Machiavelli) to improve political and economic power, and in the full articulation of revolt into attempted armed revolution or civil war.

Accordingly, this writer's synthesis of the above theories is that for people to consider revolt, a strong sense of injustice among the community concerned based on relative deprivation is necessary. This has to be coupled with a desire ('greed') for improving their access to political power as well as for increased economic benefits. However, for people to opt or to be persuaded into armed revolt or outright war for secessionism or to change the fundamental nature of the state itself, requires such armed conflict to be organisationally, militarily and financially feasible. Finally, a sense of 'nothing to lose and everything to gain' must prevail among the participants of the revolt.

Demographic and Economic Background to the Youth Revolt

Sri Lanka experienced high birth rates in late 40s and early 50s coupled with a steep decline—indeed a halving of the death rate from 20 per cent to 10 per cent, which accelerated the rate of population growth and led to a sharp increase in the labour force in the mid 60s to mid 70s. While the labour force grew by 14 per cent from 1946 to 1953, it accelerated to 16 per cent from 1953 to 1963 and then faced an exponential growth of 31 per cent from 1963–1973. Thereafter, it returned to the earlier trend with an increase of 16 per cent from 1973–82.²⁷

At the same time, the literacy rate in Sri Lanka, which was 62.8 per cent in 1946, rose to 76.8 per cent in 1963, 78 per cent in 1971 and 87.2 per cent in 1981 and 91.8 per cent in 1996–97. Literacy as well as educational attainment improved rapidly in the 1950s and 60s. In 1958, Sri Lanka adopted a policy and programme of universal free education all the way from kindergarten to the first-degree level. Right through the 60s, except in 1969, the public expenditure on education exceeded 4 per cent of GDP compared to a level below 3 per cent in the first half of the 1950s. In subsequent years up to the present, this level was exceeded only very briefly in 1971 and 1972.²⁸

The annexed Table gives the relevant population, labour force, education, economic growth and unemployment data for Sri Lanka during the period 1946–1990. The individual years shown are those for which unemployment data are available. Since 1990, official data was not collected or at least not published for the North and the East of the country due to the prevailing conditions. By then the sufficient and necessary conditions for revolt had already been well established with the Southern insurgency over in 1989 and the Northern rebellion in full swing.

As seen in this table, Sri Lanka's GDP growth rate did not match the above rapid increase in the labour force, by the entry into it of large number of youth, all of them literate and many highly educated. The average GDP growth rate was 3.7 per cent in the 50s, 4.7 per cent in the 60s and 3.1 per cent from 1970–

1977, and was totally inadequate to create the required numbers of job opportunities. This is not the place to provide a comprehensive analysis of the causes of this poor economic performance in the 70s. It should suffice to state that a post independence (post 1948) policy mix of continued dependence on the export of a few commodities, the declining terms of trade, import substitution, the taking over of the commanding heights of the economy under state control, weak state-led capital investment and industrialisation, have all attributed to this poor economic performance.²⁹

In 1963, the overall unemployment was 7.7 per cent. This increased to 14.3 per cent in 1969-1970, and to 18.7 per cent in 1971. Only in 1998 did the unemployment rate decline to a level below 10 per cent.³⁰ The actual number of unemployed people, which was 265,000 in 1963, rose to 839,000 in 1971, and to 895,000 in 1980-81 and thereafter declined. The unemployed largely, were educated youth with high aspirations. Both in the North and East as well as in the South, hundreds and thousands of educated pre-dominantly rural youth were left unemployed with no early prospect of finding a job.³¹

While the above mentioned economic policies affected job creation and pushed the youth to rebellion, the disastrous language based policies covering the official language, university admission and public sector employment mentioned earlier, drove the Tamil youth towards secessionism. It appears that the only solution from the point of view of the youth in Sri Lanka was a radical change in the political setting—indeed of the nature of the state itself. The failure of the traditional political parties of the right as well as the left to solve their problems by peaceful and democratic means also would have influenced this radicalisation of the youth. The youth of the North saw this failure to meet their aspirations as an ethnic issue due to the language based policies of the successive governments. The southern youth saw this as a class conflict, which had to be resolved via an armed revolution to create a socialist state. The southern rebels also took a populist racist line to swell its ranks benefitting from the linguistic policies of the rulers. It has also been clearly observed that youth of depressed castes, the economically and politically marginalised castes of both communities were in the forefront of the revolts.³²

Other Factors Determining the Feasibility of Youth Revolt in Sri Lanka

The previously mentioned points illustrate that the sharp increase in the labour force with educated and disadvantaged youth within a short period well beyond the capacity of the economy to gainfully employ them, formed the basis for the youth revolt. The misguided economic policies of this period had much to do with this incapacity for job creation. In the subsequent years, the resulting protracted youth based revolts further weakened the economy. The evolution of

the politics of the Sinhalese and the Tamil elites initially and the subsequent language based policies of the regime referred to earlier, turned the Tamil youth towards the path of separatism. The southern youth chose a revolutionary path for a socialist state. Unemployed youth of both the North and the South perceived their position to be one with 'nothing to lose and everything to gain' in their respective choices. In economic terms, the opportunity cost of rebellion was minimal or zero for both the northern and southern youth.

It is now opportune to examine the feasibility of revolt based on the theoretical approach discussed earlier.

Organisational – From an organisational point of view, the feasibility of revolt was very high both in the North, the East and in the South, simply due to the sudden and large increase in the number of unemployed youth. That they were educated was another factor in favour in the terms of planning, communication, and command and control of the rebels. The concentration of the population base in the North and the East in geographically isolated areas with large extents of uninhabited forests in between them and the rest of the country, was an added advantage for the northern rebels.

Military and Financial – The northern and the southern rebel movements took different approaches in military preparation. The northern rebels benefitted from alleged Indian undercover training, the availability of a safe haven and high-level support from the neighbouring Tamil Nadu along with financial support from the global Tamil diaspora. The southern rebels had a more domestic orientation wherein they had the support of some local armed forces personnel, while finances as well as arms were procured by raiding banks and the establishments of the armed forces. Naturally, the level of military and financial feasibility of the southern rebels was far less than that of their northern counterparts. The early collapse of this movement referred to earlier may also be attributed at least partly to this, and partly to the fact that it was not based in a geographically isolated area, as in the case of the northern rebellion. Another explanation for this early end is the annihilation of the high command of the Sinhala Youth organisation in 1989. This is not a very satisfactory explanation since it can easily be countered with examples elsewhere of such movements continuing even after the death of their original leader(s).

Economic Impact on Sri Lanka

The correct approach to measure the impact of the conflict on the economy is to calculate the destruction of the factors of production, to determine the country's potential output without war, and then compare this with the actual output. In other words, it is to compute the difference in output with war and without war. In reality, such an exercise is an arduous if not impossible task due to measurement difficulties and data constraints. The easiest perhaps is to measure

the military cost aspect. In economic terms however, the military expenditure incurred by the rebels is also a part of the cost, which is not easily measured. The other costs are those of meeting the needs of the internally displaced persons and the damage to the capital assets including land due to the conflict. The cost of rehabilitation of the destroyed capital assets is the next in this sequence.

Loss of income due to foregone investment because of conflict can also be very significant. Since there is conflict and associated risk, local and foreign investors do not invest in the economy concerned as much as they would have done otherwise. The crowding out of both public and private investment due to increased military expenditure is also very important. The crowding out of public investment due to military expenditure in the government budget is obvious. However, there is another crowding out. When the government borrows from the financial markets, funds available for the private sector to invest are reduced. Yet another cost of the war is the loss of income due to reduced tourist arrivals compared to the potential.

Output foregone due to the displacement of people and the resulting disruption of their economic activities is another impact. The loss of output due to deaths and injuries is easy to understand, but hard to quantify. Finally, the psychological trauma of those experiencing violence has economic costs as well. The people so affected cannot go about their daily tasks in the normal manner and so their economic output suffers. If not properly addressed, this can cause under performance in the long term and even cause further conflict particularly, when the numbers of such people are large.

A few easily observable and measurable examples of the costs of conflict in Sri Lanka are:

- (i) In 1983, the defence budget of Sri Lanka was only 1.4 per cent of GDP. Thereafter it ranged between a maximum of 6 per cent of GDP in 1996, and a minimum of 1.67 per cent in 2003. The average for the period 1985 to 2009 was 4.32 per cent of GDP compared to the 1.4 per cent before.
- (ii) In 1984, public investment was 15 per cent of GDP. During the subsequent period, this dropped sharply and in recent years, it has ranged around 6 per cent of GDP.
- (iii) Tourist arrivals to Sri Lanka in 1982 was recorded at 400,000. In 2007, the year prior to the global recession because recession is not a good year to compare—Sri Lanka had only 494,000 tourists. Therefore, it is a growth of a mere 23 per cent from 1982 to 2007. In contrast, the tourist arrivals to Thailand during the same period increased from 2.5 million to 14.5 million, an increase of 580 per cent. That is an indication of the kind of opportunity cost in terms of tourism.
- (iv) Foreign Direct Investment in Sri Lanka in 1984 was 1.3 per cent of GDP. The average annual foreign direct investment in Sri Lanka from

2001 to 2009 was only 1.24 per cent. During the same period, it was 4.5 per cent in Vietnam and 2.95 per cent in China.

- (v) Another example is the share of GDP from the northern province in the economy. This was 4.4 per cent in 1990, which reduced to 2.9 per cent in 2009. Data is not available for the earlier period. If not for the war, the percentage would have been at least maintained at a similar level.
- (vi) The impact on the annual GDP at peak times of conflicts:
- In 1971, the first revolt in the South, the GDP growth rate of the country dropped to 0.7 per cent from 4.3 per cent in 1970 and recovered to 3.2 per cent in 1972.
 - In the period 1987-1989 during the second revolt in the South, the three year average annual GDP growth rate dropped to 2.1 per cent from 4.8 per cent in the three years immediately before (1984-86), and then recovered to an average rate of 5 per cent in the subsequent three year (1990-1992) period.
 - In 2009, the peak and final year of the conflict in the North, the GDP growth rate dropped to 3.5 per cent from 6 per cent in 2008, and then recovered to 8 per cent in 2010.

N. Arunatilake, S. Jayasuriya and S. Kelagama, estimated the cost of the northern insurrection during a period of 15 years until 1999, to be about the entire GDP of the nation for two full years.³³ Given that in the subsequent 10 years the intensity of the conflict was magnified, the total cost of the northern insurrection on the same basis, may be taken to be the entire GDP of the nation for four or five full years. However, there is no such assessment of the economic impact of the southern insurrection. The GDP growth rates given in (vi) above gives an indication of the economic costs of the two southern insurrections during their peaks. However, economic costs are spread over a much longer period than just the peak periods. One cannot be faulted for speculating that four decades of conflict may have altogether cost the nation the output of one full decade.

Economic Impact on India

The author has no access to data whatsoever on the costs to India of the conflict in the North of Sri Lanka. However, a simple enumeration of the types of direct and indirect costs incurred by India may serve the purpose of illustrating the overall high magnitude of such costs. Among the direct costs to India based on the literature survey are:

- (i) the costs of (alleged) hosting and training rebel cadres
- (ii) costs of hosting thousands of Sri Lankan refugees for decades
- (iii) cost of air drops etc. of the so called 'humanitarian' assistance in 1987
- (iv) cost of deploying a large Indian Peace Keeping Force in the North and East of Sri Lanka from 1987-89

- (v) cost of increased border and coastal surveillance
- (vi) cost of aid for post war reconstruction.³⁴

Some of the indirect costs to India apparent to this author are:

- (i) potential political de-stabilisation of Tamil Nadu
- (ii) potential economic costs, including increased investment risks
- (iii) loss of output due to impediments to free the flow of goods and services between the two countries on account of heightened security and resulting red tape and bureaucracy.

Potentially Peaceful Way Forward

It appears from the aforesaid that the ethnic divide in Sri Lanka added fuel to the fire lit by the relative deprivation in the North caused primarily by large scale youth unemployment rather than the other way round. Similarly, the southern youth revolt with two armed uprisings was also caused primarily, by the frustration of youth aspirations due to the lack of jobs although there were other factors such as their marginalisation due to their caste and rural origin. The comparative study of the northern and southern youth revolts suggest that their longevity and severity are explained by their organisational, military and financial feasibility instead of relative deprivation per se.

A peaceful way forward must therefore, effectively address the challenge of youth unemployment and meet their aspirations. This has to happen with providing adequate jobs on the one hand, and the right kind of skills, including that of entrepreneurship to the youth on the other, along with economic inclusivity in all spheres. Since the government cannot create all the required jobs, the private sector has to be encouraged with a favourable business environment. Such an environment will help nurture entrepreneurship amongst the youth as well.

A mere political solution without attention to the above root cause may not be adequate for sustainable peace. On the other hand, an economic solution by itself will also not suffice. In any event, peace and stability are pre-requisites of continued economic progress, and so a political process addressing the concerns of the affected parties will have to go hand in hand with the essential economic processes.

R. Nair and others present cross-country empirical evidence of a positive correlation between the likelihood of armed conflict and employment in South Asia. They also call for a policy mix of promoting jobs as well as economic growth, rather than merely promoting economic growth with the expectation of economic growth leading to increased jobs.³⁵ This prescription is relevant to Sri Lanka as well.

Attention to increasing regional cross border trade and investment instead of supporting conflict in the neighborhood, by all the nations will be a refreshing change right across the region. The required way forward cannot be achieved

within the countries concerned by themselves. There is a regional collective responsibility for peace and stability. Sri Lanka's experience in terms of the feasibility of revolt clearly illustrates this reality.

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ANNEX 1

Population, Labour Force, Education, Economic Growth and Unemployment in Sri Lanka
(Selected Years 1946-1990)

Year	Population (^{'000})	Annual population growth rate %	Labour force (^{'000})	Literacy rate %	Education expenditure / GDP ratio %	GDP growth rate %	Unemployed number (^{'000})	Overall un- employment rate %	Educated unemploy- ment rate %
1946	6657	n.a	2611	62.8	n.a	n.a	n.a	n.a	n.a
1953	8098	2.0	2993	65.4	2.9	1.9	n.a	n.a	n.a
1963	10582	1.3	3464	71.6	4.4	2.8	265	7.7	21.13
1968/9	12252	2.5	4169	n.a	4.0	4.8	559	14.3	n.a
1971	12690	1.4	4488	78.5	4.2	0.2	839	18.7	14.78
1973	13091	1.8	4560	n.a	3.6	3.7	793	18.3	n.a
1975	13496	1.6	4957	n.a	2.7	2.8	984	19.7	n.a
1978/9	14472	1.8	5521	n.a	2.7	6.3	874	14.8	32.15
1981	14847	0.7	5016	87.2	2.4	5.8	895	17.9	16.98
1985/6	16127	1.5	5972	n.a	2.8	4.3	840	11.7	34.29
1986/7	16373	1.8	6238	n.a	2.9	1.5	967	15.5	39.81
1990	16993	1.0	6001	86.9	3.0	6.2	954	15.9	37.11

Notes:

1. The main source for these data is CBSL 1998. Where other sources are used the specific references are given below.
2. Where the available data periods do not match the population and GDP are given for the following full year. For example, for the period 1968/69, population and GDP are for 1969.
3. Literacy rate in 1946 from Gunewardana (2002).
4. Unemployment data are from Nanayakkara (2004).
5. The years selected in this table are those for which the relevant data are available.
6. There were data generated for entire country covering the North and East after 1990 till 2012.
7. n.a. = data not available.

6

Nepal's Quest for a Constitutional Settlement

Prashant Jha

On May 27, 2012, Nepal's quest for a federal, republican and democratic constitution suffered a severe set-back. The term of the elected, representative, and inclusive Constituent Assembly (CA) ended without the statute being written and promulgated, with parties unable to come to an agreement on the future federal structure of the Nepali State. The interim constitution had not envisaged a situation where the CA would fail, and thus had no prescription to offer. And Nepal was pushed into an uncertain maze.

Meanwhile, the government announced elections for a new CA. The opposition termed the move as unconstitutional, and claimed the CA's dissolution was a conspiracy to retain state power, on the part of ruling forces. Politics in Nepal since then, has been swinging between the option of either reviving the old CA, or holding elections. Various constraints and potentialities are in-built in both those options. Polarisation has deepened; institutional relations between constitutional offices, particularly between the President and Prime Minister, remain tense; there is no clear and commonly agreed upon roadmap for the future; extremist forces, both on the right and the left, are getting active; and there remains only a narrow window to re-engineer the political consensus that leads to major democratic achievements.

In this backdrop, this paper will review some of the key political developments of the past five years in Nepal, particularly the end of a despotic and feudal monarchy, the transformation of ultra-left rebels into a democratic force, the power-sharing arrangements, a unique process of integration and rehabilitation of former Maoist combatants, the opening up of the democratic space and the assertion of the marginalised communities. It will examine the nature of current crisis in Nepal, the contentious issue of federalism, and ways to break the impasse. And it will end with an assessment of the immediate and medium-term challenges in creating a stable Nepal.

From Monarchy to Democracy

In the prolonged stalemates that have become a character of Nepali politics, it is often easy to forget the long distance the country has come in less than a decade. Exactly ten years ago, King Gyanendra Bir Bikram Shah Dev had dismissed a Prime Minister elected on the floor of the house, on grounds of being 'incompetent'. He then arbitrarily, and unconstitutionally, nominated and dismissed three Prime Ministers in as many years, before taking over direct power through a coup on February 1, 2005.

Democratic space and liberties were curtailed, and efforts were made to impose an autocracy while keeping Nepal isolated from the rest of the world. Beyond Kathmandu politics, the conflict raged in the country side. At its peak, seven people were being killed every day, while Nepal reported the highest number of enforced disappearances anywhere in the world. A triangular power conflict between the palace, parliamentary parties, and Maoists seemed intractable; the constitution of 1990 was in tatters; violence was the norm; and political rights were squeezed.

Seven years ago, in November, the stalemate broke with a historic 12-point agreement between the parliamentary parties and the Maoist rebels. Stripped to its essence, the Maoists said they would accept multi-party competition and give up their instruments of violence; the parliamentary parties desired complete democracy and decided to join the struggle to end autocratic monarchy.

The pact led to the People's Movement of 2006 which forced Gyanendra to accept that sovereignty lay with the people, not the palace. The old Parliament was reinstated and the Nepali Congress (NC) leader G P Koirala became the Prime Minister once again. A ceasefire accord was signed between the government and the Maoists, and a long and difficult trek to peace and a restructured Nepali State through an elected Constituent Assembly began.

The process has been marked by continuous tensions between key political forces and years of stalemate. Protracted negotiations over issues as diverse as political power-sharing arrangement to the technical details regarding the future of the Maoist combatants have taken place. Throughout the period, the political theatre became more crowded as political parties fragmented. Meanwhile, the Madhes Movement of 2007 and 2008 established the agenda of federalism, throwing up a new set of actors and issues.

But the core effort, for a large part of the process, has been accomplishing a political deal with the Maoists—which would give them a share in the power structure, make them secure and meet their political agenda. Simultaneously, it would lock them into the discipline of multi-party democracy, transform their violent and militant culture, and catalyse a change in their views about the future economic and foreign policy trajectory of Nepal.

Peace Accord

In November 2006, a Comprehensive Peace Agreement (CPA) declared the end of the civil war. An intricate political time-table was laid out for elections to a Constituent Assembly. Provisions—though not well-defined—were framed for the future of Maoist combatants who were to be ‘possibly integrated in security organs’. Other CPA commitments included justice for victims who suffered during the war, the democratisation of the Nepal Army, land reform, and proportionate inclusion of marginalised groups in the state structure.

Subsequently, an interim legislature was constituted with Maoist presence. In January 2007, an interim constitution was promulgated, meeting a key Maoist demand that they would not accept the framework of the old constitution; and an interim government was set up with Maoist ministers. The interim constitution, continues to be Nepal’s defining document. Meanwhile, over 30,000 Maoist combatants and more than 3000 weapons were registered in UN-monitored cantonments. Towards the end of 2007, a new deal had to be negotiated for an electoral system, with a mix of first-past-the-post seats and proportional representation, and a specific provision that the monarchy would remain ‘suspended’ and then be abolished by the first sitting of the elected Constituent Assembly.

After two postponements, CA elections were held on April 10, 2008. Contrary to almost all calculations, the Maoists emerged as the single largest party in the house. They had more seats than the NC and Communist Party of Nepal (Unified Marxist Leninist) put together.

The elections results transformed the dynamic of the peace process. Till then, the bigger parties had thought they would accommodate a weak Maoist force, diluting its agenda, and it could tag along as the third force of Nepali politics. Suddenly, the third force had legitimately been voted in as representing the aspirations of over 30 per cent Nepali voters; the Maoists saw in it a vindication of their politics and agenda. This frightened the other political forces, which began seeing the Maoist intent for ‘capturing state power’. This contradiction between Maoist ambition, born by the electoral success, and the fear and insecurity of older parties, born by their dismal poll showing, was to define the politics of the coming years. The elections were also significant for they revealed the Madhesi parties as the swing force in Nepali politics. Together, the three Terai parties, espousing the agenda of dignity for the plains-people, federalism, and inclusion, won 83 seats in the 601-strong parliament.

While the election was for a CA to write the constitution, for almost all the four years that the CA was in existence, the focus was on two different issues—power-sharing and the peace process, narrowly defined as the integration and rehabilitation of former Maoist combatants in the cantonments.

Power-Sharing

The Maoist Chairman Pushpa Kamal Dahal 'Prachanda' led the first government after the CA elections. Nepali Congress, the other key partner in the journey that began with the 12-point pact, stayed in the opposition marking the end of the politics of consensus. But, Prachanda was forced to resign in May 2009 after a failed attempt to sack the then Army Chief, General Rukmangad Katawal. The President did not accept the PM's recommendation to sack the Chief. Instead, he wrote a letter directly to General Katawal to stay on in office. Prachanda's move had come in the wake of increasing tensions between the Maoists and the Nepal Army (NA). His opponents projected it as an effort by the Maoists to 'infiltrate' the army, ensure a pliable chain of command, carve out a favourable integration deal, and thus 'capture the state'.

The move galvanised the opposition, and once Prachanda resigned, 22 non-Maoist parties came together in parliament to elect UML leader Madhav Kumar Nepal as the PM. The NC played a supportive role in the government. The Madhav Nepal premiership was marked by an intense polarisation in Nepali politics. The Maoists questioned the legitimacy of the President's action; they waged a movement for 'civilian supremacy', arguing that the issue was about civilian control of armed forces. The Maoists then raised the banner of 'national independence', claiming that foreign forces in general, and India in particular, had orchestrated the anti-Maoist alliance. The rebels took an increasingly radical turn; they blocked government programmes, demanded Madhav Nepal's resignation and claimed government leadership.

According to the ruling parties, Madhav Nepal would not resign as long as the Maoists held on to the People's Liberation Army, and did not compromise on terms being offered by the NC and UML. And as long as the peace process was not complete, the constitution would not be written. The Maoist counter was strong—they would not move forward on the peace process as long as they were not in government. They demanded that the peace process and constitution writing should proceed simultaneously. Meanwhile, the CA's term expired on May 28, 2010. The parties agreed on a one-year extension of the CA, provided Madhav Nepal committed to make way for a national consensus government. Madhav Nepal resigned, but the Maoists were not able to muster up a majority in the house.

In February 2011, Maoists succeeded in breaking up the 'anti-Maoist' alliance, by supporting UML chairman Jhalanath Khanal as the PM. This was the third government post the CA elections. The new 'left alliance' brought in a new polarisation. Both NC and major Madhesi parties were outside government. The government's 'nationalist' orientation did not win it friends in New Delhi. More importantly, the Maoists still did not move ahead on the key issue of the PLA, largely because the party was immersed in internal tensions through this period.

The failure to kick-start the peace process eventually led to Mr. Khanal's resignation in August 2011.

This finally led to the election of Maoist vice-chairman and ideologue Baburam Bhattarai as the PM, with the support of the Madhesi parties. Maoists had meanwhile, made a categorical commitment to the 'peace and constitution' line, as opposed to 'people's revolt' line through a party central committee meeting. While the opposition decried it as an 'unnatural alliance', the ruling alliance projected it as a government led by forces which had emerged from movements, and where partners shared a common goal on state restructuring. For a brief period in May 2012, after the completion of the peace process, this also transformed into a national unity government. It is this government that remains in power in Nepal currently, while opposition parties, led by the NC and the UML, have demanded its immediate resignation as a precondition for consensus.

Looking back at power-sharing experiments in Nepal, it is clear that a central element of the peace process, was giving the Maoists a proportionate share in the power structure. When they remained an electorally untested force, they were a junior partner in the interim government led by GP Koirala. They formed the government after the elections, but misread the mandate as a blank cheque to implement their radical agenda, at the cost of political consensus. This led to their ouster, and the formation of a non-Maoist government. But the Madhav Nepal experiment, while showing the Maoists the limits of their power, was clear proof that keeping the former rebels out is an untenable proposition. Not only was the step undemocratic, but it led to instability and paralysed the political process. The Khanal government's sole achievement was that it ended the political isolation of the Maoists. Once the reformed Maoists came back to power under Baburam Bhattarai, the political process moved forward, the peace process ended, and the country came very close to writing a constitution. But the fact that the Nepali Congress—another key partner in the peace process—did not have an ownership of the government proved to be a major obstacle.

Despite the constant emphasis on consensus, what has remained elusive in Nepal through this period is a government of national consensus.

'Two Armies'

The key element of the peace process has been the management of the two armies. The CPA envisaged the integration and rehabilitation of the People's Liberation Army combatants, and democratisation of the Nepal Army as a part of broader security sector reform initiative. The focus has, however, largely been on setting the future of PLA combatants and ending the state of 'two armies' in the country.

For five years, former Maoist fighters lived in seven main cantonments and 21 satellite camps across the country. Initially, the UN Mission in Nepal (UNMIN) used criteria—based on age and recruitment date—developed by the

parties to verify the combatants. Over 8000 out of 31,000 combatants who had registered, did not turn up for verification. 4000 individuals were 'disqualified' for they did not meet the criteria, but they stayed on in cantonments till February 2010 when they were finally 'discharged'. 19,602 were eligible fighters entitled to state support. The combatants got a salary every month; the cantonment infrastructure was supported by donors; weapons were stored in containers, one key of which was with the Maoists while the other was with UN. A Special Committee for the Supervision, Integration and Rehabilitation of the Maoist combatants, with the mandate of settling their future, was eventually set up in late 2008.

The integration debate in Nepal touched upon several issues, the first of which was timing. Initially, the democratic parties refused to entertain the possibility of any integration before the CA elections. Their calculation appears to have been that once they performed well electorally, they could drive a hard bargain with the Maoist. Now, in hindsight, NC and UML leaders often emphasise how going into elections, while the Maoists still had their armed structure, was a mistake.

After the elections, especially when the Maoists were in power, NC and UML leaders got cold feet about integration, and began feeling that this would enhance Maoist strength further. Till the polls, the parliamentary parties saw the Maoists as allies, and their suspicion was reserved for the army, which was seen as loyal to the monarch. After 2008, the parties began seeing the army as an ally—as the final bulwark of resistance against Maoist 'onslaught'. And the army itself was resistant to integration. The attitude was reflected in the position of the democratic parties.

Maoists were not keen for integration as well, in that period, for they could retain the PLA structure. The cantonments added to their financial muscle, as each combatant contributed a part of his/her salary to the party, as well as gave them bargaining power. A strong view in the party was that PLA should be kept intact as long as the constitution was not written.

Firstly, views about timing changed after the election of Madhav Nepal as PM. Now, the democratic parties were keen to wrap up integration as soon as possible, on terms that would not affect the structure of the NA. But the Maoists rejected the proposal, for they linked it with power-sharing and demanded government leadership first. The future of the combatants was thus inextricably linked to the prospects of political power for the different parties in Kathmandu.

Secondly, the issue of numbers took up a long time. Extremist Maoist leaders kept demanding the integration of all the 19,000 combatants into the army. While extreme conservatives claimed that not a single combatant should be absorbed in the armed structure and should be packed off with rehabilitation packages. There was an informal understanding between PM Koirala and Maoists

when the peace process initially commenced, about the numbers which could be accommodated. But once Koirala passed away in March 2010, the actors did not agree on what the informal understanding had been. Maoists demanded at least 8000 combatants should be integrated, while NC leaders floated figures of 2-3000. For a long period in the negotiations, the Maoists floated the idea that combatants should be allowed to choose whether they would like to be integrated or retire, but other parties rejected it, fearing the party would inflate the numbers.

Thirdly, there were long back-channel dialogues between parties, between parties and the army, and between domestic and external actors, on the structure and 'modality' in which integration could occur. Maoists wanted direct integration in the NA, with a separate unit. Other parties believed that if integration was necessary it should be in security forces other than the army. They also believed that if the integration had to happen in the army, the combatants must be scattered across existing units.

Fourthly, a key issue of contention was regarding the 'standard norms', especially on age and education, for integration. Maoists wanted specially created norms which would take into account the fact that the combatants were already verified and had fought in a war; the parliamentary parties and NA wished to impose exact norms as they existed for normal recruitment in the forces. The Maoist argument was that this was not recruitment, and combatants made it an issue of pride that their 'chests not be measured'.

Fifthly, a long debate took place about the highest rank at which the Maoists would be integrated. The former rebels initially pushed for a Major-General, gradually came down to a Brigadier-General, and eventually settled for a Colonel. The other parties said that rank should be a function of the years of service, and no PLA officer could rise beyond a Major.

In early 2011, Nepal Army proposed the formation of a directorate which could include a mix of Maoist combatants, and personnel from security forces. This was a step forward in the process of integration. Another step towards integration was after the election of the Bhattarai Government, when the Maoists handed over the keys of the weapon containers to the Special Committee, which had been monitoring camps after the exit of UNMIN in early 2010.

On November 1, 2011, the parties arrived at a historic seven-point agreement. They decided that a maximum of 6500 combatants could be integrated and that there would be a general directorate under the Nepal Army command, led by a major general. 35 per cent of this force would consist of Maoist fighters and 65 per cent personnel would come from NA, Nepal Police and Armed Police Force. It was also decided that the mandate of the force would be industrial security, development, disaster relief, and forest protection. There would be flexibility on age, educational norms, and marital status for Maoist combatants; and ranks

would be determined subsequently. Along with integration, detailed rehabilitation packages were drawn up and the option of retiring with cash was also offered to the combatants. Depending on the rank, they were offered monetary compensation ranging between NRS 500,000 and 700,000.

On April 10, 2012 another key development took place when internal tensions broke out in the camps. To quell the unrest, and ensure that the chain of command remained intact, the Maoist-led government sent the Nepal Army to the cantonments, bringing it under the formal control of the state.

Over several rounds of regrouping, the results turned out to be startling. Only six of the 17,000 combatants in the camps opted for rehabilitation. Only 3000 opted for integration—after tests, the final number of soldiers and officers is about 1500. This has raised questions about the need for a directorate at all. And an overwhelming majority, 15,000 plus former fighters who waged the war to effect a revolution, and joined the peace process to overhaul the security structure, opted to retire and walk away with cash.

The cantonments closed down in October 2012; the final instalments of payments have been made; those to be integrated have taken short leave before they go through rigorous training regimes; and the People's Liberation Army (PLA), which drew the Nepal Army to a stalemate, has ceased to exist. But it has thrown up important questions. What will former combatants, who feel resentful both with the state and their own party leadership, do next? Will radical Maoists be able to tap into this discontent to ignite a new rebellion?

The Maoist Rift

A constant feature of the entire process has been the internal tension within the Maoist party, which finally crystallised in a split in June 2012. As is well-known now, the tensions in the party went back to the war-period. At the historic Chunbang meeting in 2005, Maoists made a decision to ally with democratic parties against monarchy, and fight for a democratic republic as their goal. This was a political line pushed by Bhattarai, and necessitated closer engagement with the Indian establishment. Two key leaders, Mohan Vaidya 'Kiran' and C.P. Gajurel were in Indian prisons at the time. More dogmatic in their orientation, they were uncomfortable with the changed political line. The tension was a continuation of the rift within Nepal's communist movement between the 'democratic' and the 'nationalist' left. Soon after King Mahendra had taken over power in 1960, one left faction had allied with the palace in the name of 'nationalism', read anti-Indianism, while another more progressive line, led by Pushpa Lal, was in favour of allying with democratic Nepali Congress.

After coming into open politics, this tension manifested itself on several occasions. In 2007, the radicals led by Kiran, and strongly supported by a younger radical leader from Rolpa, Netra Bikram Chand 'Biplab', forced the Maoists to

withdraw from the interim government, demanding immediate abolition of the monarchy and a fully proportionate representation based electoral system. At the end of 2008, when the monarchy had been abolished and Prachanda was leading the government, the dogmatic group within the party pushed for a new political line at a meeting in Kharipati, Bhaktapur. Now that the feudal monarchy was abolished, they argued, the party's core contradiction was with 'expansionists' (read India), and its 'brokers' (read Nepali Congress and other democratic parties). Observers feel that it was this push that forced Prachanda to take drastic measures against the army, and create a new polarisation.

Subsequently, it was Kiran and Biplab who encouraged the Maoist leadership to go on a 'nationalist' overdrive, and target India while opposing the Madhav Nepal government. In a major meeting at the end of 2009 in Palungtar of Gorkha, the contradictions within the party came to the fore. Kiran presented a paper stating that the core contradiction was with Indian expansionists and ruling class and the aim should be a people's republic through a 'people's revolt'; Bhattarai argued that the enemy retained remnants of feudalism and the goal should remain institutionalizing the federal democratic republic through the 'peace and constitution line'. Prachanda veered towards Kiran's line, before shifting back to Bhattarai's line in April 2012.

For a brief while, on the question of organisational restructuring, Kiran and Bhattarai worked together against Prachanda. But this was short-lived and soon after Bhattarai's elevation as PM, the Maoist handover of keys to weapon containers, and the November 1, 2011 peace agreement, Kiran's group got irreversibly alienated. They termed it as 'surrender' and a 'betrayal of revolution'. They projected the understanding with Madhesi parties, the government's cordial ties with India, the signing of the Bilateral Investment Promotion and Protection Agreement (BIPPA) as 'anti-national acts', once again indicating their aversion and resistance to India. Kiran and Biplab even engaged with the NC and the UML in the run up to the end of the CA, and toyed with the idea of displacing their own party's Prime Minister.

Thus, as the mainstream Maoists accepted multi-party democracy, implemented commitments vis-a-vis the peace process, stopped the use of violence, refined views on nationalism and gave up their hollow anti-India rhetoric, a new radical splinter was born. Soon after the CA ended, Kiran split in June 2012. They accused Prachanda of right-wing revisionism, said that the failed integration process and constitution project indicated the failure of the peace and constitution line, and promised to wage a new struggle for a People's Republic.

In the months leading up to November 2012, this group has launched an 'anti India' campaign. It has set up a body of ex-combatants, angry with the old party leadership, and threatened to wage another rebellion. The party's most radical leader, Biplab, is understood to be making silent preparations for a second revolt.

This group is in contact with royalists, and has even reached an understanding with the royalist party led by Kamal Thapa to co-ordinate on issues of ‘nationalism and sovereignty’. The steps taken by this outfit will be a key determinant in shaping Nepal’s future political trajectory.

The Constitution-Making Project

While the transformation of the Maoists has been an integral element of the political process, an equally important development has been the assertion of marginalised groups. Madhesis, people of plains-origin who speak Maithili, Hindi, Bhojpuri, Awadhi, Urdu and share linguistic, cultural, kinship ties with people across the border in Bihar and UP; Janjatis, the indigenous peoples like Limbus, Rais, Tamangs, Newars, Gurungs, Magars and Tharus; Dalits and women are more politically aware than at any point in Nepal’s history. Madhesi demands include a redefinition of Nepali nationalism, federalism with a single or two Madhes provinces in the plains, and inclusion in state organs, especially the Nepal Army. Janjati demands revolve around the question of representation and federalism which incorporates an ethnic identity. The assertion of these groups has a major impact on the constitution-making process.

Once the republic was declared, it was obvious that navigating the federalism challenge would be the biggest challenge. But there was little public discussion on the issue, with discourse centred largely on the peace process and government change. The NC and the UML can be called reluctant converts to federalism—they were forced to incorporate the issue in the interim constitution after the Madhes movement. There remained strong elements in both parties resistant to the idea of federalism. Those who accepted it, argued that state restructuring should happen on grounds of economic feasibility and resource division rather than identity. The Maoists, during their war-time mobilisation, had backed creation of autonomous republics—they had created a narrative of how a centralised state, run a by tiny Nepali speaking Bahun-Chhetri elite, had colonised the rest of the country and how ‘ethnic’ or identity based provinces could unlock the discrimination. While the party leadership itself was led by Hindu upper-castes, its social base was Janjati and Madhesi intermediate and lower castes, which ensured that the party did not give up on the federal agenda. The debate on federalism was polarised through this process, where one’s surname was the determinant of one’s position. Most Madhesis and Janjatis were firm advocates of identity federalism, while a large section of Bahuns and Chhetris supported resource based federalism.

These positions got reflected in the various proposals that emerged in the federal discussions. The CA committee on state restructuring was divided, but majority members voted for a 14-state province. The Maoists and Janjati members of the UML were on one side, while the NC was on the other. These 14 provinces

would include two non-contiguous provinces in the Terai with a tiny stretch of central Terai connected to a hill province. Most hill provinces were named after the ethnic group which claimed that respective region as their homeland, and had a demographic advantage there. So Kathmandu would become Newa province, named after the Newars; the regions adjoining the capital would be Tamsaling; the eastern hills would have Limbuwan and Kirat and so on. An additional proposal of the CA committee that drew widespread opposition was that of 'agraadhikar' or preferential political rights, according to which only a member of the dominant ethnic group would be eligible to become the chief minister of that province for two consecutive terms.

In 2011, the government set up a State Restructuring Commission (SRC). The SRC was divided with Maoist-nominated Janjati members, Madhesi members, and a Dalit member on one side, and mostly the NC and the UML hill upper caste members on the other side. The SRC majority proposal was for ten provinces. This would include two provinces in the Terai—Madhes and Tharuhat, and eight in the hills. To reach out to other communities, and respect the notion of individual rights, the majority members also removed the idea of political preferential rights. So while provinces would be named on ethnic and regional identities, and would be carved out in a manner where such groups would have a slight demographic advantage, it would not give any special rights to members of those groups. A minority proposal backed creation of six states. Here, hill and Terai regions would be mixed—anathema to the Madhesis who saw this as a conspiracy to divide the Madhes, dilute their identity, and ensure hill-domination. In most of the hill provinces carved out under this proposal, the hill upper castes would retain a demographic majority.

For a long time, the NC and the UML have been toying with the idea of postponing federalism. The Maoists and the Madhesi groups have, however, made it clear that they believed in federalism with identity, constitution with federalism, and constitution from the CA.

On May 15, 2012, a fortnight before the constitution was to be promulgated, the parties came to an agreement. They decided Nepal would have a mixed form of government—with a directly elected President, and a PM elected by the legislature, and powers would be divided between the two. While there were concerns that this would paralyse decision-making, the other crucial agreement was to have eleven provinces. They said the boundaries of the future provinces would be decided by a Federal Commission to be set up in the future; that names of provinces would be determined by future provincial assemblies. The Madhesi parties said they did not agree, but would not obstruct the constitution-making process. Informally, those in discussions leaked details of the eleven state proposal—specifically, this would have entailed dividing the Terai into five provinces and it would give upper castes a continued demographic advantage, which could translate into a political advantage vis-a-vis Janjatis, in hill provinces.

The backlash of the agreement began. Madhesi parties said they could not accept the deal; Janjati groups called a three-day bandh to express their opposition, which took a violent turn at times; and Maoists, sensing the mood of their allies, backed out of the pact. For the first time, Madhesis, Janjatis across party lines and the Maoists allied on the floor of the house. However, the NC, the UML and the Bahun-Chhetri groups outside the house continued supporting the pact.

This polarisation in the final fortnight of the CA could not be resolved. The government realised that framing a constitution was becoming increasingly difficult, and sought to extend the term of the house by another three months. But the Supreme Court prohibited further extensions. On May 27, parties discussed various options—of promulgating the constitution by leaving federalism which was not acceptable to ruling parties; of declaring an emergency to extend the CA which initially the opposition rejected and later the government was not very keen on; amending the constitution to save the parliament even as the CA dissolved and related proposals. Eventually, 45 minutes before midnight, the government called for fresh elections to a new CA even as the opposition criticised the move as unconstitutional.

Current Crisis

Nepal is currently caught up in a constitutional and political deadlock. The interim constitution did not envisage the failure of the CA, does not have provisions for fresh elections, or any other alternative. The interim constitution cannot be amended as there is no parliament. Laws cannot be passed, and even the full budget cannot be brought in through normal channels. There is only one constitutional way out, which is for the President to use Article 158, which gives him the 'power to remove obstacles'. The government has sought to bring in ordinances, a full budget, and amend election related laws using this provision—but the President has chosen not to use it, and said he would do so only on the basis of a political consensus.

The consensus is elusive, for NC and UML have made the government's resignation a precondition for a deal. The opposition believes that the Maoists deliberately 'dissolved' the CA to 'capture state power', while the Maoists claim they saved the country from a vacuum by declaring elections. The opposition wants the President to replace the PM, while the ruling parties argue there is no constitutional mechanism to arbitrarily replace the PM. For several months since the CA ended, political discussions in Nepal also revolved around possible solutions.

One option, first floated by former lawmakers, and picked up by Maoist Chairman Prachanda, and NC leaders, is arriving at an agreement on contentious issues of the constitution, postponing remaining issues for the next elected house, reinstating the old CA for a short period, and promulgating the constitution.

The obvious advantage of this option is that it will be quicker, lock in the agreements that have already happened, create a framework for the system, and end the constitutional uncertainty. But there are obvious challenges too—legally, reviving a CA whose term could not be extended as per a judicial verdict will be difficult; politically, the landscape is more crowded with newer actors who have emerged since the CA dissolved. Substantively, an agreement on federalism and constitutional issues is elusive; and morally, CA members who could not deliver a constitution in four years have a difficult task in convincing people that it ought to be revived.

The other option is conducting a fresh poll. Here, the key issues include the nature of the election system to be adopted, especially in the light of a new census; the date for elections; and most importantly, the composition of the election government. Maoists want the current government to be transformed into a national unity formation. The PM makes the case that constitutionally, no one else can be appointed; that the peace process is over and so other parties should not be reluctant to accept Maoist leadership. But this is unacceptable to the opposition. A possible compromise formula being floated is a government led by a neutral figure—either a former Supreme Court Chief Justice, or a civil society representative. Once the parties come to a broad agreement, they can—on the basis of a consensus—ask the President to use Article 158 to amend election laws.

In the absence of any deal, political crisis will deepen. The President is sympathetic to the opposition's stance, and there are hints of increasing tension between the head of state and government. If the President, Ram Baran Yadav, does take a drastic step, like dismissing the PM, he would invite a crisis—the Maoists would resist the move and embark on a radical path; it would also be unconstitutional and undemocratic. At the same time, status quo is dangerous, for the credibility of the entire post-2006 class and process is getting steadily eroded. Elections may not bring out a solution since the polity is even more fragmented and polarized than it was in 2008. Newer regional and ethnic parties have come to the fore. But there appears to be no other way except a deal which would own the work done by the last CA, work out details for elections, and hold polls next spring.

Way Ahead

Nepal has come a long way, and there are definite achievements over the past six years. The country is at relative peace and war has ended. Maoist rebels are now a part of the political structure, and within the confines of multiparty democracy; the country has become a secular, federal, democratic republic even if the details of institutional arrangements are yet to be worked out. Democratic space has opened up; and the marginalised sections are asserting themselves breaking an exclusionary state structure.

At the same time, the current moment in Nepal is fraught with danger. There is a constitutional and political crisis. Any adventurist move, either by the President or the government, can derail the entire political process. The extreme right and extreme left, which lost out by the 2006 democratic change, are working together—trying to spark chaos under the banner of ultra nationalism. The federalism debate, if not negotiated well, threatens to polarize Nepali society irreversibly. Governance and service-delivery have taken a back-seat in the constant political game of one-upmanship. And the political transition remains incomplete, as all achievements are yet to be institutionalised in a commonly agreed upon constitution. It is time for Nepal's political class to show the spirit they did when they signed the 12-point agreement, when they waged a people's movement, when they signed a peace deal, when they held elections, and when they declared the country would be a federal democratic republic. Without that spirit of consensus, Nepal is headed for another decade of instability.

P.S. This paper was presented in November 2012. Since then, Nepali parties agreed to hold Constituent Assembly elections under a neutral government led by the incumbent Chief Justice, Khila Raj Regmi. This government included former bureaucrats. While the June timeline for elections were missed, the second CA polls have been slated for November 19, 2013.

7

From Monarchy to Democracy in Bhutan: Dynamics of Transition and Future Trends

Dago Tshering

With four thousand years of rich heritage, feudalism, hundred years of traditional monarchy and agrarian economic experience, Bhutan's transition to democracy has been an interesting journey. Within the country, the Kingdom of Bhutan is referred to as Druk Yul (Druk—thunder dragon, Yul—land). The term “Druk Yul” is derived from the Mahayana Buddhism School of “Drukpa Kahgyu” since its establishment in the country, and the people of Bhutan are called Drukpa. The name “Bhutan”, some scholars believe, may have been given by ancient travellers to the Himalayan region which means “Bhot-Anta” (end of Tibet). Indeed, geographically Tibet ends where Bhutan begins.

Geographic Location

Bhutan is located in the heart of the Himalayas, sandwiched between India and China. The southern frontier with India follows a line of the tropical foot-hills overlooking the Indian plains, and at places is almost at sea level. The northern frontier with Tibet Autonomous Region of China is formed by great snow-clad ranges in which peaks soar to above 20,000 feet (6096 mt.).

There are three distinct climate zones and vegetation. The tropical zone starts from the southern foothills with luxuriant ever green forests, encouraged by the drenching monsoon rains. The temperate zone is adorned by oak, maple, birch and chestnuts merging into an extensive conifer belt of pines, running through the exhibitionist rhododendrons and azalea. The alpine zone in the north is somewhat dry climate with abundant medicinal plants, gentians, primulae cordicep and turquoise poppy etc.

Demography and People

Most of the people are of Mongoloid stock and some with Aryan background. The people in the eastern part of the country are called “Sharchops” those in the

west and central part are known as “Sha-Wang-Pa-Sum” or “Ngalop” and those settled in the southern parts of the country are called “Lhotshampa”. The 2010 census recorded the population to be almost 700,000 (male 363,383, female 332,439). The population under sixty-four was 449,431. Most inhabitants of Bhutan are Buddhists of the Mahayana School. Hindus are found mostly in the south.

History and Culture

Historical artifacts unearthed from ancient burial grounds in parts of Lhuntse Dzongkha, a district in the northern part, indicate that civilisation existed in the area, as far back as 4,000 years ago. An earthen pot was unearthed from Lhuntse by the Home Ministry, and was assessed by the Osaka Museum of Ethnology. There are also historical relics and other artifacts like Adze, fossils, stone tools and implements and monoliths found in different parts of the country, similar to the artifacts found in the Hunan Province. The cultural heritage and tradition of Bhutan is heavily influenced by the Mahayana School of Buddhism.

The Written History

The written history of the Kingdom is, however, available only from the 7th and 8th century with the advent of Buddhism, when monasteries such as Paro Kichu and Jamba Lhakhang in Bumthang Dzongkhag were established. These monasteries are maintained and in use even today by the monastic body. A combination of Animism and Bonism probably continued to be practiced in Bhutan. It was only after the arrival of the patron saint Padma Sambhava and his follower Denma Tsemang, the Mahayana School of Buddhism was firmly established in the 7th century. The written form of Dzongkha was also introduced by Denma Tsemang during his visit with Guru Rinpoche to Bhutan, as a piece of scripture written by him in Bumthang was found within an image in Lhodrak monastery in Tibet. Thereafter, many Buddhist teachers from the neighboring countries descended in different parts of the country, strengthening the spirit and culture of Buddhism throughout the country.

The Drukpa Kahgyu School

It was however great teachers like Phajo Drugom Zhigpo in the 12th century and Zhapdrung Ngawang Namgyal in the 17th century, who consolidated the Drukpa Kahgyu tradition and unified Bhutan as the land of Drukpa. The theocratic form of governance continued with much presence of feudalism. The country remained independent despite several forays by the British colonialists from India, and several incursions from the Tibetans from the North. The British stopped advances after Bhutan ceded the 18 Duars in the south, and the Tibetan invaders retreated after their defeat at Druk Gyal Dzong in Paro. A Dzong (fort)

was erected in the area and appropriately named Druk Gyal Dzong (the victorious Druk Dzong).

The Dominance of Spiritualism

Zhabdrung Ngawang Namgyal received two Portuguese Jesuits, Father Estevio Cacella and Father Joao Cabral in 1627, at Cherry Monastery. The visitors were much impressed by Zhabdrung's compassion and personal charm. Zhabdrung also reached out for friendship with the neighbouring countries such as Kathmandu in Nepal, Tawang in the Indian state of Arunachal Pradesh, Ladakh, Kuch Behar and Sikkim. Zhabdrung's teachings are still popular in these regions. He built many Dzongs in different parts of the country. The period from the 17th to early 20th century has seen an extension of ecclesiastical/theocratic form of governance called the dual form, spiritual and temporal. People of Bhutan, by and large, lived in peace and stability. All taxes were paid in kind and generally followed an agrarian lifestyle.

The Hereditary Monarchy

It was fifty-first Desi Jigme Namgyel (1870–1873) who after holding many important positions as the *desi*, attempted to consolidate the entire administration under Tongsa Dzong. He was succeeded by his son who later reigned over Bhutan as Gongsa Ugyen Wangchuck. Wangchuck was the first hereditary monarch of the kingdom (1907 to 1926) by way of the unique Agreement of December 17, 1907 offered by the people of Bhutan. He successfully consolidated parts of the country under the central administration. He went to Tibet and was stationed at Jangtse Dzong area, and was the main mediator between the Tibetans and the British Expedition team led by Colonel Francis Edward Younghusband (1903–1904). The British government in India was much appreciative of the mediating role played by then Trongsa Penlop, Ugyen Wangchuck and decorated him with Knight Commander of the Indian Empire.

He was succeeded by His Majesty Jigme Wangchuk, the Second King of Bhutan (1926 to 1952). It was during his reign that the 1949 Treaty of Friendship and Cooperation was negotiated and signed with independent India.

His Majesty Jigme Dorji Wangchuk, the Third King (1952 to 1972) was a visionary and a benevolent king. He introduced the first National Assembly in 1953, of 150 members composed of government officials, monks, and people representatives elected by the local community from each district, sub-division and from the block level. He abolished serfdom and monetised taxes, but the practices of barter system remained in the country side. Paper money was introduced for all forms of payments. Earlier metal coins—"Tickchung", and "Chetrum" of smaller denominations were in circulation. The road construction from Phuntsholing to Thimphu started in 1959-60, and the Five-Year Socio-

Economic Development Plan was launched in 1961 with financial support from India, which was agreed during Prime Minister Jawaharlal Nehru's historic visit to Paro. Pandit Nehru and his daughter, Mrs. Indira Gandhi traversed Nathu La pass, Yatung in Chumbi valley and Ha and Paro in 1958. This was a historic visit to Bhutan by the first Prime Minister of India and his daughter. In mid-sixties after many discussions by the eight-member Royal Advisory Council (RAC) and extensive debate at the National Assembly, and with the support of India, Bhutan finally became a member of the United Nations in 1971. The main responsibility of the eight members of the Royal Advisory Council was to advise the King on issues of national interest. Thus, the foundation of democracy and modernisation process was laid by the third King and he was known as the Father of modern Bhutan.

The Fourth King and Gross National Happiness (GNH)

The National Assembly in 1972, owing to the demise of the Third King, unanimously resolved that the Crown Prince, HRH Jigme Singye Wangchuck would succeed and ascend the golden throne immediately instead of having the interim Council of Regent. The coronation of the eighteen-year-old fourth King took place in 1974. In his address to the Nation he said:

“...The most important task before us at present is to achieve economic self-reliance to ensure the continued progress of our country in the future. Bhutan having a small population, abundant land and rich natural resources, sound planning on our part will enable us to realize our aim of economic self-reliance in the near future.”¹

Through this statement he re-kindled the hope in the people for a prosperous and bright future. While responding to a question from a journalist His Majesty had once said, “Gross National Happiness is more important than Gross National Product”.² At that time the people of Bhutan failed to understand the significance of the statement. Today, this philosophy guides the socio-economic development of Bhutan. Aung San Suu Kyi, who was then living in Bhutan, commented on the concept of GNH calling it, “the practical way in which the Bhutanese seem to be handling the choices and problems which confront them as they take their place among the nations of the twentieth century.”³ The concept was later introduced through the third Five-Year Plan with four-prong strategies for implementing development programmes. GNH therefore stands on four pillars:

- (i) Sustainable development and equitable growth
- (ii) Conservation of environment and protection of eco-system
- (iii) Promotion of culture, protection of heritage and value system
- (iv) Good governance⁴

The Devolution Process

In order to implement the concept in practical terms, a complete decentralisation programme from the centre to the twenty Dzongkhags (districts) was initiated in 1981 by establishing District Development Councils popularly called DYT (Dzongkhag Yargay Tshongchung). After a decade, further decentralisation took place, to the 205 Gewogs (villages) level in 1991, where Village Development Committees called GYT (Gewog Yargay Tshogchung) were put in place. The members of the Councils and the village-level committee members were elected by the local communities for a term of three years. The overall effect on the system was what Jawaharlal Nehru also referred to, taking a cue from Ursula Hick's book *Development from Below*. It empowered the people to determine their own priorities for the Five-Year Plan programmes, and implementation in their own locality.

Jigme Singye Wangchuck also initiated the practice of holding public meetings at every Dzongkhag (district), to review progress of the programmes under implementation, just before launching the next Five-Year Plan, and to obtain views on the planned programmes. People freely expressed their mind making the exercise more meaningful. Such was the process of devolution and decentralisation which completely empowered the people. It not only made the system transparent and gave a greater sense of ownership over the local projects and programmes, but also made the people responsible and accountable. The job of the central and district authorities was to ensure adequate backup, both financial and technical support, and to monitor progress.

Such has been the process of GNH for the well-being of people, which according to the Fourth King should be seen in the extent to which people are happy. Therefore, the responsibility of the government was to create conditions that would enable the people to pursue and increase their happiness. This had to be achieved through a holistic approach to development, whereby the needs of the body and the mind are balanced, and where one complements the other.

Bhutan was then totally dependent on the locally available resources. As a small land-locked country, something needed to be done that could challenge the common wisdom, and at the same time a mechanism suited to the Bhutanese culture and environment was needed, that could transform the lives of the people, by implementing the GNH programmes. Basically, Bhutan needed to act locally.

The Implementation Process

In order to implement the programmes and to ensure delivery, the Bhutan Government proceeded to enact laws that supported decentralisation and peoples' participation. This has ensured a legal face to the system, the mechanism for peoples' participation and the processes served to legally empower the people. Thus, the responsibility of planning and implementation of the local infrastructure

for their own well being was fully transferred to the local people. The Home Ministry was responsible for implementing the mechanism and putting it into practice. As the Home Minister then, it was a privilege for this author to have been involved in the process of decentralisation. The sense of ownership over the local infrastructure strengthened the enthusiasm, responsibility and accountability of the local people over the projects undertaken by them.

GNH was declared in 1975 as the guiding principle for socio-economic development of Bhutan. This decision was taken after having observed many development models being practiced in the neighborhood and beyond, and having pondered the meaning and purpose of development. Bhutan on its part chose not to be confused by conventional development practices. The GNH concept has guided Bhutan's development process, now for over four decades and all the development efforts have led to strengthening the four pillars of GNH.

The economy has steadily moved on the path of sustainable development and balanced growth. Today, Bhutan's environment is healthy and resilient with over 72 per cent forest cover, and 51 per cent of this declared protected National Parks. The constitution requires Bhutan to maintain 60 per cent green coverage at all times. Mahayana Buddhist cultural heritage and tradition with strong value system continue to guide the thinking and everyday life of Bhutan's people. The government's commitment to good governance has given the people a democracy today that has truly empowered the people.

The Democratic Constitutional Monarchy

Bhutan became a Parliamentary Democracy in 2008 in a unique way. The constitution vested all legislative powers in the Parliament which is composed of the Druk Gyalpo (the head of state of Bhutan), the National Council and the National Assembly. This did not happen suddenly or impulsively. Democracy in Bhutan defies all conventional notions of preconditions and outcomes of democracy. The transformation took place over 34 years, spanning the entire reign of the Fourth King. During these 34 years, step-by-step legal instruments, institutional arrangements and administrative systems were methodically and meticulously put in place, to support the process of democratisation. It culminated in the parliamentary election of 2008 and the constitution declared Bhutan a "Democratic Constitutional Monarchy".

Bhutan's transition from Monarchy to Democracy was exemplary and unique as it was accomplished without any uprising. The Fourth King once said, "Bhutan is too small and too vulnerable to be left in the hands of one person who is chosen by birth not by merit. The destiny of the country must be left in the hands of the Bhutanese people." Ironically, it was in 1975 that a Royal Decree dislodged all saw mills out of the forest, at a time when people were feverishly harvesting blue-pine and exporting it to the neighboring states in India. The

affected people did show their concern against the Royal Decree. Thereafter, many national parks were established in Bhutan. Now the people of Bhutan, including those who practiced blue pine capitalism, look back at the Royal Decree with much satisfaction as they see more greenery and healthy environment. The government has also declared Bhutan a carbon neutral country.

In 1998, the Cabinet was dissolved and a new set of Council of Ministers (Lhengyal Zhungtshog) was formed. The National Assembly elected the Council of Ministers from the candidates nominated by the Druk Gyalpo, with a yearly rotating chairperson. This Council of Ministers is fully empowered with executive powers. It would be less than candid to claim that the democratisation process progressed without problems. The people-centric programmes could have been realized at a faster pace, but for the impediments that confronted the government in the late eighties and the nineties.

The Southern Bhutan Problem

The Southern Bhutan and the ULFA (United Liberation Front of Assam)—Bodo problems diverted Bhutan's attention and resources from the process of development and democratisation. As Bhutan is not well-endowed with human resources, it has to rely on foreign workforce, particularly from India and Nepal. Mechanisation has been encouraged, but the progress is slow owing to resource constraints. The demand for foreign workers increased with the implementation of programmes under the Five-Year Plan. The migrant workers also brought their relatives at times. Many began to take advantage of the free education and health facilities of Bhutan. They even occupied government/community land and began to till the land. Many ethnic Nepalese entered through the porous and open borders of Bhutan.

As the progress of development programmes slowed down and public pressure for more facilities became apparent, the 1988 census was launched in Bhutan. It revealed the presence of over hundred and twenty thousand foreign migrants, which was a burden on Bhutan's limited health and educational facilities. When these migrants were asked to leave, the Bhutanese people faced agitation and acts of terrorism. Some Bhutanese left the country and many officially emigrated. When a few persons arrived in eastern Nepal and claimed to be Bhutanese, Nepal and the UNHCR quickly opened the camps in eastern Nepal, even when there were only 305 persons who claimed to have come from Bhutan. Unfortunately, there was not even a screening post at the entry points until 1993. With free ration and accommodation, more people were attracted to the camps claiming to have come from Bhutan. At that time wage rate in the region was also very low. Even now many migrant workers continue to enter through the porous border and marriages with the Bhutanese are taking place.

The problem is indeed a complex issue with its genesis rooted in illegal migration, in a region marked by population movement. The two Governments of Bhutan and Nepal agreed to work towards finding a viable solution, as Bhutan could ill-afford to create a precedent, in violation of the laws of the land, by granting citizenship to the migrant workers. The bilateral process began in 1993 between the two Home Ministers. Despite frequent changes of government in Nepal and thereby changes in the leader of the delegation, the two delegations did make substantial progress. The Home Ministers meeting in 1993 in Thimphu agreed that the Ministerial Joint Committee (MJC) would work on the following:

- (i) To determine the different categories of people claiming to be Bhutanese in the camps in eastern Nepal;
- (ii) To specify the positions of the two governments on each of these categories;
- (iii) To arrive at a mutually acceptable agreement on each of these categories, which will provide the basis for the resolution of the problem.⁵

In October 1993, the MJC meeting in Kathmandu agreed on the four categories of people in the camps:

- (i) Bonafide Bhutanese if (they) have been forcefully evicted;
- (ii) Bhutanese who emigrated;
- (iii) Non-Bhutanese;
- (iv) Bhutanese who have committed criminal acts.⁶

The third round of the MJC in 1994 established the Joint Verification Team and agreed on the thirteen point terms of reference (TOR) for verification, including a comprehensive format for identification of the people at the camps in eastern Nepal. Finally at the 12th MJC the two governments' positions were also harmonised:

- (i) the people placed in the first category would be repatriated to Bhutan;
- (iv) those in the second category would be given the option to apply for Bhutanese or Nepalese citizenship;
- (iii) those in the third category should return to their respective countries;
- (iv) And those in the fourth category would be governed by the laws of the two countries.⁷

On January 23, 2001, the Joint Verification Team (JVT) composed of six officials from each country, visited the Khudunabari camp and began identification and verification of 12,183 persons. The result⁸ as announced on June 21, 2003 was:

(i) Bonafide Bhutanese	293
(ii) Bhutanese who emigrated	8595
(iii) Non Bhutanese	2948
(iv) Bhutanese who committed criminal acts	347

Of the 12,183 residents interviewed at Khudunabari camp there were only 293 bonafide Bhutanese. The JVT apparently decided to brief the people at the

camp about the result of the exercise and the procedures for returning home, by those who would opt to do so. While the briefing was in progress a mob violently attacked the Bhutanese JVT members, injuring three of them and the work came to a halt. A request was made to the Nepalese Government for an immediate inquiry but no result was announced, probably due to political instability and frequent changes of the government. Unfortunately, the process remains discontinued. The Bhutanese Government declared its commitment to the bilateral process and to all earlier agreements, in finding a mutually agreeable resolution of the problem. Bhutan has been keen to arrive at a viable solution to put an end to the acts of terrorism from beyond the border, and those Maoist inspired groups coming from the camps in Nepal, but the political instability has not been helpful.

Fortunately, the core group recognizing the complexity and magnitude of the problem, has considered and decided to alleviate the plight of the people at the camps. So far over 60,000 people have been transferred and rehabilitated in the USA and a few thousand in other core group member countries composed of Canada, Australia, Denmark, New Zealand, Norway, the Netherlands, U.K and U.S, making the total to over 71,000 people as of September 2012. Migration and the concerns of migrant workers is not an unfamiliar phenomenon in South Asia. Bhutan and Nepal should come together to find a viable solution including “local integration”. Many Bhutanese continue to visit Nepal on pilgrimage and business. Trade between the two countries is picking up. The two land-locked neighbours will be able to resolve this human problem amicably, as they have more in common than that divides them.

The ULFA-Bodo Challenge

The challenges posed by the United Liberation Front of Assam (ULFA), Bodo Liberation Tigers (BLT), National Democratic Front of Bodoland (NDFB) and Kamtapur Liberation Organisation (KLO) were a huge problem for tiny Bhutan. In the nineties just when the southern Bhutan problem caused by the migrants was being brought under control, in the neighbouring State of Assam, Operation Rhino was in progress. The militants of ULFA, BLT, NDFB and KLO from the state of Assam, India, entered into Bhutan’s rich forest along the international border. They not only impeded the development programmes and the democratisation process, but also posed a serious threat to the very survival of Bhutan as a sovereign independent country.

The presence of over 3000 well-trained and well-equipped militants in some 30 camps located within the forests of Bhutan had created serious implications for Bhutan’s friendly, cooperative, and good neighbourly relations with India. At places, local people were even unable to move from place to place without being accosted by the armed militants. Some people in India even thought Bhutan was harboring the militants. The militants were asked to leave peacefully several times. Their standard response was that they would leave Bhutan as soon as they could

realise their goals for the State of Assam in India. Several notices from the government fell on their deaf ears. In the meantime, several raids were reported in the State of Assam, which were attributed to the militants of ULFA and KLO cadre. India desired even hot pursuit into Bhutan.

The Security Forces of Bhutan

Finally the security forces composed of Royal Bhutan Army (RBA), Royal Body Guard (RBG) and Royal Bhutan Police (RBP), had to be deployed. There were also the young volunteers, both men and women, which formed the militia cadre. In December 2003, the militants were flushed out of their camps in Bhutan and the leaders, with women and children, and many militants were handed over to the authorities in India. The Bhutanese security forces proved their loyalty to the call of the Tsa-Wa-Tsum (the King, Country and the Government) and a few soldiers paid with their lives. The campaign to oust the militants began on December 15, 2003 two days before the National Day on the 17th, and by December 20, 2003 it was all over. The country observed the National Day celebrations as usual, but some people kept their fingers crossed while visiting the monasteries.

Under the selfless and farsighted leadership of the fourth Druk Gyalpo, Bhutan returned to its peaceful state, with the New Year of 2004, and energetically continued the process of development and democratisation.

It sometimes seems necessary that a country must develop new approaches to certain problems. For that we need leaders with courage and unusual wisdom, and the ability to see beyond predictable solutions. Such creativity and leadership distinguishes the extraordinary from the ordinary. His Majesty Jigme Singye Wangchuck, the Fourth King of Bhutan, belongs to that rare breed of uncommon leaders.

The Constitution and Consultation with the People

In 2001, even in the face of security threats, a thirty-nine member committee headed by the Chief Justice was established to draft the Constitution. The draft Constitution was ready and unveiled in March 2005. His majesty and Trongsa Penlop, the Crown Prince started consultation on the draft Constitution with the people of twenty Dzongkhags (districts). After six months of campaigning and explaining the content and significance of the Draft Constitution, at six-seven Dzongkhags the consultation continued under the able guidance of Trongsa Penlop, the Crown Prince. People were not sure if the time had come to hand over the “sovereign power” to the people, and transform the government to that of a “Democratic Constitutional Monarchy” as mentioned in Article I (1.2) of the Constitution.

More than that people were opposing the provision, “Upon reaching the age of sixty-five years, the Druk Gyalpo shall step down and hand over the throne to the Crown Prince or Crown Princess, provided the Royal Heir comes of age”—Article 2 (6) of the Constitution. People were voicing the opinion that, “Why fix it if not broken.” Realizing that their voice was not going to yield results, the people of Bhutan then moved to amend the retirement age of the reigning monarch from sixty-five to seventy-five. This was also not accepted.

The Constitutional Offices

In December 2005, a Royal Decree established the Anti-Corruption Commission (ACC) and Election Commission (EC). At the same time, more private newspapers and radio stations were also established. The role of media, both electronic and print received much encouragement as political parties began to register and prepared to campaign. The media became proactive under the “right to freedom of speech, opinion and expression” and as also envisaged in the draft constitution. The judiciary separated from the executive branch was already well-established, as well as the Royal Civil Service Commission (RCSC) and the Royal Audit Authority (RAA). The ACC, EC, Judiciary, RCSC and RAA have become the five constitutional bodies for providing checks and balances in a democratic system.

On the occasion of the 99th National Day celebrations on 17th December 2006, at Tashi Yangtse Dzongkhag, the Fourth King in his public address stunned the nation by announcing his abdication of the throne and entrusting the reign to the Crown Prince. Much of the final touches on the Draft Constitution and democratisation responsibilities now rested on Trongsa Penlop, the Crown Prince and the Interim Government.

The Revised Treaty of Friendship with India

The 1949 Treaty of Friendship between India and Bhutan has been under consideration for a while. Negotiations were concluded and the revised India-Bhutan Friendship Treaty was signed in New Delhi by the Crown Prince, HRH Jigme Khesar Namgyel Wangchuck, and the then Foreign Minister, H.E. Mr. Pranab Mukherji on February, 8, 2007.

A significant change in the revised Treaty is in its Article 2. The new Article 2, while reaffirming “their respect for each other’s independence, sovereignty and territorial integrity”, replaces the old article and states,

“In keeping with the abiding ties of close friendship and cooperation between Bhutan and India, the government of the Kingdom of Bhutan and the Government of the Republic of India shall cooperate closely with each other on issues of their national interests. Neither government shall allow the use of their Territory for activities harmful to the national security and interest of the other.”

As the Ambassador to India it was my privilege to witness the signing ceremony at the lawn of the historic Hyderabad House.

It was also during the reign of the Fourth King that Bhutan's northern border negotiation with People's Republic of China began. Even in the absence of formal diplomatic relations, the two delegations concluded 20 rounds of meeting alternating in Beijing and in Thimphu till October 2012. The 20th round was held in Thimphu. The two countries have now arrived at a stage of verification on the ground by the technical people. Given the good neighbourly relations and China being a large country, the people in Bhutan are hopeful that the border dispute could be resolved to the mutual satisfaction of the two neighbours, at an appropriate time.

The General Election

In April 2007, a country-wide mock election was launched to make the people familiar with the election procedures and the electronic voting machines (EVMs) received from India. The electronic machines have been of great help to accelerate the voting process and in announcing the results on the same day, except for some of the postal ballots. The mock election exercise has been a good precursor to the general election.

This was followed by the National Council Election. This non-party affiliated election was completed in two stages and elected twenty nonpartisan National Council members from the twenty Dzongkhags in December 2007 and on January 29, 2008. Five members were nominated by His Majesty as enshrined in the Constitution, taking the total number of members to 25. Bhutan, according to the Constitution, has a bicameral Parliament.

The first election of the Parliament members of the National Assembly was conducted on March 24, 2008 between the two main political parties, the Druk Phuensum Tshogpa (DPT) and the Peoples Democratic Party (PDP). The Druk Phuensum Tshogpa (DPT) secured 45 of the 47 seats of the Parliament. The Peoples Democratic Party (PDP) could win only two seats and became the first Opposition Party.

As this was the first major parliamentary election in the history of Bhutan, many observers from the SAARC member countries and the European Commission, including a large number of people from the foreign media, descended at Thimphu. Prior to the election, there was a lot of speculation, enough to make the people feel nervous. Looking around and beyond South Asia, and Bhutan being a small country with a small population, people surmised there could be a serious struggle between people power and money power. It was speculated that the elections would result in the victory of money power, as experienced in some countries. Fortunately, the people's power triumphed in the case of Bhutan.

Various factors such as the integrity displayed by the parliamentary candidates, the attentive presence demonstrated by the ACC, and the strict regulations enforced by the Election Commission were responsible for the fair elections and their results. Media also rose to the occasion and registered their presence with reports from every constituency and voting station. This first experience of parliamentary election was a resounding success and the people in general went through this process with mixed feelings. It was reported by the Election Commission that over 80 per cent came out to exercise their franchise. Some senior citizens—men and women walked days to the voting station to cast their vote. Such enthusiasm indeed augured well for the process of democracy in Bhutan.

The First Session of Parliament

The inaugural of the joint session of the Parliament was held on May 8, 2008. Thereafter, the Draft Constitution was placed before the Parliament. It was debated and each phrase was carefully considered, and its text in Dzongkha and English was finally approved. The Constitution, after the Royal Assent, was finally signed on an auspicious day in the Bhutanese calendar, fifteenth Day of the Fifth Month of the Male Earth Rat Year corresponding to July 18, 2008.

With this the Kingdom of Bhutan, ever so smoothly transitioned to “Democratic Constitutional Monarchy” around the time when freedom, liberty and democracy had, according to some global assessments, entered the lowest point in the last 40 years, since the Cold War.

How was this transition so peaceful and successful? The success story can be attributed to the following:

- (i) GNH as the guiding philosophy for the Five Year development programmes.
- (ii) The Policy of Decentralisation and Peoples’ Participation.
- (iii) Timely establishment of the five constitutional bodies;
 - The Anti-Corruption Commission
 - The Election Commission
 - The Judiciary
 - The Royal Audit Authority and
 - The Royal Civil Service Commission

The encouragement of free media, both print and electronic, also plays an important role and continues to attract attention.

The Future of Democracy in Bhutan

The people have much faith and confidence in the future growth of democratic process as there is strong political commitment. The commitment from the Throne is also unwavering and constant. His Majesty the Fifth King at the inaugural session of the first Parliament session has said:

“The highest achievement of 100 years of Monarchy has been the constant nurturing of Democracy. This has culminated today with the first sitting of Parliament and the start of democracy, whereby, my father the Fourth Druk Gyalpo and I Hereby return to our People the powers that had been vested in our kings by our forefathers 100 years ago. We do so with absolute faith and confidence, offer our complete support and our prayers for the success of democracy.”⁹

The Build-up to the Second General Election

There were four more political parties in the process of registration by October 2012, in addition to the two main parties—Druk Phuensum Tshogpa (DPT) and Peoples Democratic Party (PDP). They were all to have registered by end of the year. How many parties finally participated in the second election depended on how many of them were able to conform to the Electoral Laws.

The Article 15 Section 5 of the Constitution requires, “election to the National Assembly shall be by two political parties established through a primary round of election in which all registered political parties may participate”. Each party is also required to field at least 47 candidates and as prescribed by the Constitution be of age 25 to 65 and fulfill “necessary educational and other qualifications prescribed in the Electoral Law.”

As a young Democracy some teething problems are inevitable. One such example was the debate between the Election Commission and the newly-formed Government over the interpretation of a constitutional provision concerning the Local Government Election. The Election could finally be held in 2011. Another instance was the first constitutional court case, initiated by the Opposition Party, at the High Court over “levying of taxes”, and the government took it to the Supreme Court. The verdict of the Supreme Court was, “levying of taxes” by the Government, without placing it before the Parliament was “unconstitutional”. The Government lost the case. The media was also active in explaining the verdict. Such instances not only reflect the new democratic environment, but also reveal that the mechanism put in place for the purpose, is working. These episodes will go a long way to help build the confidence of the people in the Constitutional Offices and the future of Democracy in Bhutan.

Change in governance must also contribute towards the well-being of the people. Having been elected to govern, did the party fulfill the campaign pledges made during the last elections? The political economy indicates that Bhutan’s Gross Domestic Product (GDP) growth was 4.7 per cent in 2008, 6.7 per cent in 2009, 11.8 per cent in 2010 and 8.5 per cent in 2011.¹⁰ Such results indicate that the political party in power was also working to fulfill the campaign pledges. Indeed there were many activities undertaken by the government such as building farm roads, taking electricity to their respective constituency, restoring local monasteries as well as Hindu temples, and marketing of agricultural products,

reportedly all in the interest and welfare of people living in the rural areas, and to enhance their happiness. At present, the democratic process in Bhutan is helping to accelerate the pace of development and delivery of the services to the people.

Peace and stability in the country gave a fillip to the democratisation process and development. The confidence of the people in the democratic process needs to be strengthened. Whichever political party is in power it must strengthen delivery of security, development, and dignity of the people. The political parties in the fray for the 2013 parliamentary elections took into account the political and economic situation in the country. In their campaigns and in their manifestoes they declared measures that they thought would bring them to power.

At the end of the day, it was the people of Bhutan who had to make the choice of candidates, and the choice of the political party who could best deliver the pledges made. Looking back to the devolution process of the 80s, decentralisation experience of the 90s, and the first parliamentary and local government elections, the people were better prepared to make their choice. Their choice would determine what lies ahead.

2013 Second Parliamentary Elections

Election of the twenty-five members of the National Council was held in April 2013. The National Council comprises of one member elected by the voters in each of the twenty Dzongkhags, and five eminent persons nominated by the Druk Gyalpo. The constitution states that “A candidate to or a member of the National Council (NC) shall not belong to any political party”.

According to the electoral law, parliamentary elections are to be conducted in two phases, the Primary Round and the General Election. Since there were only two political parties during the 2008 election there was no need for the primary phase of the election to be conducted at the First Parliamentary Elections. Five years later, Bhutan has seen the emergence of five political parties. However, one of the new parties was disqualified, and four remained in the election fray. Two of the new parties were headed by women, but were eliminated in the primary round held on May 31, 2013.

The result¹¹ of the primary round was:

Druk Chirwang Tshogpa (DCT)	6 per cent
Druk Nyamrup Tshogpa (DNT)	17 per cent
People’s Democratic Party (PDP)	33 per cent
Druk Phuensum Tshogpa (DPT)	45 per cent

The general election was held on July 13, 2013 between Druk Phuensum Tshogpa (DPT) and People’s Democratic Party (PDP) providing the second opportunity for the people of Bhutan to exercise their franchise this year. At that stage DPT the incumbent party, appeared to have an edge over the opposition party PDP who had garnered only two seats of the 47-member National Assembly

in the last Parliament. Some people, reflecting on the result of the 2013 primary round, speculated that DPT could return with a reduced strength. However, seven candidates of Druk Nyamrup Tshogpa (DNT) left their party, including the President and Vice President of the party, and surprisingly joined People's Democratic Party (PDP). Campaigning began in earnest and PDP came up with some colourful pledges.

A fortnight before the Election Day, the Indian Oil Corporation (IOC) conveyed in writing, that the Ministry of External Affairs had withdrawn kerosene and cooking gas subsidy to Bhutan, as the Tenth Five-Year Plan financial year ended on June 30, 2013. There were even reports of Chukha electricity rate reduction from Rs. 2 to Rs. 1.55 as well as a halt in refund of excise duty. DPT senior members and former ministers, in the middle of their campaign, suddenly returned to Thimpu to take stock of the situation, as the cost of cooking gas and kerosene suddenly increased with effect from July 1, 2013. It was a rise of more than three times what the people used to pay. The Government of India clarified that the timing was a "coincidence", and more recently, media reports in India attributed it to a misunderstanding of a letter/note intended to seek opinion of the Ministry of Commerce by the MEA. The subsidy, however, has been restored from August 1, 2013 as requested by the Interim Government in Bhutan. As far as the rates of electricity and refund of excise duty are concerned, both India and Bhutan would stand by the relevant agreements of 2006.

On July 13, 2013 the second general election result was clear, and it was declared by the Election Commission of Bhutan (ECB) that of the 47 National Assembly seats, PDP had won 32 seats, and DPT 15 seats. It was a big surprise, particularly to the supporters of DPT. The President of the DPT, who was elected with a large margin from his constituency, reportedly has submitted his resignation to the Speaker of the National Assembly, and a decision is awaited. The PDP has done well with a robust campaign and attractive pledges, and has now formed the government. The dust of the second general election is slowly settling down, and with peace and harmony at home. The people of Bhutan are now looking forward to the new Parliament and the government for a successful tenure and for further strengthening peace, security, prosperity and above all happiness.

NOTES

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8

Challenges to Political Stability in Maldives*

Fuwad Thowfeek

Introduction

Maldives being a new democracy, and the smallest country in the South Asia region faces huge challenges in maintaining the democratic gains it has achieved in the past, especially since the adoption of the new constitution in the country. Maldives, a country of more than 1,100 islands spread in the Indian Ocean, with an estimated population of 325,135 (mid 2011), adopted its new constitution on August 07, 2008. This constitution was written over a period of four years, by an assembly formed for this purpose, called the *Special Majlis*, in an initiative taken by the then President, Maumoon Abdul Gayoom, to establish a more democratic system in the country, in keeping with the promise he made when he took the oath for a sixth term in office. The civil unrest in the country due to the death of a detainee, Evan Naseem in jail in 2003, was also an important catalyst in these initiatives. Many new rights that were previously not available to the Maldivians were guaranteed by the new constitution. Some of the notable ones include: Freedom of expression (Article-27), freedom of media (Article-28), freedom of acquiring and imparting knowledge (Article-29), freedom to form political parties (Article-30), right to strike (Article-31) and freedom to assembly (Article-32).¹ However, when the new constitution was introduced, enough efforts were not made to impart civic education to the citizens, which according to Amy Guttman, is necessary to “cultivate the virtues, knowledge, and skills necessary for political participation”² and enough time was not spent in assessing the impact of the newly brought about changes in the constitution, on society.

The new constitution along with the new rights, created many new problems that the Maldivians had not seen. However, such problems are not unique only

*The Elections Commission is an independent institution, and the contents of this chapter reflect the views and ideas of the author and do not reflect the stand of the government of the Republic of Maldives.

to the Maldives. Research shows that most of the newly democratic countries face such problems in the infancy stages of their democracy. However, for a country to concentrate all its effort on development, it is important for the country to have a stable government apart from a strong legislative structure, a reasonably free media, active political parties and a sustainable economy. This paper focuses on the main factors that affect the political stability of the country, such as: the “media”, which is largely controlled by business tycoons with strong political affiliations; “law makers”, who are perceived to be prioritising their self-interest ahead of the nation; “role of the independent institutions”, wherein most institutions’ legislation related work still needs to be completed; “religion”, which is manipulated by some to acquire power and; the “economy”, which determines the extent to which the government can afford to be a welfare state. It is important to acknowledge that the Maldives is in a very difficult situation, with 15 political parties contesting the government. The paper will also discuss some measures that can be taken to overcome these challenges.

Media

Like many developing countries, most of the popular local television and radio channels in the Maldives, are largely owned and controlled by business tycoons. The private channels are accused by the general public for playing a vital role in campaigning for the political parties that they are affiliated to. For example, reports about members of the parties that do not belong to the parties supported by these channels, are presented by them in a negative manner. On the other hand, reports about the members of those who are supported by these channels are presented in a positive manner. At times, it has been found that some reports by these channels were meant to defame certain political parties and politicians, but it is very difficult to take proper action against them even though Maldives Broadcasting Commission (MBC) has the mandate to regulate media.

A very good example of how politicised the media was, can be seen from the incidents before and after February 06-07, 2012 that led to the resignation of President Mohamed Nasheed. In the last few weeks before his resignation, the majority of programs on some private television and radio channels continuously ran shows, explaining why the Maldivians needed to remove Nasheed’s government from power. Guests invited for political discussions/programmes in some of these stations, included senior members of the opposition, while very limited opportunities were given to supporters of Mr. Nasheed’s party. A similar strategy was used by the national television channel, then called the Maldives National Broadcasting Cooperation Channel One (MNBC1). They covered limited activity related to the opposition and majority of the news was meant to promote the government.

Why was all this possible? One of the main reasons is that because some of the laws/regulations for regulating media, have not yet been passed. An independent institution was established on August 22, 2010 under Article-3 of the Broadcasting Act (16/2010), with a mandate to regulate broadcasting.³ However, because of inadequate funds, the MBC publicly acknowledged that they were not able to fulfil their duties as efficiently as they would like.

How is it progressing now? What are the changes that need to be brought about to rectify this problem? After the change of government on February 7, 2012, many changes were made in the policy relating to national television—now called Television Maldives (TVM)—to make the channel a more acceptable public broadcaster. With less or unbiased political information shown on it now, it seems that it has gained more confidence of the viewers than any other local channel. However, some private television and radio channels continue to support the current regime of President Dr. Mohamed Waheed Hassan. The political parties affiliated with the present government claim that Raajje TV (a private television channel) is a mouthpiece of the Maldivian Democratic Party (MDP), that works against the current regime. At the moment, all the major political parties believe that they should have control in a television channel to help them campaign for political office, and the major political parties who do not control a television channel currently, are very likely to own one in the near future. It is also very interesting to note that many statements have been made by senior officials of both the VTV and DhiTV (two of the largest private television channels) regarding how their channels are being run at a loss.

The six registered television and nine radio channels in the country need to better contribute for the social and economic development of the country. As for the young MBC, they have brought the issue of inadequate funds to the attention of all the related authorities. It is expected that they would be able to function much better in future, with more funds, which will enable them to develop better technical capacities and infrastructure. It is believed that when MBC develops more capacity, they will be able to regulate the media better and they will make arrangements with the private local channels, to include more programmes related to civic education and public awareness messages, rather than concentrating mainly on political programmes.

Lawmakers

In Maldives, the *People's Majlis* (parliament) is the legislative body that makes the laws consisting of 77 elected members from 21 administrative divisions of the Maldives. The current 17th *Majlis* was instated on May 28, 2009 for a period of five years.⁴ Since then, according to the majority of the locals, it has become a 'battlefield' for the major political parties. The situation got worse when television channels were given the opportunity to broadcast the meetings live.

Knowing that they are being shown live on television, many lawmakers took this opportunity to promote themselves, rather than doing what they were supposed to do i.e. make laws.

In order to fully implement the new constitution, it will be necessary to pass about 140 laws and there are a significant number of bills submitted to the *Majlis*, that are still to be passed. Moreover, some of the bills that have been ratified and are currently being implemented, need to be revised. According to a recent report published in the *Haveeru Daily*, a majority of the public are of the view that the *Majlis* members do not do enough, in view of the number of pending bills in the *Majlis*.

Other reasons for the reduced popularity of the lawmakers, includes the authority that they have over adjusting their own remuneration package, as well as that of independent institutions, as they can vote to increase or decrease it. Even though they are among the best paid officials in the country, they have recently again increased their remuneration by introducing an allowance.⁵ This issue led to some public protests against parliamentarians. In addition, they also passed a privileges bill for *Majlis* members in 2011, which gives them a lifelong pension and many other perks that will become a law once ratified by the president.

When it comes to making laws and voting for bills, most people believe that *Majlis* members vote only in their own interest, and not for the interest of the country. Since many of the members are businessmen or resort owners - directly or indirectly - it has always been found that some laws that they pass are favouring themselves; for example those relating to the lease extension of tourist resorts and the taxes imposed on the tourism related services (T-GST) were passed with a percentage less than the amount proposed by the government.

What is the reason for this? How can the situation be improved? It is very common in newly democratic countries- especially the developing countries, for senior government posts and elected posts to be filled by activists rather than intellectuals. Many Maldivians believe that the reason that the lawmakers are not able to perform to the expectations of the people is because of their lack of intellectual capacity. Many Maldivians publicly acknowledge on social media like 'Facebook', (34.55 per cent of the total population uses Facebook)⁶ that they regret having voted for relatively uneducated parliamentarians, and would prefer to see a better group of lawmakers in the future.

It is noteworthy to mention that some lawmakers are highly educated and experienced public servants and politicians. Many Maldivians including the author of this paper share the optimistic view, that within the next 10 years (two terms of parliament), more educated and better parliamentarians will be voted in to the office, as the general public becomes more aware of the democratic process and the importance of voting for the best candidates.

Role of Independent Institutions

In any democracy, independent institutions play a huge role in maintaining peace, harmony and stability in society. However, this can only happen if the independent institutions are truly independent. The members of the independent commissions are approved by the *Majlis*, from a list of candidates, provided by the president or directly by the *Majlis*. Majority of the public claims that members for most of the independent commissions are approved, based on negotiations among the influential political parties within the *Majlis*. Even though, many of these independent institutions have been set up as per the constitution, many related laws are still pending in the *Majlis*, which hinder the efficient functioning of these institutions. For example, there is no law that governs the political parties, and till today political parties are regulated on the basis of a presidential decree passed in 2005, which is very naive.

The independent institutions not having an independent budgets is also an issue. For example, the annual budgets of independent commissions are controlled by the ministry of finance and treasury (MoFT), and the *Majlis' Finance Committee* also plays a vital role in approving the public budget. Since the state's and government's financial transactions are maintained by a Public Accounting System controlled by MoFT, the government has the possibility of controlling some of the activities carried out by independent institutions.

How can the situation be rectified? Even by establishing a merit based system, one does not see how the members of the independent commissions can be chosen, without the blessings of the major political parties in the *Majlis*. Regarding financial independence, the issue has already been brought into limelight, and many discussions are being held at the highest level of the government, including the President's Office. As for the laws that need to be passed by the *Majlis*, it is with pleasure that one notes the eagerness of most independent institutions, to contribute to the laws that will enable them to do their duty. Many have drafted the necessary laws and regulations, and submitted them to the appropriate authorities for enactment, and have been pressurising them to pass them.

Religion as a Political Tool

Since Maldives is an Islamic state by constitution, with the new freedom gained, many parties, including those who are interested in gaining political power, have started using religion as a political tool. For example, some famous religious figures started giving speeches, categorising some political parties as those working against the state religion. They claimed that it is the religious obligation of the public to elect religious figures, or those supported by them to the public offices. In recent years, there have been incidents of orchestrated violence in the name of religion. For example, the blast of an explosive device in the Sultan Park in September 2007, and a group of people with a certain religious belief establishing

a separate mosque in the island of Himandhoo, while rejecting the government built mosque, and entering into a confrontation with the Maldivian police in October, 2007.

With the appointment of the new government in 2008, a new ministry was formed by the name of Ministry of Islamic Affairs, to regulate and promote all the activities related to religion. It also had the mandate to create religious awareness, and educate the general public in a manner, that would maintain harmony in the society.⁷ With the resignation of President Nasheed in February 2012, the new president also highlighted the importance of the Ministry of Islamic Affairs, and has given the same mandate to the ministry as before. With a very young minister heading the ministry, it seems that the ministry is now more proactive and is doing more to educate the general public about religion. It is believed that the earlier violence related to religion is due to misconceptions about religion, and was conducted by the followers of scholars who have studied in religious institutions, and do not share the same moderate beliefs that the Maldivians have been practising for a long time. The policies of the government to tackle these problems include, the registration of Islamic clerics in the ministry to preach religion, and providing opportunities to those interested in studying religion, in moderate institutions.

Economy

In order for the government to be stable, it is also very important for the economy to be stable. According to the statistics of the Central Bank of Maldives, the Maldives Monetary Authority (MMA), the Gross Domestic Product (GDP) has been on the rise for the last decade, maintaining a 5-10 per cent increase every year, except for 2005, which took a huge loss as a result of the Boxing Day tsunami; and 2009, the year after the 30 year presidency changed and the year in which the parliamentary elections were held. Even though the GDP is constantly rising, there are lots of concerns regarding rising inflation. According to the statistics of MMA, the inflation rate in the country has increased from 6.6 per cent in 2010 to 12.3 per cent in 2011.⁸ In 2012, it was observed that the inflation rate was still on the rise. For example according to statistics published by the Department of National Planning (DNP), the monthly inflation rate for June 2012 stood at 16.06 per cent, an increase of 11.59 per cent compared to June 2011.⁹ Among the key economic indicators, it is not only inflation that is now a problem for the country, but the increase in the unemployment rate is also posing a new and a serious economic problem. For example, according to the *Household and Income and Expenses Survey 2009-2010* conducted by DNP, the rate of unemployment went up from 14.4 per cent in 2006 to 28 per cent in 2010.¹⁰ In 2010, the rate of unemployment in Male' stood at 24 per cent while unemployment in the atolls rose to 31 per cent, with unemployment most common among the 15-19 year old population.¹¹ We have not yet seen any

public uprising against the government in the Maldives because of the high unemployment rate, but recently we have seen protests in countries like Tunisia and Yemen which were triggered as a result of the high unemployment rate, and ultimately resulted in the overthrow of the government and creating political turmoil.

The origin of large official protests against President Nasheed's government goes back to May 1, 2011, against the rising prices of commodities, at a time many local businesses were having a hard time purchasing United States dollars (the commonly used currency in Maldives to complete international transactions) from banks. On April 10, 2011, the MMA changed the value of the Maldivian rufiyaa, which was previously valued at, US\$ 12.85 selling price, and US\$ 12.75 buying price, to be sold and bought at a rate between US\$ 10.28 and US\$ 15.42, which effectively devalued the selling rate of the local currency to US\$ 15.42.

It is also important to note that it was around this period that some of the large businesses changed their stand towards the Nasheed government. To make matters worse, a taxation bill, was passed on August 29, 2011 introducing a goods and services tax (GST) in the country for the first time. With the introduction of the new GST, the government planned to cut the import tax on many items, nullifying the effect of the GST. However, because import tax had already been paid on the goods in the market businesses were not able to reduce prices initially, and the general public saw the price of all the goods go up due to the additional GST. Both the business community and the general public blamed the government for not being able to manage the economy.

While President Nasheed was in power, he initiated a huge project to provide opportunity to the unemployed youth to develop vocational skills, required for them to become productive members of the society. This makes sense as the previously discussed DNP study showed that the majority of the unemployed fall in the age group 15-19, because in Maldives students finish their General Certificate of Education (GCE) Ordinary Level at 16 years but are not be able to apply for a job until they are 18 years (the legal age to start employment).

President Dr. Waheed is continuing the youth vocational programmes, but it does not seem that much is being done to control inflation. On September, 2012, it was found that MVR 6.1 billion was spent on recurrent expenditure while only MVR 1.1 billion was spent as capital expenditure. At the end of August 2012, the total government expenditure touched MVR 8 billion, 31 per cent more than the government income during the period.¹² According to a 2010 World Bank report titled 'How Did the Maldives Get into this Situation?' it was explained, "the origin of the crisis is very clear... the wage bill for public sector employees grew dramatically in a very short time".¹³ According to them, the 66 per cent increase in salaries and allowances for government employees between 2006 and 2008 was "by far the highest increase in compensation over

a three year period to government employees of any country in the world".¹⁴ Furthermore, the expansion of public service sector to better implement the new constitution, especially with the establishment of nine independent institutions and 1,091 local council members, led to a very huge increase in public sector wage bills. Ultimately, democracy is a very costly system for the people of this country.

Proportionately, the expenditure for conducting elections in this country is one of the highest in the world. The parliamentary elections held in 2009 cost MVR 22,069,176.83 (US\$ 1,717,445.66) and the local council elections held in 2011 cost MVR 45,434,174.37 (US\$ 2,946,444). US\$ 8.08 and US\$ 13.16 were spent on each eligible voter in parliamentary elections held in 2009, and local council elections held in 2011 respectively. Due to some provisions in the Local Council Act, the Elections Commission has to conduct more frequent by-elections now than in the past. In 2012, the Commission has held 16 by-elections till date and nearly MVR 100,000 is spent on each by-election.

As per the statistics of MMA, the Maldivian economy is very much dependent on the tourism sector, as 30 per cent of the GDP comes from the tourism industry.¹⁵ Since the economy of the country is so dependent on one industry, it is very important for the country to protect the industry, while making plans to reduce economic dependence on the tourism sector, and diversify the economy. Looking at ways in which economies can be built, we see from recent history that in many countries in the Association of South East Asian Nations (ASEAN) economic development was linked to Foreign Direct Investments (FDI), that enabled them to make investments that they could not afford on their own. For example, when Singapore initiated its FDI policy in 1960s it did not have any FDI capital, but by the end of 2000 its cumulative FDI capital stood at US\$ 114 billion.¹⁶

While it is important to make an effort to attract FDI, it is also important to have a strong legal structure pertaining to it, otherwise it may not lead to expected results, and instead may create more difficulties for the government. For example, President Nasheed's government was a very pro-business government, and promoted Private Public Partnership (PPP) and FDI. However, the lack of laws and regulations related to foreign investments, was a hindrance in attracting multi-national corporations and other foreign investments.

Conclusion

The recent political changes in Maldives have led to many new challenges. It has not been five years since Maldives held its first fully democratic presidential elections. Just like many other countries in this situation, the Maldivians are still learning about democracy and how to make the best of it. Lots of work needs to be done to stop the misuse of media, and to make the best use of it for

the social and economic development of the country. Parliamentarians need to be made more responsible, and measures need to be taken to establish boundaries within which they can act. Independent institutions need to be given more authority and power to make the necessary decisions they need to take, in order to perform their duties better. More programmes relating to religious tolerance and adoption of a moderate path need to be introduced and promoted among the general public. Economic policies need to be made in such a way they will reduce dependence on one industry and promote FDI to the country.

Maldives is a country that has very high literacy rate (over 97 per cent in 2011) and has a culture that is very technology friendly. For a long time, Maldivians were not aware of how democracies work in practice, but it is in this moment that the Maldivians are learning about democracy, the privileges and the responsibilities that come along with it. Many believe that civic education and political awareness programmes need to be embedded in the education system of the country at the grass root level so as to derive maximum benefit from democracy. It is with pleasure that one would emphasise the fact that, Maldives is lucky to have the world's largest democracy India, as a neighbour and a friend who has helped Maldives in many different ways, to improve the lives of the Maldivians.

One is very optimistic about the future of Maldives. In a democracy, power originates from the people, and one believes that the current challenges to the political stability of the country will be under control, as soon as the general public becomes more aware of the democratic process, and gets used to the responsibilities that come with it.

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9

Post-2014 Afghanistan: A Shift to Stability or a Failed State?

Waliullah Rahmani

The goal of the international community is a stable Afghanistan by the time of their scheduled exit in 2014. The question is, will they have accomplished their stated goal and leave behind a stable Afghanistan? For Afghans, the question does not revolve around whether the international community is proved victorious or defeated. For Afghans, the question is far more grave. It is an existential question. Will they survive once the international community leaves or will international community leave behind a state so fragile, that it is bound to collapse?

Imagine being an Afghan and having to plan for what happens when the international community withdraws. How does someone plan for the distinct possibility of ending up in, say, a massive tribal war? Do they run for cover to their old ways? On the other hand, what if they are, in fact, able to continue life in a modernising stable state? Can they count on an improving system of law and order?

The first milestone on this unknown road ahead will be the next presidential elections, also scheduled for 2014. Will they be conducted fairly? Or will they be manipulated? What are the other signs Afghans are looking at so they can determine where they are headed?

This paper will address these questions that Afghans are asking. What are the prospects for growing stability in Afghanistan once the international community leaves? What are the signs that are worrisome? How can negative outcomes be avoided? How will Afghans come together to stabilise (or de-stabilise) themselves post-2014? For Afghans, the answers to these questions are not only about who wins or loses, whose face is saved, whose is not. No, for Afghans the answers to these questions are far more grave. They boil down to who will live and who will die.

2014: Electoral Process and Political Transition

On May 5, 2014, ends Hamid Karzai's second term as Afghanistan's democratically-elected president.¹ What makes these elections critical is that, these will be the first presidential elections conducted and managed by Afghans, rather than the international community. For many Afghans, a successful electoral process will be convincing proof that history has, in fact, changed course in Afghanistan. Success in their minds, will be defined by a peaceful transfer of power,—as opposed to the way change has taken place for most of the past century² when only one leader, Abdur Rahman, the so-called Iron King of Afghanistan, was able to exit power by dying a natural death, rather than meeting a violent or a revolutionary end. From the beginning of the twentieth century every king, president, and even the Taliban Amir of the faithful, has either been assassinated or otherwise forcefully ousted from power. And so for the first time in Afghanistan's history, Afghans are hoping for a bloodless transition of political power.

In his various statements, President Karzai has indicated his willingness to see this process through. During recent press conferences and in joint statements with leaders of the international community, such as President Barack Obama and British Prime Minister, David Cameron, President Karzai has mentioned that the next elections shall be free and fair, and that he is preparing to exit office, and becoming the first ex-president of Afghanistan. During a visit to Washington in January 2013, he gave assurances to President Obama that the process would be smooth and constitutional, as is evident by the joint statement of the two leaders on January 11, 2013:

During the leaders' meetings, President Karzai outlined the Government of Afghanistan's plans to hold free, fair, inclusive, and democratic elections in 2014. The leaders reviewed preparations for the 2014 elections and agreed that independent Afghan institutions are to lead election preparations and implementation, in close consultation with legitimate stakeholders in the democratic process. President Obama welcomed the Afghan Independent Election Commission's establishment of April 5, 2014 as the date for presidential and provincial council elections, and he reiterated that the United States' role is not to support any particular candidate but to support a fair and inclusive electoral process.³

Independent reports confirm that President Karzai understands that there is no viable alternative to securing peace in Afghanistan, but the forthcoming presidential elections. Afghanistan's history underscores this point. The major lesson of the past four decades is that all wars and conflicts have had their roots in the transition of political power, especially since the post-Soviet period and the mujahideen rule in Afghanistan. During the 1990s, it was the constant grabbing for power by political parties that resulted in a devastating and bloody

civil war, when none of the parties were prepared to cede power peacefully. And so the current story can be reduced to two outcomes, a stable shift of power among the elites, or a conflict and violent struggle for power.⁴

Considering Afghanistan's history of violent power struggles some possible post-2014 scenarios are as follows:

- (i) The ruling team will concede to the holding of elections, but will allow them to be opaque and subject to manipulation. Evidence contributing to this fear can be found in the recent reshuffle of the Afghan security establishment. In particular, the appointment of Omar Daudzai as acting minister of interior (MoI) has raised concerns over how next year's elections will proceed.⁵ If presidential elections are not transparent, free and fair, then Afghanistan could face a situation, as potentially destabilising as that in the post-2010 parliamentary elections, and the disputed 2009 presidential elections. Already two strong political blocs appear to be forming. The first and more visible one is the "Grand Electoral Coalition", a bloc comprising of non-Pashtun, former anti-Soviet jihadi leaders, led by Ahmad Zia Massoud, former vice-president of Afghanistan, a brother of the late Ahmad Shah Massoud, Afghan National Front leader,⁶ and a son-in-law of the late Afghan President Burhanuddin Rabbani. This coalition represents the most serious challenge to President Karzai's power base. The strength of Massoud's coalition lies in the support he has amassed from Hazara and Uzbek leaders. The support of such minorities is highly valued as during the past four elections, Hazara, Uzbek, and Tajik electorates are believed to have shown the highest participation in elections. That said, Massoud has been unable to secure, to date, the support of leading Pashtun tribes in Eastern and Southern Afghanistan, still the heartland of Karzai's base. While support for Hamid Karzai and his designees appears to be waning, he is still in power, and as such, is still in a position to exert strong influence in the upcoming elections. If he manages to avoid fragmenting his power base, he can still benefit from the legacy he will leave behind in 2014.⁷
- (ii) The 2014 elections are called off. This would likely push Afghanistan to the brink of a 1990s style civil war, where political elites descend into an endless power struggles with one another. Since President Karzai has catered to fears of just such a resurgence of the mujahideen, the risk that such a scenario will ensue after the international pull out from Afghanistan, cannot be ruled out.

Security Transition: The Outcome for Afghanistan

On May 18, 2013 the fifth and final round of the transition of power to Afghans took place, when the Afghan National Security Forces (ANSF) took control of

34 provinces from the US-led NATO forces. With this move, Afghan forces took charge of counter-insurgency, and the international forces retreated into the role of trainers, advisers, and assistants in a mission, that was optimistically named “Resolute Support”.⁸

Among the challenges this mission faces are the domestic ones: completing the security transition to an inexperienced and low-morale Afghan security force; weak political leadership and governance structures; and the still-distinct ethno-centric dividing lines that make nation building in Afghanistan so difficult.⁹

These strategic challenges have been highlighted even in some unclassified reports of US security agencies:

Lack of Professional Training

As a result of a strategic mistake committed mainly by the international community, Afghanistan lost time and the opportunity of building a strong ANSF. At the Bonn conference in 2001, the international community designed a 70,000 strong Afghan National Army (ANA) and 50,000 strong Afghan National Police (ANP) for post-Taliban Afghanistan.¹⁰ They never thought of Afghanistan as a conflict-affected and conflict-zone country, which had experienced three decades of war. But later, in 2006-07, the international actors acknowledged the mistakes they made in designing the ANSF, and increased the goal of those to be trained to 400,000 personnel. But saying that one is going to train 400,000 Afghans is one thing, and actually training them, is another thing altogether. In 2009, following the surge strategy of President Barack Obama, Afghanistan has had to recruit around 100,000 personnel to the ANSF per year, just to meet the timeline set for the complete transfer of Afghanistan’s territories to ANSF. The ill-trained security forces have resulted in many lost lives on the battlefield. A recent study by US forces in Afghanistan revealed that there was a sharp rise in ANSF military casualties from 2010 to 2013.¹¹ Another recent study by the Brookings Institution, showed that during the 2007 and 2008 period, there was essentially zero partnership between NATO and Afghan forces. In 2009, partnerships on the ground rose but only to the extent of ten per cent, which fell again in 2010, and then jumped to 70 per cent in 2011 and 89 per cent in 2012.¹² This record suggests that the international forces were not focused on transferring the security function to Afghans, until sometime after 2010.

Challenge of Attrition

Attrition has been another key challenge and a strong barrier to the development of ANSF and transition in Afghanistan. While the regular monthly recruitment for ANSF continues, the US Department of Defense (DoD) reported an average of three per cent attrition in the ANA from September 2012 to March 2013. The US DoD report indicates that:

...Attrition within the ANA continues to be a significant challenge, as continued high attrition increases the overall cost of sustaining the force and creates a burden on recruiting and training structures. The ANA attrition rate remained well above the 1.4 percent monthly goal, reaching 4.1 percent in one month during this reporting period. Attrition fell to 2.5 percent in March.¹³

What are the key reasons for the sharp rise in attrition of ANA and ANP in Afghanistan? DoD findings show that incompetent commanders are a primary reason for the high attrition rate in the rank and file of ANA:

Since many of the underlying issues with attrition pertain to leadership, the MoD formed an evaluation commission to assess more than 500 commanders, and if need be, replace unsatisfactory leaders from battalion through corps levels. The evaluation commission has identified more than 30 poorly performing commanders; approximately 10 of these commanders have been re-assigned.¹⁴

Interviews with Afghan National Army commanders, conducted on the condition of anonymity, suggest that, another leading cause of attrition is corruption. Also cited were low-quality uniforms, poor living conditions, bad food, and a lack of necessary equipment.¹⁵ These contribute to low morale, apart from the usual divisive factors in Afghanistan, namely, ethnic, sectarian and regional tensions, which also contribute to the high attrition rates in the ANSF.¹⁶ Efforts to recruit on the basis of per capita population, statistics of each major ethnicity in Afghanistan, have done little to resolve the situation. A Brookings Afghanistan index survey found that Pashtuns comprise 44 per cent of the ANSF; Tajiks 25 per cent; Hazaras 10 per cent; Uzbeks 8 per cent; and other ethnicities 13 per cent.¹⁷ Even an ethno-centrally designed ANSF has been unable to reduce attrition levels.

Challenge of Funding Post-2014

Economic sustainability is a key concern for Afghanistan beyond 2014. Many worry that the economic infrastructure in Afghanistan is inadequate to sustain the country, after the full US-led NATO withdrawal in 2014. The World Bank and the IMF are not seen as being sufficiently strong to bridge the foreign aid cuts that will begin in 2014. In fact, a 2013 study by the World Bank warns that if not managed carefully, the inevitable cuts will trigger a major recession by 2014, the year that Afghanistan is scheduled to have an election and be totally reliant on Afghan forces for its security. This echoes earlier warnings, including a 2011 World Bank study, which noted that: "abrupt aid cut-offs lead to fiscal implosion, loss of control over security sector, collapse of political authority, and possibly civil war."¹⁸

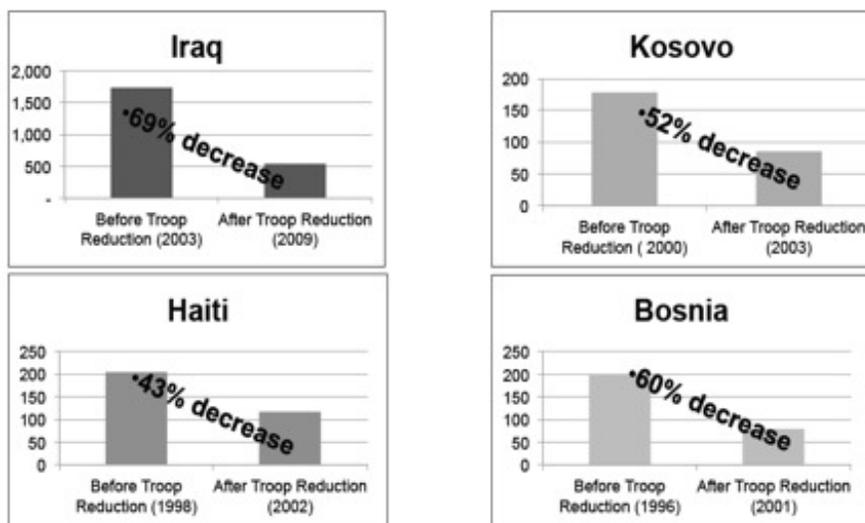
The general impact of aid cuts related to the NATO withdrawal will likely directly impact Afghanistan security forces and the security transition. The New

Yorker Magazine reported “...recruiting, training, equipping and operating of ANSF costs about 6.5 billion (annually) : the Afghan government provides 500 million of that, the international community 300 million USD and the US remaining 5.7 billion.”¹⁹

Moreover, such reports do not take into account, the military contracting and foreign aid, that have shored up the Afghan economy, for almost over a decade. Various studies including a US Congressional Research Service (CRS) report estimate that foreign aid and military spending accounts for 90 per cent of Afghanistan’s gross domestic product (GDP).²⁰ Moreover, various assessments suggest that Afghanistan will remain highly dependent on foreign aid, till at least 2024. A joint 2012 World Bank and IMF report anticipates a US\$70 billion financing gap between 2015 and 2024. Similarly, the 2013 World Bank study projects a financing gap of 40 per cent of the GDP in 2014-2015, dropping to 25 per cent in 2020-2025.²¹ While it is not clear how significant the drop, in outside assistance to Afghanistan will be in 2014 and beyond, estimates of the reduction in current military spending range from 70-90 percent.

All of these reports portend one thing. Afghanistan is in for highly risky and critical times, as has been the case in other places the US has abandoned, including Iraq, Kosovo, Haiti and Bosnia. An April 2013, study by the Center for Strategic and International Studies, noted that historical precedents also indicate that a withdrawal or significant reduction in troop levels, tend to be followed by substantial reductions in aid. Post-war Iraq has seen military aid reduced by some 69 per cent, Kosovo by 52 per cent, Bosnia 60 per cent, and Haiti saw a 43 per cent reduction.

Figure 1: Level of Aid Before and After Reduction of Troop Levels



Source: CSIS Report, Meeting the Challenges of Transition, May 2013.

According to a 2012 US Congressional Report Afghanistan was the largest recipient of US aid worldwide with Israel ranked second.²² If lucky, perhaps Afghanistan could work out an arrangement with the US as Israel did in 2007, when the Bush Administration signed a 10-year, \$30 billion military aid package, that raised Israel's annual Foreign Military Financing (FMF) grant from US\$2.55 billion to US\$3.1 billion. Afghanistan has signed a Strategic Partnership Agreement with the United States, which makes the country a major non-NATO ally of the United States. But a deal similar to that with Israel, is by no means probable, thanks to the freeze in Kabul-Washington relations and the poor political rapport between the two allies, during Hamid Karzai's second term as president. With the Bilateral Security Agreement (BSA) between Afghanistan and the United States under negotiation, a stronger alliance between the US and Afghanistan is highly possible. But the failure of the Afghan leadership to negotiate a financial support agreement, has been a strong blow to future Afghan stability, and that of its security forces.

What are the major signs that portend success in Afghanistan, beyond 2014, from a security perspective? Long-term commitment and enduring support from the US-led international community in Afghanistan. The United States and its allies in Afghanistan, have agreed to talk about the decade beyond 2014, in order to give Afghanistan enough time to transition to its own resources. This decade of transition as it is referred to, means that the international community is not planning to entirely abandon Afghanistan, as it learns to use its own domestic strengths and resources. To this end, the US and its allies have pledged some US\$4 billion in a military aid package for the ANSF. That said, there has been no significant progress in addressing the estimated US\$70 billion shortfall, needed to stabilise Afghanistan during this decade of transition.

Stabilisation Strategy Beyond 2014: The Role of Reconciliation

The so-called soft stabilisation strategy led by Hamid Karzai, was articulated by him in a speech to the Council of Ulema, in Kabul in April 2003. Karzai spoke of adopting a peaceful approach toward the, then underground Taliban insurgents, who were being strongly squeezed by the US-led coalition. President Karzai said that a "clear line" had to be drawn between "ordinary Taliban who are real and honest sons of this country" and those "who [would] still use the Taliban cover to disturb peace and security in the country...No one," he continued, "[had] "the right to harass/persecute anyone under the name of Taliban..."²³ Almost a decade later and little has come of Karzai's reconciliation initiative. Then again, the president appears not to have conceived a viable strategy, as which ever Taliban he may have met, were unable it would appear, to influence significant numbers of their brothers in arms, to achieve the peace Karzai was looking for.

What Karzai did achieve, was the sidelining and weakening of the non-Pashtun mujahideen figures, who could have been potential allies of his government. Terms such as warlords, transitional justice, criminal courts and human rights violators all came to be used during this period, when on the one hand the Afghan President, was taking international support, that of his friends, for the fight against the so-called warlords in his government, and on the other hand, approaching those Taliban who had never had a presence inside Afghanistan either as a political group or as active insurgents.

In a tactical move, President Karzai undertook a number of peace initiatives with the Taliban. He set up the Independent National Commission for Peace in Afghanistan, under former Afghan President, Sibghatullah Mojadedi, in 2005 which was meant to facilitate the reconciliation process with former Taliban members. In the initial weeks of its formation, Mojadedi announced that the amnesty offer from Karzai's government extended to all Taliban leaders, including the regime's former head, Mullah Mohammad Omar.²⁴ Efforts were made to categorise the Taliban insurgents, as good and bad Taliban; moderate and radical Taliban; and even Afghan and Pakistani Taliban.²⁵ *Jirgas* were called in Afghanistan, between Afghans and Pakistanis, in Kabul and Islamabad. But there was never any clear strategy offered or an idea of intended outcomes. The only so-called strategy on reconciliation was set by the Afghan High Peace Council. It was termed as a roadmap to peace with a timeline of 2015,²⁶ which is too far in the future, to gauge its potential for success.

Afghanistan is yet to design a grand strategy that is capable of dealing with Islamabad's grand strategy for insurgency in Afghanistan. Unfortunately, any initiative undertaken in Kabul has to take into account Pakistan's strategy for Afghanistan. Otherwise it will end in the same way as all other negotiations—the Doha Process, the Mecca Process or even Dubai Process²⁷—as a grand and abysmal failure.

Regional Stakeholders: The Nexus in Focus

While insurgency in Afghanistan has emerged as a strategic threat to its survival and future, there is a dominant discourse on a regional solution to the conflicts and insurgency in Afghanistan. A regional solution has been promoted by Turkey, Pakistan, Iran and a few others. But the main question is whether a regional solution is the key to managing the security challenges of Afghanistan, considering the role of Iran, Pakistan and India—the three close neighbours of Afghanistan, in influencing trends, issues and events in the country over the last four decades.

Pakistan: Security-Centric Vision

Pakistan's friendship or animosity towards Afghanistan dates back to the Durand-line agreement or dispute—depending on your point of view—between British-India and Afghanistan in 1903. After this imaginary line was drawn, the Afghan

prime minister Sardar Daud Khan's nationalistic agenda was born, and a territorial dispute formally came into being, along 2,400 kilometres of the now defined border between Afghanistan and Pakistan.²⁸

After Daud Khan's coup against his own royal family and the establishment of the first republic in Afghanistan, Pakistan's sensitivities and fears vis-à-vis Afghanistan increased to the extent, that a strategic foreign policy doctrine was formulated during Zulfikar Ali Bhutto's government, and then that of General Zia-ul-Haq, who perceived Afghanistan as a threat to the national security of Pakistan. According to Naseerullah Khan Babar, who was the inspector-general of the Frontier Corps, at the time, Zulfikar Ali Bhutto's government had started supporting the anti-Daud resistance movement in Afghanistan as early as 1973, by providing weapons and clandestine guerrilla training, with a view to countering such moves by Afghanistan.²⁹ Since then and during the military rule of General Zia-ul-Haq, Pakistan continued with a hostile strategy towards Afghanistan, providing safe havens and resources to the anti-Soviet, Islamist fighters in Afghanistan.³⁰

With the Soviet invasion of Afghanistan came jihad (1979-1989), and further interference by the Pakistani security establishment. For Pakistan, the anti-Soviet jihad was a perfect opportunity to weaken the Afghan elites and increase the influence of Pashtuns with the strategic goal of ensuring that Afghanistan remained a destabilised, fragmented and a weak nation-state.³¹ This policy of "Strategic Depth" against Afghanistan was continued by the governments of Benazir Bhutto as well as Nawaz Sharif, through the 1994 civil war in Kabul, and their subsequent support of the Taliban. In the eyes of many Afghans Pakistan's goal was no less than the policy of "Afghanistan becoming a fifth State" after North West Frontier Province (NWFP or current Khyber Pakhtunkhwa).³² During the post-Taliban phase, President Musharraf had little choice but to offer his whole-hearted support to the US-led *Operation Enduring Freedom*, given the choice George W. Bush offered him in his famous words, that you are "either with us or against us".

Pakistan to this day, continues its long-term strategy of making Afghanistan part of its sphere of influence, by using nefarious and covert ways. This is why any hint of Indian influence in Afghanistan is so galling to the Pakistani elite, security establishment, and even the Pakistani media and press. During a joint press conference of the Afghan and Pakistani Presidents some time ago, a Pakistani journalist raised the issue of there being some 14 Indian consulates in Afghanistan, and asked President Karzai to close them down. And then there was General Ashfaq Kayani's hacked e-mail, in which he said he considered the Taliban as Pakistan's strategic asset in Afghanistan, and mentioned strengthening Islamabad's support for the group.

Indications of Pakistani support to the Taliban as their proxy force in Afghanistan, particularly after 2014, explains the grand strategy of Pakistan toward Afghanistan, which has continued because of a weak nation-state in Afghanistan.

As a result, while many discuss a regional solution with a direct engagement of Pakistan in the peace building and reconciliation process of Afghanistan, no breakthrough is likely until Pakistan ceases and desists with its policy to subvert law and order in Afghanistan via their proxy, the Taliban.

Iran: Targeting the Global Enemy

Iran and Afghanistan share many things in common—language, culture, beliefs and values. Tehran is happy that the hostile Taliban regime was overthrown in Afghanistan, but is highly sensitive to the idea of the Great Satan, or U.S. being so involved with a brotherly neighbour.³³

Due to US involvement, Tehran combats the US-led NATO mission in Afghanistan in two ways. First, it tries to counter what it terms as “cultural NATO” or the influence of Western political values such as freedom of speech, free media, open society, and a democratic state where the rights of citizens are protected. In a speech in Tehran, Ali Larijani, the speaker of the Iranian Parliament, contrasted the NATO vision of Afghanistan, with Iran’s cultural vision for the country. Comparing the Western engagement in Afghanistan with the Soviet Union’s, by its focus on security, he contrasted it to Iran’s cultural engagement in Afghanistan.³⁴ The *Christian Science Monitor* carried a news report on the financial investments that the Iranians have made in Herat, an Afghan city that borders Iran, and serves as a hub for Iranian influence in Afghanistan. The report contrasted the limited Iranian investment in culture and religion, with the vast amounts of money spent by NATO, to highlight how much further the Iranian investment had gone as far as winning Afghan hearts and minds was concerned.³⁵

Secondly Tehran tries to counter American influence, by its support of anti-American elements in Afghanistan, as well as its support of the insurgency. While hard evidence of Tehran’s involvement on this front is sparse, Afghan officials widely believe that Iran has invested in training Afghan insurgents. While it seems far from reality that the two ideological enemies,—the Taliban and Iran—could engage with each other against the US, the common goal of defeating their enemy could pave the way for such cooperation.

Iran’s role in Afghan affairs is not perceived to be as destructive as that of Pakistan, at least by Afghans. Many high-ranking officials in Afghanistan told this author that they were aware of ways in which Iran is exploiting the situation, and fuelling the insurgency, and even resented it. But because things are so much worse with respect to Pakistan, they did not want to escalate tensions with Iran to the point of opening another hostile front.³⁶

US-NATO Post-2014: The Legacy

With the US-led NATO coalition ending its presence in Afghanistan after more than a decade, Afghanistan’s greatest concern is not what the ISAF is doing, but

what will happen when it packs up and leaves. The current design of NATO post-2014 engagement in Afghanistan suggests that, Afghanistan will not be completely abandoned. The main reason for this perception is the belief in the strategic importance of Afghanistan, with respect to NATO's future in a multi-polar world. Many European analysts and experts are of the opinion that the fate of NATO is closely linked to what happens in Afghanistan.³⁷ In the words of former Atlantic Council chairman, General James Jones, failure in Afghanistan would mean that, "NATO's [entire] cohesion, effectiveness and credibility will be shaken and the rationale for NATO's expeditionary, out of area, role would be undermined."³⁸

The Upcoming Model

It appears that post-2014, the US-led NATO mission in Afghanistan will follow a different model of engagement. The new stabilisation and combat model currently under discussion in the US and by NATO security officials, is concentrated on special operations, drone strikes and the small military footprint, expected to be retained after the majority of ISAF forces pull out. Similar models have been implemented in post-conflict situations in Pakistan, Yemen and the Horn of Africa, to ensure that counter terrorism and stabilisation missions continue where needed. Most experts seem to believe that the future US-NATO military engagement in Afghanistan will follow the same model.³⁹

For many on the European side of the Atlantic, the idea of continuing with the financial and personnel burdens of active operations in Afghanistan is hardly bearable, given the fragile state of so many Western economies. Most European states and nations have lost any enthusiasm they may have once had, for peace building missions without obvious national security interests being at stake, that would gain them the support of their domestic constituents.

Nevertheless, the stakes of failing in Afghanistan also loom large in the European consciousness. Because of this, there is a high likelihood that these nations will not be able to abandon Afghanistan to the radical elements. Since NATO's global reputation is very much connected to what happens in Afghanistan, as much as NATO might like to leave, the more likely scenario is, that it will be bound to have at least some presence in Afghanistan in the foreseeable future.

Conclusion

In the final analysis, Afghanistan is still, more than a decade after the international community ousted the Taliban, on the verge of becoming a failed state, but for the presence of the Western powers. Orderly presidential elections without a strong international presence would be, however, a bright spot in an otherwise uncertain future. The strategic implications of successful elections and handover of power

to a new administration in 2014, would signal to ordinary Afghans, that the country has largely stabilised.

A new administration might also bode well for the economy, as the Karzai government has managed to alienate a large number of the country's donor benefactors, who currently provide some 90 per cent of Kabul's financial needs, through military and civilian aid packages. These donor nations include the United States, which provides some 62 per cent of the aid—US\$15.7 billion in aid in 2010-2011. With this level of dependence it is more critical than ever, that relations between Washington and Kabul thaw in time to stave off whatever disaster scenarios threaten to loom, once a majority of the international forces leave.

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10

Myanmar in Transition: From Military to Civilian Rule

Nyunt Maung Shein

This paper focuses on the trends in democratising the polity in Myanmar. It intends to bring out the reasons for the democratisation process, which has led to relative political stability and stimulated economic growth, since the inception of the new civilian government, elected democratically, in accordance with the relevant provisions of the 2008 Constitution.

Brief Background on Myanmar's Political Evolution

Myanmar's political system evolved in three eras. The first era was the period of parliamentary democracy: beginning with the independence of the country in 1948 and lasting until March 1962. The second and third eras, which spanned a period of almost five decades, were dominated by the military. During the second era, the country closed itself to the outside world in a self-imposed isolation. However, in the third era, although the military government wanted to open up the country and reach out to the world, the West did not concur and imposed sanctions. As a consequence of the suppression of the democracy movement in 1988 by the Myanmar Government, many activists sought refuge in neighbouring countries, especially in India and Thailand. The West ostracised the government for this action by the imposition of sanctions on Myanmar. Over the years, the sanctions were strengthened to cover trade, sale of military equipment, withdrawal of preferential tariffs for agriculture and industrial goods, visa ban on certain persons, ban on investment and denial of assistance from international financial institutions. These actions by the West effectively closed the country to the outside world. Once again the country became isolated, not by self-imposition, but by the imposition of sanctions by outside powers.

The New Civilian Government

Pursuant to the provisions of the 2008 Constitution, elections took place in November 2010. A total of 36 political parties and several independent candidates participated in the elections. As many had expected, the State Peace and Development Council (SPDC)-backed Union Solidarity and Development Party won the majority of seats in both the houses of the *Hluttaw* or Parliament. This was supported by the Armed Forces representatives of the *Hluttaw*, amounting to 25 per cent of the total seats as stipulated in the constitution. The first regular session of the First Legislature of the *Hluttaws* was called in January 2011, and deliberations continued into February 2011. The President and the two Vice Presidents were elected by the *Hluttaw*. The cabinet was then formed by the President, and the newly elected civilian government was installed on March 30, 2011. After taking office, the new government, to the surprise of many analysts, carried out sweeping reforms first in the political field and later in the economic and administrative fields.

Political and Social Reforms

Daw Aung San Suu Kyi was released from house arrest a week after the elections. The President's historic meeting with her in August 2011 heralded a new chapter in the recent history of the country. Daw Aung San Suu Kyi stated that she was satisfied with her meeting with the President. Tens of thousands of prisoners were released and the count totalled more than 28,000 as of January 2012. Among those released were several hundreds of prisoners of conscience, including high-profile persons. In September 2012, hundreds of prisoners were again released, including a good number of political prisoners.

The relaxation of media restrictions and recognition of the role of civil society are also major reforms undertaken by the government since its inception. Such recognition was unthinkable in and unheard of in the past 50 years. Now the media is free to write on anything, and does not need to worry about press censorship. A new media-friendly law will be drafted and deliberated in the Parliament for eventual enactment into law. To address the human rights issues, an independent body, namely, the National Human Rights Commission has been formed. As for labour rights, the constitution now allows formation of labour unions as well as the right to strike. Eradication of endemic and rampant corruption, which has plagued the country for a long time, now receives top priority attention of the government. A new law to tackle this issue is under discussion in the Parliament. And it is hoped that its enactment will come about soon.

Under the initiative and guidance of the President, poverty in the country is being addressed. A vast majority of the population, about 70 per cent, lives in the rural areas. Of this, about 26 per cent live under the poverty line. A national

level workshop was convened in Nay Pyi Taw in this regard, and eight different sub-committees were formed to tackle the various aspects of this problem. A target was set to reduce poverty by half by the year 2015, in keeping with the Millennium Development Goal No. 1 of the United Nations (UN).

The Elections Commission amended the provisions of the electoral law, paving the way for the National League for Democracy (NLD) to participate in the by-elections, which took place in April 2012. In the by-elections, held to fill 46 vacant seats, NLD won 42 seats, 38 in the lower and 4 in the upper house. Daw Aung San Suu Kyi was elected to the lower house of Parliament. In August 2012, she was appointed as Chairperson of the Parliamentary Committee on the Rule of Law.

The government has also extended invitation to the armed ethnic groups for peace talks, from where the next stage is to build lasting peace in the whole country. As of now, 10 out of the 11 armed ethnic groups have signed ceasefire agreements with the government. Negotiations with the Kachin continue. It is hoped that trust and confidence with them can be built soon, so that a ceasefire agreement comes into effect. The national brethren living in Kachin State have suffered enough for the past one year or more already. President U Thein Sein has underscored the importance of cessation of hostilities with the ethnic groups, development of democracy and the need to provide equal rights to all ethnic groups.

Myanmar is now on the right track on its path to democracy. No doubt more needs to be done. The path to democracy is not smooth. In spite of the many opportunities there are also challenges that need to be overcome. Myanmar requires all the support and encouragement from the international community in its transition.

Economic Reforms

The second phase of the reforms is in the economic sector. Monopoly of the economy by a handful of persons has been terminated, and the playing field is now level, so that potential entrepreneurs have equal opportunities to enjoy the fruits of the economic reforms. With assistance and advice from the International Monetary Fund (IMF), Myanmar has reformed its complex multiple exchange rate system. A managed float system for the national currency was introduced on April 1, 2012, with a view to unifying the multiple exchange rates. This process will be completed at end of 2013.

Liberalisation of the banking sector has also taken place. Now, private banks in Myanmar are allowed to conduct foreign exchange transactions domestically and internationally. Another important aspect of financial reforms lies in the independence of the Central Bank from the Ministry of Finance. Legal advice is being sought from the IMF, for realising this aim. In the future, the Central

Bank will be a totally independent entity, which will exercise its own authority, without intervention from the Finance Ministry.

Myanmar also has set plans to establish a stock market by 2015 with support of the Tokyo Stock Exchange and the Daiwa Securities Group Inc. An Memorandum of Understanding (MoU) has been signed with the Tokyo Stock Exchange in this respect. In preparation for this event, public companies are being formed. Privatisation of state enterprises through open tenders is planned for Financial Year 2013. A new foreign investment law will soon be signed by the President, once the Parliament approves the changes suggested by him. The government has ensured that the new Foreign Direct Investment (FDI) law will be investor friendly.

Response by the West to Myanmar's Reforms

Encouraged by these developments, the West has responded favourably and positively. A flurry of foreign dignitaries visited the country starting with the historic visit of the US Secretary of State Hilary Clinton in December 2011. The British Prime Minister also paid a visit to Myanmar in early 2012. In recognition of the tangible reforms, the European Union (EU) suspended economic sanctions for a trial period of one year, starting from April 23, 2012. For the time being the arms embargo is still being kept.

Relations with the US have been normalised with the appointment of an American Ambassador, after a gap of over 20 years. Partial lifting of sanctions by the US in February 2012 enabled Myanmar to re-engage with international financial institutions such as the World Bank, the IMF and the Asian Development Bank (ADB). Satisfied with the outcome of the by-elections, the US further relaxed sanctions on the country, including some restrictions on financial transactions. It also permitted US private companies to invest in Myanmar. At the request of the President, as well as Daw Aung Suu Kyi, during their visits to the US in September 2012, the US Administration lifted the ban on the import of Myanmar goods. Other western nations followed suit and soon, Canada lifted all sanctions imposed on Myanmar, with the exception of the ban on arms sales. Australia also eased its sanctions against Myanmar.

Japan for its part waived US\$ 3.7 billion out of the total amount of US\$ 6.4 billion, owed by Myanmar. It also extended over US\$ 900 million as a bridge to enable Myanmar to repay its loans to the ADB and the World Bank. This gesture by Japan will enable the Myanmar Government to seek fresh loans from these two financial institutions. Currently, Japan is negotiating with Myanmar for bilateral investment treaty protection. It has also decided to provide as grant aid US\$ 20 million to help solve electricity shortage problems. At the recently concluded IMF meeting in Tokyo, Japan announced that it would resume ODA loans to Myanmar in early 2013. Likewise, the EU extended an €150 million

package aid to improve health, education, agriculture, and to provide shelters for displaced persons, while Australia increased its aid to Myanmar from the current AUS\$ 15 million to AUS\$ 64 million in 2012. Continued reforms in Myanmar will lead to the total removal of sanctions, which would further contribute to the development and prosperity of the country.

Challenges Ahead for the International Community in Engaging Myanmar

Political and economic transformation in Myanmar is taking place rapidly. Any reversal at this stage will be detrimental to the investment and growth potential of the country. Although the President has repeatedly assured the international community that the reforms undertaken are irreversible, there are certain factors which are of concern to potential investors from abroad. These factors are sensitive and delicate in nature, and they must be handled and addressed in a careful manner. The first issue in the priority list of the government is the democratisation process and the reduction of the role of the military, in the political and economic landscape of Myanmar. If there is any resistance from the military, the reforms may either be slowed down, or in the worst case scenario may shift into back gear. The NLD has been calling for the review and subsequent amendments to the constitution, with regard to the role of the military, in the country's politics. Both the government and the political parties concerned will need to cooperate in reforming the constitution. Such cooperation and positive results thereof are needed to allay the concerns of the international community.

The second issue is the national reconciliation with the ethnic groups. As mentioned earlier, the government has succeeded in achieving ceasefire agreements with 10 out of the 11 armed ethnic groups engaged in hostilities against the armed forces. The Kachin Independence Army (KIA) is the only one left. Negotiations continue with this group, and the government is rather optimistic in achieving a ceasefire agreement. The fourth round of negotiations with the KIA is expected in the not too distant future.

Another issue which can affect the political stability of the country, is the recent communal violence in the Rakhine State, in the western part of Myanmar. This issue is sensitive, and the government needs to handle it with care and find a lasting solution to the problem.

Challenges in the economic reform process are posed by the sanctions imposed by the West. Full elimination of the sanctions is required for the economy to grow without any impediments. Economic reforms could also be undermined by political instability and uncertainty as well as mismanagement, corruption and bureaucratic inefficiency. There is an urgent need for increased budget allocations for the social sector, namely, in health and education. The parliament has already taken some initiatives in this regard. Defence spending has been reduced for the

Financial Year 2012-2013, while a slight increase in the health and education budget has been approved. This is just the beginning, and it is hoped that more allocations will be accorded to the social services in future.

Future Prospects

Myanmar is located at the crossroads of India, China and Southeast Asia. It has a population of about 60 million. It is endowed with natural resources. It is the last Shangri-La in Asia. With the winds of change blowing fast, the country is poised to become one of the world's fastest growing economies over the next decade. A senior official of the ADB, who visited Myanmar a few months ago, predicted that the country would see GDP growing between 7 to 8 per cent annually from 2015 onwards. President U Thein Sein has recently stated, that his government is working hard to triple the country's GDP per capita by 2015, an ambitious yet achievable target. He called for foreign loans and grants and expertise to develop the country in achieving this target. The key drivers of the economy are forecast to be in increased exports, particularly of gas and electricity, and agricultural products, FDIs, government spending and domestic consumption.

Myanmar is the sole Association of Southeast Asian Nations (ASEAN) member state which has observer status in the South Asian Association for Regional Cooperation (SAARC). Because of this unique privilege, and due to its location between India, China and Southeast Asia, Myanmar bridges the two dynamic regions of ASEAN and SAARC. Myanmar shares land and maritime borders with two SAARC member states, namely, India and Bangladesh. The land border with Bangladesh has already been demarcated, while that with India has almost been demarcated, except for a short stretch of about 70 miles in the Kabaw Valley and at the tri-junction point where the borders of India, China and Myanmar meet. The maritime borders with both these countries have been delimited.

On account of its geo-strategic location, a politically stable and economically vibrant Myanmar could contribute to the peace and stable environment of both these neighbours. Myanmar could help transform the north-eastern hinterlands of India into a commercial hub. It could also provide hydroelectric power to this region for economic development. At the same time, India could benefit economically by using Myanmar as transit for the multimodal transportation of goods: from the landlocked Indian state of Mizoram to the Bay of Bengal. This access to the sea is vital for the development and prosperity of Mizoram. A politically strong and democratic Myanmar could also be conducive to a peaceful and secure border area between the north-east frontier region of India and Sagaing region of north-west Myanmar. India and Myanmar have traditionally cooperated in the suppression of Naga separatists in this stretch of the common border.

As for Bangladesh, an economically strong Myanmar could contribute to the well-being and prosperity of the people living along the border regions of Bangladesh through border trade conducted at designated places. Myanmar could also ensure energy and food security for both India and Bangladesh owing to its vast reserves of gas offshore, abundant potential for the supply of hydroelectric power and increased agricultural products in the country.

Conclusion

Since independence, Myanmar has undergone several political transformations. The parliamentary democracy experience that began in 1948 ended with failure in 1962. Similarly, Myanmar's exercise with socialism ended in futility in 1988. The military government of the State Law and Order Restoration Council (SLORC), and later the SPDC, withstood the pressure and sanctions imposed by the West. With the implementation of the seven-stage roadmap to democracy, it relinquished power after the elections of November 2010. Now a new era has emerged in the annals of Myanmar's modern political history, that is, the return to multi-party democracy constituting the legislature, the executive and the judiciary branches of state power.

Why did Myanmar abruptly change its political system? This is a question frequently asked by outsiders. Unlike the Arab Spring, the political transformation in Myanmar was initiated top-down, following the seven-stage roadmap to democracy laid down by the military government. The military government recognised that the country was lagging far behind its neighbours economically, which probably damaged the pride of the leadership. The public was also increasingly making their voices heard, in their desire to shape their own destiny. Therefore, once the final stage of the roadmap was implemented, the military relinquished power and handed over to President U Thein Sein's Government. This is perhaps the logical answer to the question.

Myanmar is a multi-ethnic country comprising over 100 different ethnic groups. Myanmar can echo ASEAN's motto of "Unity in Diversity". Successive governments have stressed unity and solidarity of the ethnic groups. To emphasise this point, the three main political causes propounded by the military government are as follows:

- Non-disintegration of the Union
- Non-disintegration of National Unity
- Perpetuation of Sovereignty

The 1947 constitution provides for secession by states after 10 years of independence. This was seen as a weak point of the constitution by the governments that ensued in the post-parliamentary democracy era. Therefore, no mention of this stipulation appeared in the 1974 and the 2008 Constitutions.

Although democracy in Myanmar will not be a mirror image of that practised in the West, there are now the *Hluttaws* which serve also as platforms for the people to express their opinions and views through their representatives, an opportunity which was absent from Myanmar's political landscape for the last 50 years.

The President's public statements that the reforms under way are irreversible are a morale booster for the people of Myanmar, as well as serve as an assurance to the outside world that Myanmar will continue to tread the path of democracy. Indeed, it has been a long time that Myanmar isolated itself from the mainstream international community. Now with the quick pace of reforms and strong commitment to building democracy, Myanmar should be supported and encouraged by the international community by way of abolishing all sanctions imposed on Myanmar. Furthermore, it should cooperate with Myanmar in its efforts to build a developed and modern society. A stable and peaceful Myanmar will be conducive to the peace and prosperity of the region in particular and the world in general.

PART II

Economic Growth in
South Asia

11

Reviving Pakistan's Economic Growth: The Regional Dimension

Ijaz Nabi

The paper¹ focuses on Pakistan's recent lacklustre economic growth and what needs to be done to move up to a higher growth trajectory. Pakistan needs growth rates of 7 per cent or more for the next four decades to ensure that Gross Domestic Product (GDP) doubles every 10 years and there is significant improvement in per capita income.² Given that Pakistan has averaged similar growth rates for several decades in the past, this is not such a tall order. In order to achieve this growth, however, Pakistan must look for a growth driver that can deliver sustained high growth for several decades and also improve regional equity, thus, contributing to political stability. The paper argues that regional trade that allows Pakistan to take advantage of its geography and history is such a growth driver.

Pakistan's Recent Growth Performance

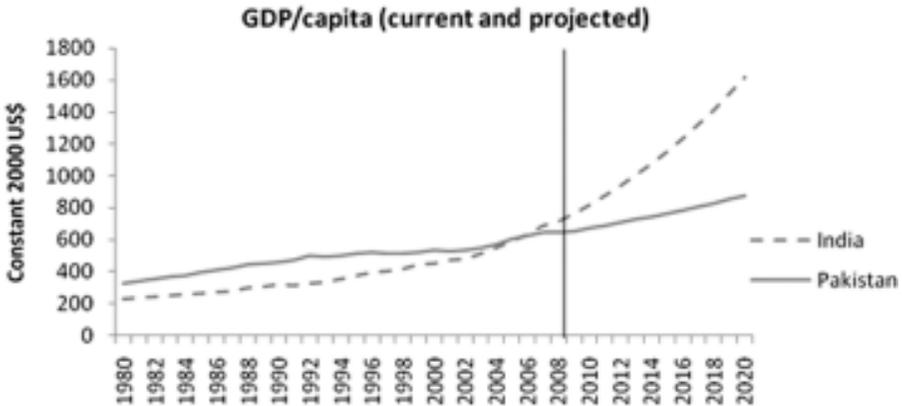
A comparison of Pakistan-India recent growth performance (shown in Figure 1) is sobering. Starting with independence and up to the 1990s, Pakistan GDP growth was above India's for most years. Since 1993, India's growth has been higher than Pakistan's in all but one year. Figure 2 compares income per capita in the two countries. India's income per capita caught up with Pakistan's in 2006 and, based on projections carried out before the recent slump in India's growth, is likely to rise well above Pakistan's. Clearly, in recent years, Pakistan has not performed well in its own neighbourhood.

There are consequences of poor economic growth for future living standards. Table 1 shows that if current growth trends persist, in 10 years, 1 per cent of GDP in Pakistan will be worth a lot less than 1 per cent of India's GDP. Thus, falling behind on GDP growth will accelerate the living standard difference in the two countries.

Figure 1: GDP Growth in India and Pakistan 1980-2008



Figure 2: Current and Projected GDP per capita in Pakistan and India (in the absence of an improvement in Pakistan's growth)



Source: WDI, 2011.

Note: The projections have been done using growth rates averaging over the last 5 years.

A Historical Perspective on Pakistan's Economic Growth

For centuries, the lands that constitute modern Pakistan enjoyed a strategic location advantage in the region. Persian, Central Asian, Chinese and Indian societies mingled here, shared cultural ties and carried out economic transactions. Cities such as Peshawar, Lahore, Multan and those in Upper Sindh, which lay on trade routes connecting lands to their west (Iran, Central Asia and China) with those to the east (India and beyond) became centres of trade, commerce and culture and brought prosperity to regions they commanded.

Lahore, in Punjab, was the hub of economic transactions and cultural exchange for a region that included Indian Punjab, Haryana, Jammu and Kashmir valleys and Himachal Pradesh to its east, and linked these regions with Persia

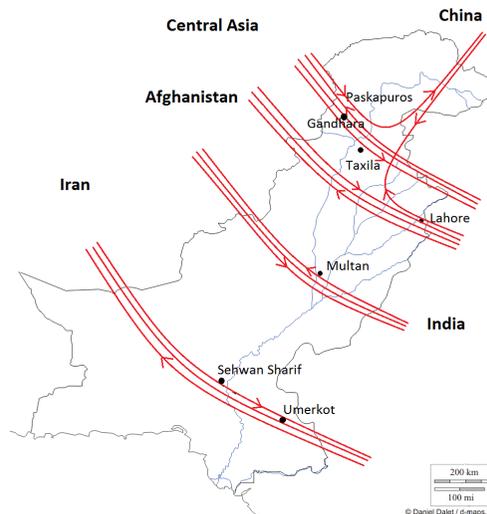
and Central Asia to its west. Lahore was cut off from the lands in the West with the coming of the British, and from the East soon after 1947 as a result of India-Pakistan feuds.

The ancient walled city of Peshawar has cast a large shadow on South Asia's culture. Famous South Asian actors (e.g., Raj Kapoor, Dilip Kumar and Shahrukh Khan) trace their ancestry to Peshawar, as do several world squash champions, successful business houses and men of letters. The merchants of the walled city controlled a prosperous hub of economic transactions between South Asia and the Central Asian territories. The influence of trade on the surrounding Pashtun areas would also have been substantial. Imperial rivalry between Russia and Britain cut off Peshawar from its northern markets, and 1947 severed access to those in India. The pool of economic transactions for Peshawar shrank dramatically. It is also noteworthy that the modern silk route through Hazara and Gilgit-Baltistan, on the China border, is an attempt to recreate the ancient trade links that were severed during the colonial times.

Sindh is hugely significant in shaping the South Asian religious/cultural psyche embedded in the venerated Sufi tradition of Islam. The Sufi saints chose to settle in Sindh along the Indus because there were receptive host communities that benefited from the trade routes between markets in territories that now lie in India and Iran through Baluchistan.

These cultural centres have defined themselves historically as parts of much larger regions that lie outside the borders of the modern nation state of Pakistan. Indeed, historically, these centres were better connected with trade and cultural hubs outside the modern nation state of Pakistan than those within it.

Figure 3: The Historical East-West Trade of Pakistan Regions



A major nation-building challenge for Pakistan, has been the integration of regions of Pakistan into a large and well-connected market. Hemmed in by the colonial borders and the hopelessly bad relations with India, Pakistani policymakers have attempted to reshape the country's economic geography. As a departure from historical East-West trade patterns, they created the North-South corridor defined by our new borders. This was key to Pakistan's growth in the six decades after 1947.

Pakistan's Recent Growth "Vents"

The region that constitutes Pakistan has seen at least five major "vents" for economic growth in the last 100 years:

Canal Irrigation: Starting in the 1860s, the Indian sub-continent saw a remarkable expansion of the irrigation system. For 60 years, the average annual increase in the area under canal irrigation was a phenomenal 50,000 acres³ Punjab, Sindh and parts of Khyber Pakhtunkhwa were major beneficiaries of this phase of canal expansion in British India. Several complementary developments, such as a legal framework governing land related transactions, a network of roads and railways and public services such as education, health and policing, jump started economic growth in the regions constituting the Indus basin market and brought about a substantial increase in income and living standards for nearly 100 years.

The Korean War and Import Substituting Industrialisation: The Korean War led to stockpiling of raw material. Jute and cotton produced by Pakistan benefited from the resulting price increase. India, a major importer of Pakistani cotton and jute, banned imports from Pakistan following differences on exchange rate management, which provided Pakistan the opportunity to diversify exports to non-traditional markets and look to foreign trade as a source of economic growth. By not devaluing the rupee, the government kept the cost of imported capital goods low, which contributed to a successful phase of import substituting industrialisation. However, the lack of competition resulted in inefficient production⁴ and high concentration of wealth. Manufacturing was concentrated primarily in Lahore, Karachi and Faisalabad that together accounted for 60 percent of the total value added in 1959-60. This disparity persisted for a decade and contributed to the dissatisfaction that eventually resulted in East Pakistan separating from the federation.

The Green Revolution: Ayub Khan's government began to focus on agriculture in the 1960s. During the first half of the 1960s, there was massive investment in irrigation: link canals were completed, Mangla dam was constructed and the number of tube wells increased from a few hundred in 1960 to a whopping 156,000 by 1975.⁵ The timely availability of water helped introduce a technology

package of high-yielding varieties (HYV) comprising seeds, fertilizers and pesticides with dramatic results. The agricultural growth rate started rising in the early sixties within the band of 3-6 percent but after 1966, when all the agricultural inputs were improved, growth rates jumped to 10 percent per annum.

Overseas Migration and Remittances: The 1970s and 1980s were characterised by a large outflow of labour, both skilled and unskilled, to the oil rich Middle East. The number of migrant workers increased from 79,000 per annum in 1970s to 107,000 in 1980s, and remittances jumped from US\$565 million to US\$2.3 billion per annum. The high volume of remittance income was geographically spread, benefiting even the poorer regions. At the household level, remittances improved the living standards of recipient families propelling them to a middle class status. Remittances also had macroeconomic benefits, allowing high volume of imports at a relatively stable exchange rate. But there was a downside. Remittances fuelled consumption-led growth for nearly three decades, which contributed to the loss of international competitiveness of manufacturing.⁶ This manifestation of the Dutch disease in Pakistan has resulted in anaemic growth of manufacturing and a paucity of high productivity and high wage jobs.

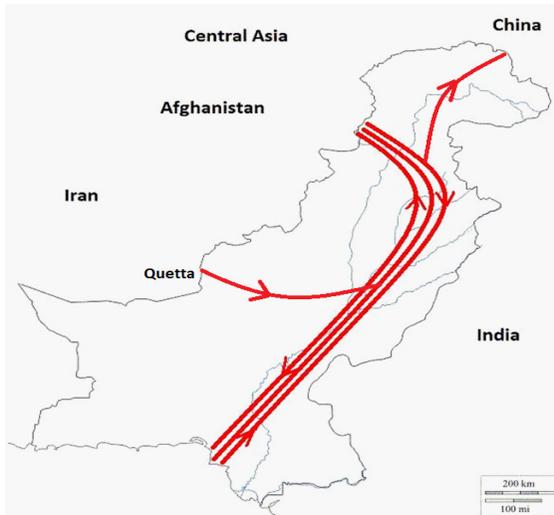
War on Terror: A major growth spurt occurred under Musharraf in 2002-07. For its role in war on terror, Pakistan was rewarded in concessionary capital from International Financial Institutions (IFIs). There was also a substantial write-off, rescheduling of external debt and increase in foreign direct investment. Remittances that had fallen sharply in the preceding years, shot up again as confidence in the rupee was restored. This resulted in a substantial improvement in Pakistan's balance of payments and contributed to economic stability that spurred economic growth. However, the end years of this growth phase (2006-2008) coincided with rising inflation and energy shortfalls. The share of investment and manufacturing in GDP and employment did not show any increase. The growth in imports far exceeded that of exports, and the tax-to-GDP ratio stagnated. Growth and its salutary effects, thus, were short lived.

The Indus Basin Market

Another way to look at the growth in the six decades since 1947 is in terms of the creation, perhaps for the first time in history, of an integrated Indus Basin market. A strong and interdependent market for products, labour and financial flows has been created between the border with India on the East, and the Indus River on the West. Pakistan's economic managers wisely invested in communications infrastructure spanning railways, ports, roads, postal system and telephones that was key to the development of the Indus Basin market. Spokes in the Southwest extends the market to Quetta in Baluchistan and in the Northeast to the regions of the Karakoram and the Hindu Kush. The market enjoys perhaps the best connectivity of any sub-region in South Asia. The

National Trade Corridor (NTC) links Peshawar through Lahore to Karachi and Port Qasim and handles the major part of Pakistan's external and internal trade⁷. This connectivity has facilitated Pakistan's growth episodes and the sharing of welfare from that growth across a wide region.

Figure 4: Pakistan's Indus Basin Market along the North-South Trade Corridor



Searching for a New Growth “Vent”

The recent unsatisfactory growth performance shows that the Indus Basin market needs to be revitalised. This will come partly from strengthening competitiveness with the Indus Basin but also, as argued here, from strengthening international trade, especially regional trade across the land borders.

The Changing World Around Pakistan's Land Borders

As recently as the 1980s, it did not matter that the old East-West trade routes lay abandoned. China was in a long slumber and was performing far below its capabilities as a potential economic giant. Western China, in particular, was mired in low growth, and that was the more relevant China for Pakistan. In Central Asia, the mineral wealth was exploited in the interest of Russia. And India, with its modest “Hindu” growth rate, was shackled to a stifling regulatory framework born out of Fabian aspirations and a decaying colonial bureaucratic heritage. In the last 30 years, all this has changed.

China, under Deng Xiaoping, came out of its slumber in the early 1980s, and has since become an economic powerhouse, with growth rates of 10 percent per annum, for over two decades. China is undergoing a major restructuring to

deepen growth beyond the Pacific coast to Western China, and thus bring it to Pakistan's land border in the North. The rising Chinese middle class constitutes a potentially huge consumer market for Pakistan's products. Also, China's high savings could be a deep pool of investment for Pakistan. Thus, an economy of a billion plus people with the potential to grow at 10 percent for several more decades, beckons from our Northern land border.

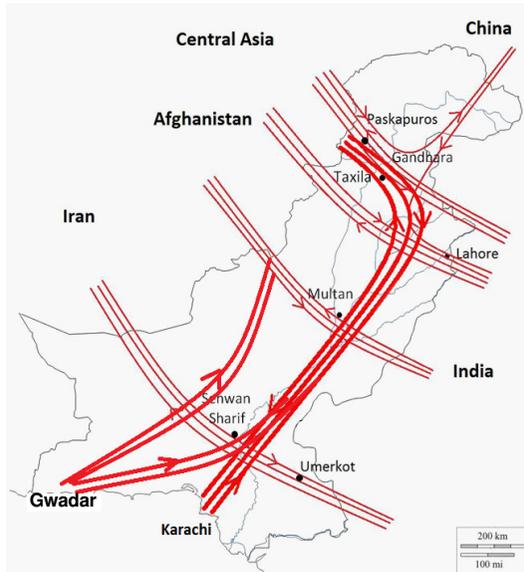
India followed China a decade later. The cumbersome regulatory framework has started to be dismantled. The spectacular growth in IT exports has given India a "techi" shine that is attracting the world's attention. Until the recent loss of confidence, India was on an impressive growth trajectory of 7-8 percent growth per annum, and recognised as a major emerging economic power. In short, another economy with a billion plus people, with high savings and rising living standards, lies beyond the long Eastern land border.

Across the North-Western border, beyond troubled Afghanistan and Pakistan's volatile tribal belt, are the newly independent Central Asian Republics (Turkmenistan, Uzbekistan, Kazakhstan, Kyrgyzstan and Tajikistan). Rich in natural resources, no longer siphoned off by the Soviet behemoth, the Central Asian Republics are engaged with the world to exchange their mineral wealth for goods and services, which satisfy growing consumption and rising living standards of their citizens.

Beyond the Western Border lies Iran; it is rich in oil and natural gas, which it would be free to sell to the needy South Asia in exchange for skilled manpower and consumption goods once its strategic interests are allied with the welfare of its citizens.

Reopening the historic East-West trade routes and connecting the energy rich economies of Central Asia with the fast developing economies of India and China will bring rich rewards to Pakistan as the regional trading hub. Modernisation of the North-South corridor will deepen and enlarge the land mass and population base (stretching to Central Asia and Western China and India) that seeks access to the Indian Ocean via multiple ports along Pakistan's Makran coast on the strategic Arabian sea. Pakistan will benefit initially as the transport hub facilitating this access. Strengthened international competitiveness, furthermore, has the promise of converting Pakistan from a transportation hub to a manufacturing hub, thus, increasing economic transactions manifold. This will bring a new vibrancy to the Indus Basin market (Figure 5), spurring high and regionally balanced economic growth, raising productivity and high wage employment, and thus bringing about sustained improvement in citizen welfare.

Figure 5: Enhanced Vibrancy of the North-South (Indus Basin) Trade Flows from Re-opening of the Historical East-West Trade Routes



What Will it Take to Revive Regional Trade?

Internal Peace and Security

The current climate of uncertainty regarding Afghanistan's future, militancy in the tribal belt and the sectarian/ethnic strife it fuels in Pakistan, especially in Karachi and Quetta, and restive Baluchistan pose severe challenges to the economic well-being of Pakistan and indeed the whole region. Without addressing these challenges, the benefits of regional trade and economic integration cannot be realised.

International Competitiveness

Sustained welfare improvements for the citizens of a regional hub arise when it transitions from a transportation hub of goods and energy, to become a manufacturing hub that creates high productivity, high wage jobs in multiple regional growth nodes. Such a transition requires strengthening Pakistan's international competitiveness as a manufacturing base. Ongoing rapid urbanisation in Pakistan has the potential of agglomeration economies that will fuel growth in the Indus Basin, and also will contribute to regional trade. Key to realising the agglomeration economies are skilled workforce, modern infrastructure (ports, roads and energy), substantially improved governance to expand service delivery and a development framework that promotes investment and manufacturing over consumption. Several bodies of work have been

completed recently that detail ongoing/proposed reform in each of these areas⁸. The analytical work is being distilled to draw up an agenda of reform to strengthen Pakistan's international competitiveness. This will facilitate the transition from a transportation hub to a manufacturing hub, which sustains high growth and creates employment opportunities to improve living standards across Pakistan.

Engaging with India

A number of studies⁹ have estimated the salutary impact of India-Pakistan trade liberalisation on Pakistan's economy both in terms of overall trade volumes as well as on the vast majority of stakeholders. Pakistan's role as a hub of regional trade is incomplete without the East-West trade (and also the North-South) routes extending to India. This is illustrated in the trade flow chart of Figure 5 that shows greater vibrancy of the Indus Basin economic transactions following the re-establishment of the East-West trade corridors.

Recent liberalisation of the investment regime by India and the earlier announcement by Pakistan to move from a positive list to a negative list based bilateral trade (granting of Most Favoured Nation) are welcome developments. However, for trade to resume on a meaningful scale, several remaining stumbling blocks need to be addressed. These include:

- (i) *Goods and Services Related Non-Tariff Barriers*: Institutional capacity must be developed to use the WTO framework for addressing non-tariff barriers and anti-dumping complaints with a view to promoting trade rather than hindering it.
- (ii) *Land Routes*: The maximum benefits from a more liberal trade regime with India will come from land routes that minimise response time to market forces. As many land routes as possible must be opened up, building on the old road and railway networks, all along the border from the Kashmir region to the Arabian Sea.
- (iii) *Travel*: Travel (visa, air/road/railway transport) must be facilitated to promote competitive trade in goods and services that benefits small- and medium-sized firms, to tap into the large pool of Indian skilled workers, gain access to Indian farm and other technology and encourage cross-border tourism.

To create a sustained momentum for liberalising trade and investment flows, it would be useful to set up a regional trade forum (comprising the private sector, academia and the media) that monitors progress in the key areas outlined above. The forum should identify barriers to trade embedded in the trade policy, the payment system and communications (including travel). The forum should also help identify likely losers from liberalising trade with India and suggest ways to compensate them. It should help in formulating a broader regional trade and investment promotion strategy.

India's Role in Promoting Bilateral and Regional Trade¹⁰

All paths to economic development and prosperity do not have to be routed through sweatshops catering to affluent western consumers. A large and vibrant Asian regional market would constitute a significant and, given demographic shifts, growing part of global demand for products. India's long-term strategic interest is to help create that Asian market. That, in turn, requires strengthening Pakistan to be an effective regional hub that connects the Asia-wide market.

Successful management of the new liberalised India-Pakistan trade regime to scale it up to a full-fledged economic relationship will be key. In the short term, it may well mean exercising voluntary restraint on exports that hurt small- and medium-sized Pakistani manufacturers. It would also require focusing on export of machinery and technology to Pakistani firms that currently import these at high cost from more expensive developed country sources. Joint ventures and other investment strategies would need to be developed to set up production units for the Asia-wide market.

Conclusion

Pakistan's recent growth performance is worrisome because it is far below trend growth rate and living standards have started to fall behind those in China, India, Central Asian Republics and Iran. To restore Pakistan's robust economic growth, infrastructure investments and institutions that created the vibrant Indus Basin market need to be revitalised and pool of skilled workers deepened. This, in turn, will help realise the agglomeration economies associated with ongoing rapid urbanisation.

Energised regional trade, especially trade with India, and the revitalisation of the Indus Basin market that will follow will be a key element of the strategy to put Pakistan on a much higher growth trajectory. Regional trade will also help promote regionally balanced growth, which will contribute to political stability. Regional trade and economic integration will benefit the entire South Asia region in terms of improved living standards.

The prerequisite for enjoying the benefits of regional integration and a resurgent Indus Basin market is the resolution of militancy and regional strife that afflict Pakistan and discourage investment. It is thus in the interest of Pakistan and its neighbours to cooperate to restore peace and stability in Pakistan's restive regions.

NOTES

1. The ideas presented here are drawn from several papers published recently, viz.: I. Nabi and A. Nasim, "Trading with the Enemy: A Case for Liberalizing Pakistan-India Trade", in S. Lahiri (ed.) *Regionalism and Globalisation: Theory and Practice*, Routledge, London, 2001, pp.170-197; I. Nabi, "Pakistan's Quest for Economic Growth: Lessons from History", *Lahore*

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- Journal of Economics*, September 2012; "Regional Trade Report", Pakistan Business Council, 2011, 2013.
2. *Regional Trade Report*, Pakistan Business Council, 2011.
 3. I. Stone, *Canal Irrigation in British India: Perspectives on Technological Change in a Peasant Economy*, Cambridge University Press, Cambridge, 1984, p.340.
 4. Hasan, 1998, p.16.
 5. S. Zaidi (ed.), *Issues in Pakistan's Economy*, Oxford University Press, New York, 2005, p.30.
 6. Ijaz Nabi, "Economic Growth and Structural Change in South Asia: Miracle or Mirage", Development Policy Research Center Monograph, Lahore University of Management Sciences, 2010.
 7. "Export Competitiveness Report", World Bank, 2006.
 8. These include: "A New Growth Framework", Planning Commission, Government of Pakistan, 2011; I. Nabi, No. 6.; "Export Competitiveness Report", No. 7; "Doing Business", World Bank, 2010; Beaconhouse University Reports on Pakistan Economy.
 9. I. Nabi and A. Nasim, No.1; Z. Naqvi and I. Nabi, "Pakistan-India Trade: the Way Forward", in M. Kugelman and R. Hathaway (eds.), *Hard Sell: Attaining Pakistan's Competitiveness in Global Trade*, Woodrow Wilson Center, Washington DC, 2008; .Mohsin S. Khan,"India-Pakistan Trade: A Roadmap for Enhancing Economic Relations", Peterson Institute for International Economics Policy Brief No. PB09-15, Washington DC, 2009; Ijaz Nabi, No.1.
 10. This discussion is based on: Ijaz Nabi, "Lifting the India-Pakistan Trade Game", *The Hindu*, March 28, 2012.

12

Prospects of Economic Growth in Bangladesh

Bazlul H. Khondker

Introduction and Background

Over the last four decades, Bangladesh has enhanced its per capita income four fold, reduced head count poverty by more than half, and is well placed to attain most of the millennium development goals. Bangladesh is one of the few countries which attained noteworthy success in social development with low per capita income. However, the pace of progress and development has not been smooth during the last four decades. More specifically, the pace of economic growth picked up significantly only in the last decade, leading to much faster rate of poverty reduction. Inspired by a stable and moderate level of economic growth, the policy makers as well as people of Bangladesh have started to believe that moving into higher growth trajectories over the medium and longer term is a real possibility, thereby translating the country into a 'middle income' status by 2021. This belief has been aptly reflected in the medium- and long-term plan documents. The high growth optimism has also been shared by development partners, private commercial banks and multinational corporations.

Against this backdrop, the objective of the paper is to assess the likelihood of achieving higher economic growth over the next decade. A thorough review of the past growth experiences has been attempted to detect the pace, nature and main drivers of growth. Thereafter, key factors, which might facilitate future growth expansion in Bangladesh, have been also identified. The paper is based on secondary sources, namely plan documents¹ of the government, Bangladesh Bureau of Statistic's data sets and reports of development partners and think tanks.

The paper is organised in four sections apart from the introduction and background. An assessment of the growth experience in Bangladesh is provided in the second section. Medium- and long-term growth outlook is presented in the third section. The fourth section provides a detailed analysis of key constraints or bottlenecks. Concluding observations are presented in the last section.

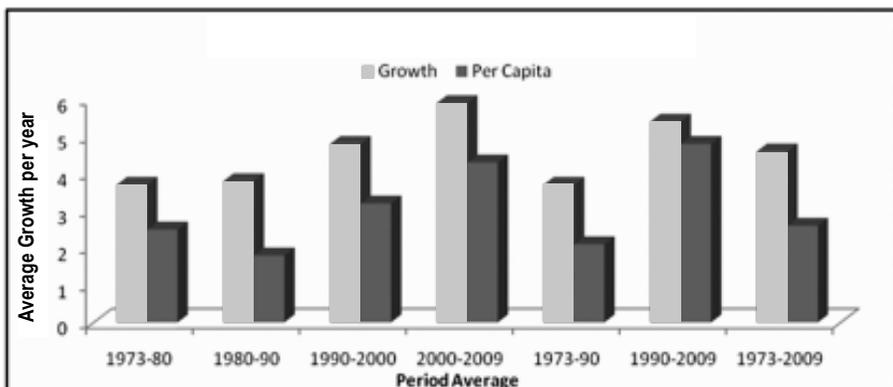
Growth Experiences of Bangladesh

A review of the growth experience of Bangladesh over the last few decades suggests a remarkably encouraging story. Soon after independence, in 1972, the Bangladesh economy was in shambles, and rough estimates put Bangladesh's per capita GDP at around \$110. Most of the physical infrastructure was destroyed. The economic and financial structure was also in a mess. The initial economic management did not help either. A combination of hasty decisions to nationalise most productive assets, resort to price controls, import licensing and trade protection put the economy on a downward spiral. Poor monetary and fiscal management along with production failures fuelled an unprecedented inflationary spiral. Floods and natural disasters combined with poor infrastructure saw one of the worst famines in the nation's history in 1974.²

It was apparent that this course of economic management was unsustainable, and Bangladesh quickly shifted to a market-oriented economy with proper government interventions/regulations to protect social interests and provide an equitable social environment.

Figure 1 shows the long-term trend in GDP and per capita growth rates by decades. Major observations are: First, Bangladesh has continued to improve its rate of growth steadily over the past four decades. Second, one can distinguish two distinct growth phases. During phase 1 (1973-90), the growth rate expansion was subdued, somewhat below 4 per cent per annum on average and only 2.2 per cent in per capita terms. During the second phase (1990-2009), the growth rate expanded significantly leading to over 5 per cent per annum on a 10-year average, but importantly exceeding the 6 per cent mark for a number of years in 2000-09.³ *The rising long-term growth trend gives optimism that even higher growth (i.e. over 6 per cent) is possible provided policy reforms further strengthen the determinants of past growth.*

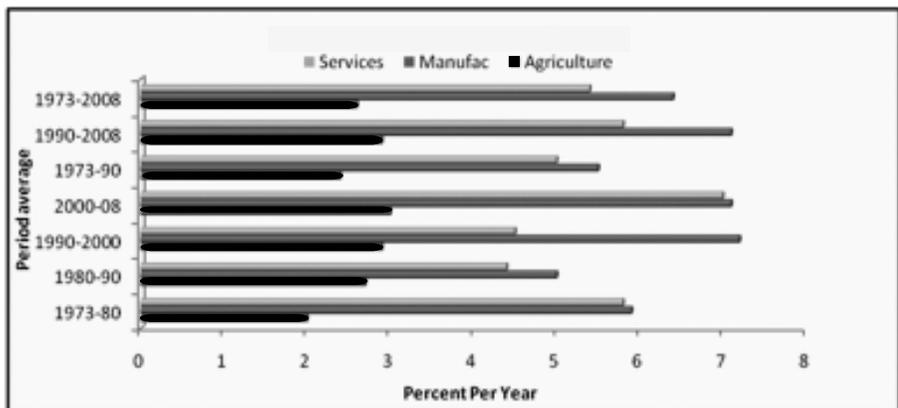
Figure 1: Bangladesh Long-term Growth Trend 1973-2009



Source: Bangladesh Bureau of Statistics.

Determinants of Growth: In order to understand the determinants of growth, it is important to look at the sectoral composition of growth and underlying structural changes. Figure 2 shows the relative growth rates of the three broad activities. During the last four decades, agriculture has been a relative drag on the growth of the economy. Agriculture grew below 3 per cent on average. Manufacturing and services both grew faster than the overall GDP. On the whole, manufacturing grew the fastest (6.4 per cent per year), while services sector grew at 5.4 per cent annually. This relative performance ranking did not change between Phase 1 and Phase 2. Instead all sectors including agriculture grew faster in Phase 2 relative to phase 1.

Figure 2: Sectoral Growth Rates, 1973-2008

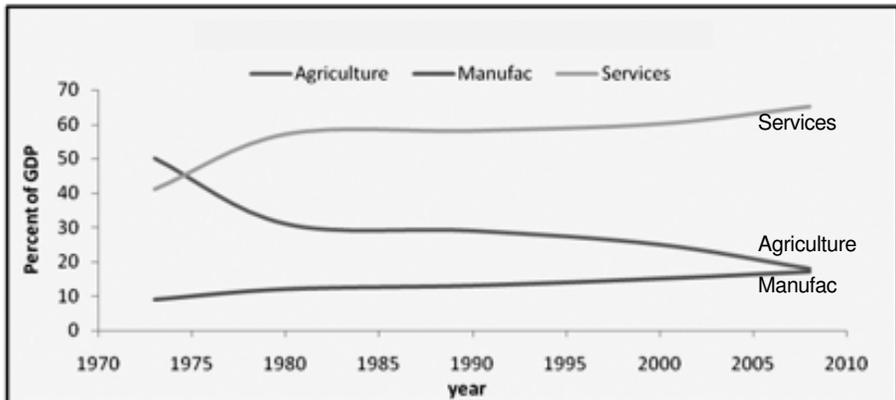


Source: Bangladesh Bureau of Statistics and Worlds Bank World Development Reports.

It is quite clear from the relative growth rates of the last four decades that the growth dynamism is largely provided by modern manufacturing and services sectors. It has been argued that this “transformation of a peasant agrarian economy to an organized manufacturing and services economy also provides the employment base for absorbing a growing labour force into productive and relatively well paid jobs.”⁴ However, despite its impressive performance, manufacturing share in overall GDP did not improve substantially. To understand this feature, it is important look at the initial condition (Figure 3). Thus, due to the low initial base, the relative share of manufacturing in GDP did not improve significantly in spite of the stronger growth performance of the sector. On the other hand, services sector gained share both due to a good growth performance, but also because of higher initial weight in the composition of GDP. In contrast, the slow growing agriculture substantially lost ground mainly due to low growth.

Key Factors of Growth Success: In the first phase, growth relied to a great deal on nationalised production, state interventions in terms of licensing and price controls, heavy trade protection and subsidies. Reforms were partial and hesitant.

Figure 3: Structure of the Bangladesh Economy, 1973-2008

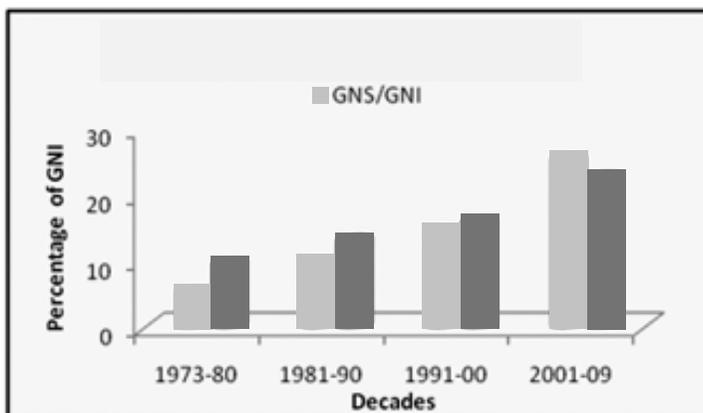


Source: Bangladesh Bureau of Statistics.

In phase 2, the incentive regime in Bangladesh changed rapidly. Private sector production and investment and exports supported by inflow of remittances were the main drivers of growth. Remittances in particular spurred the expansion of construction, especially housing and other service-oriented commercial enterprises. Banking reforms opened new opportunities for financing. A stream of trade liberalisation spurred investment in export enterprises, of which readymade garments is a shining example.

One important feature to note is that, in both phases growth was largely fuelled by the expansion of investment, mostly from the private sector, and financed by national savings (Figure 4) and by an expanding labour force. Contribution of total factor productivity was very limited⁵. While the domestic saving rate has been on a rising trend, the rapid growth in the national saving rate since 2000 has been prompted by the huge expansion in remittances.⁶

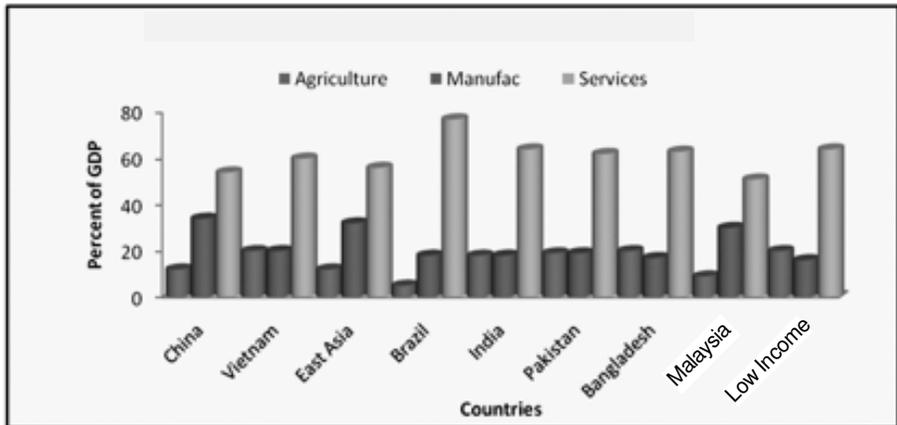
Figure 4: Average Trend in National Saving and Investment, 1973-2009



Source: Bangladesh Bureau of Statistics and World Bank.

Bangladesh Structure of Economy and International Experiences: A comparison of Bangladesh's growth dynamism and the resultant economic transformations with the dynamic East Asian economies may appear insipid (Figure 5).

Figure 5: International Comparison Structure of Economy, 2006



Source: World Development Report 2008.

A review of Figure 5 suggests some interesting features:

- (i) The structure of the Bangladeshi economy resembles strikingly that of average low income economies. Bangladesh, like other low income economies is yet to make the transition to a modern manufacturing and services oriented economy.
- (ii) The manufacturing share of China, Malaysia and East Asia on average is over 30 per cent, as compared to a low 17 per cent in Bangladesh, and hence it remains a low industrialised economy. The cases of India and Brazil, which also exhibit low share of manufacturing require a bit of explanation. Brazil, with a per capita income of \$4,710 in 2009 is in a different league and is already fairly well industrialised with organised services providing the high income jobs and linked to serving the manufacturing sector. India similarly is fairly well industrialised and its lower share is a reflection of the much faster expansion of export-oriented modern services such as Information Technology (IT).
- (iii) All economies including Bangladesh exhibit a high share of services in GDP. This is partly due to the definition of service sector. All non-manufacturing activities including mining and public utilities, which are conventionally lumped under industry in national accounts, are grouped here under services. Although utilities rightly belong to the services category but the inclusion of mining is an anomaly. More importantly, the catch-all term 'services' is a bit of a misnomer. It combines both formal and informal services.⁷

Despite these shortcomings of the transformation of the production structure, it is inspiring to note that Bangladesh's growth performance perplexed the proponents who had dubbed Bangladesh as a 'basket case' in early 1972.

Medium- and Long-Term Growth Outlook

Inspired by the growth dynamism, structural shifts in production, and near self-sufficiency in rice production, the policy makers as well as people of Bangladesh tend to believe that moving into higher growth trajectories over the medium and longer term is not an insurmountable goal. This belief has been aptly reflected in the medium and long term plan documents. According to the 'Perspective Plan', the goal is to transform Bangladesh into a middle income country by 2021. In the case of Bangladesh, the journey to middle income country and high Human Development Index (HDI) status requires sustained equitable and inclusive growth. It was found from 'the technical framework' underlying the Perspective Plan that the economy needs to grow at a consistently high rate over the next decade for the realisation of the vision. The Perspective Plan targets annual real Gross Domestic Product (GDP) growth rate to rise to 8.0 per cent by 2015, and further to 10.0 per cent by 2021 with significant improvement in living standards through substantial rise in employment, higher output and export growth, as well as drastic reduction in poverty while maintaining macroeconomic stability. Per capita annual income is projected to rise to about \$ 2,000 (at constant 2013 dollars) by 2021, thus crossing the middle income threshold. To achieve and sustain the high rates of growth, gross domestic investment will reach 38 per cent of GDP, with gross national savings at 39 per cent, and headcount poverty dropping to only 13.5 per cent. (Table 1).

Table 1: Key Macroeconomic Indicators

	Benchmark FY10	Target FY15	Target FY21
Real GDP Growth (per cent)	6.1	8.0	10.0
CPI Inflation (per cent)	7.5	6.0	5.2
	As per cent of GDP		
Gross Investment (per cent)	24.4	32.5	38.0
Gross National Savings (per cent)	30.0	32.1	39.1
Total Government Revenue (per cent)	10.9	14.6	20.0
Total Government Expenditure (per cent)	14.6	19.6	25.0
Exports (billion US\$)	16.2	38.8	82.0
Imports (billion US\$)	21.4	52.8	110.5
Remittances (billion US\$)	10.9	17.8	38.5
Unemployment Rate (per cent)	30.0	20.0	15.0
Poverty (Head Count, per cent)	31.5	22.5	13.5

Source: SFYP and Perspective Plan Projections.

“Acceleration of economic growth and reduction of poverty—two principal goals of the Perspective Plan—will come about through the dynamism and inter-linkages among the three broad sectors of the economy: agriculture, industry, and services. A vibrant and highly productive agricultural sector is a prerequisite for the kind of growth acceleration envisaged in the Perspective Plan. Provision of food security is also a constitutional obligation.”⁸ However, attainment of long term growth targets is premised on a productive and competitive manufacturing sector growing at or near double digits during the 2010-21 decade.⁹ Consequently, the broad industrial sector will continue to account for a much larger share of GDP, approaching 37 per cent by 2021, compensating for the secular decline in the share of agricultural sector, which falls to 15 per cent. This trend is consistent with the stylised facts of structural change in the process of development. For Bangladesh to reach middle income threshold by 2021, industrial expansion must accompany concomitantly with highly productive farm and non-farm agriculture. Accelerated pace of industrialisation will be necessary to address the increasingly diminishing capacity of agriculture to absorb the incremental labour force, strengthen backward and forward linkages with agriculture and services sectors, cater to the growing domestic demand for industrial goods and take advantage of emerging opportunities in the global market.

Manufacturing Exports: Within the manufacturing sector, the main driver will be the export markets. At the same time, growing domestic demand from higher income generation will also provide impetus to import substitute production. It is projected that the share of exports in relation to GDP will rise to about 25 per cent of GDP by 2021, reflecting a leading role of the export sector in the economy.”¹⁰ “The target with regard to the external sector is to ensure strengthened global integration of the Bangladesh economy by building necessary trade-related supply side capacities. This will be realised through raising the competitiveness of Bangladesh’s exports, ensuring a larger share for the country in the global trade in goods and services, and by encouraging both product and market diversification. This will be done by renewing efforts at moving up market and by raising the efficacy of trade facilitation measures. Bangladesh’s strong performance in the global labour services market will be continued and further consolidated.”¹¹ Based on the recent performance, export sector under the Sixth and Seventh Plan period is projected to grow by 12-15 per cent per annum in US dollar terms. The projection entails an increase in the share of exports in relation to GDP to rise to about 25 per cent of GDP by 2021 reflecting a leading role of the export sector in the coming decade. The overarching goal here will be to ensure that trade-GDP ratio rises to nearly 60 per cent of GDP with export of goods and remittance earnings approaching 40 per cent 2021.

Strengthened Global Integration: The target is to ensure strengthened global integration of the Bangladesh economy by building necessary trade-related supply side capacities. This will be realised through raising the competitiveness of Bangladesh's exports, ensuring a larger share for the country in the global trade in goods and services and by encouraging both product and market diversification. This will be done by renewing efforts at moving up market and by raising the efficacy of trade facilitation measures. Bangladesh's strong performance in the global labour services market will continue and be further consolidated. Some of the important measures envisaged in the 'Perspective Plan' include:

- (i) Export diversification, involving product and market diversification
- (ii) Seizing opportunities in export markets created by eroding competitiveness of China in low-cost labour intensive products
- (iii) Restructuring export production by seizing opportunities from globalised production chains and forging intra-industry linkages in a globalised economy
- (iv) Working on market access issues in multilateral, bilateral and regional fora
- (v) Close monitoring and supervision of the activities and practices of recruitment agencies
- (vi) Moving to technology-based system of effective practices for remitting money
- (vii) Training workers in the vocations and skills that have a high future demand in global markets
- (viii) Making the Overseas Employment Policy more comprehensive so that it covers multiple aspects of migration, including workers' and employers' documentation, employment contracts, their implementation and settlement of workers welfare

Multilateralism: Addressing the multilateral trading regime will mean coping with the challenges of asymmetric and inequitable trading rules that are prejudicial to the trading interests and performance of Least Developed Countries (LDCs), including Bangladesh. Strategic actions to be pursued during the Perspective Plan will include (i) supporting negotiations for reduction and elimination of export and domestic subsidies and in favour of agricultural trade liberalisation; (ii) mainstreaming trade in the country's national development agenda, and should particularly incorporate Aid for Trade; (iii) enhancing Duty-Free Quota-Free access under provisions of Non-Agricultural Market Access (NAMA); (iv) as Bangladesh approaches middle income status, more effort should be focused on enhancing competitiveness of Bangladesh's exports; (v) regarding trade in services, trying to secure 'permanent, non-reciprocal, special priority', notwithstanding any provisions of the General Agreement on Trade in Services (GATS); (vi) negotiating for establishing simple, transparent, and preferential Rules of Origin and (vii) consolidating and expanding capacity for trade negotiations.

Regional Cooperation: In recent years, proposals for sub-regional cooperation between Bangladesh, India, Nepal and Bhutan have been gaining ground. Bangladesh, India, Nepal, Bhutan and Myanmar are endowed with rich complementary resources that offer significant opportunities for cooperation in several sectors. The framework for cooperation stipulates huge gains for Bangladesh in several areas, including trade and trade facilitation, regional transport, energy trade, water management, Foreign Direct Investment (FDI) and joint ventures and cooperation on road and railway projects. Long-term strategies for strengthening regional cooperation include (i) more vigorous efforts in multiple forums to make South Asia Free Trade Agreement (SAFTA), Asia-Pacific Trade Agreement (APTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) more effective organisations; (ii) forging effective cooperation in trade, cross-border investment and all the

BOX 1: IMPLICATIONS OF EASING THE TRANSACTION COST OF TRADE

An assessment of the implications of easing transaction efficiency on the India–Bangladesh bilateral trade with the help of the gravity analysis suggests that bilateral trade is highly responsive to improvements in transaction efficiencies. The gravity estimates suggest that a 10 per cent reduction in the trade-related documentation could result in a 7.31 per cent increase in bilateral trade. Similarly, a 10 per cent improvement in the efficiency of clearance processes by border control agencies, including customs, might lead to a 3.91 per cent increase in bilateral trade. In the case of trade infrastructure, a 10 per cent improvement in the quality of trade and transport-related infrastructure could lead to a 2.33 per cent increase in bilateral trade. Besides, it also shows that further trade liberalisation (10 per cent cut in tariff) would lead to rise in bilateral trade (7.37 per cent). Furthermore, analysis also shows that regional transit in South Asia is extremely important, and would help increase Bangladesh's exports to South Asia substantially. Improved trade facilitation (as defined by the Trade Facilitation Index (TFI)) will have the strongest effect on Bangladesh's bilateral trade; a 1 per cent improvement in trade facilitation would result in an almost 4 per cent increase in Bangladesh's exports. These results also show that the gravity model with the TFI could also be used to evaluate the effectiveness of initiatives to improve logistics.

It would be very important to place the objectives of reducing transaction costs of trading between India and Bangladesh within the larger context of regional transit in South Asia. And to gain the full benefits of regional transit, integration of transportation networks should be a priority objective of South Asian cooperation.

Two other elements that would help bilateral trade between India and Bangladesh are foreign direct investment and trade in energy—elements that might require further study. Foreign investment would help increase Bangladesh exports in the medium to long run. Inflow of foreign capital would stimulate exports and imports, transfer of technology, and generate employment. The energy sector, too, offers enormous investment and trade opportunities for both countries, particularly in a sub-regional context that includes Bhutan and Nepal. For details please see De, Raihan and Kathuria (2012).

other areas of mutually beneficial activities; (iii) initiatives to resolve cross-border issues and undertake joint projects, such as production and distribution of electricity, gas, coal, fertilizer and other products, all on a win-win basis and (iv) participation in the grand Asian Highway and Asian Railway Systems that generate win-win outcomes.

Major Challenges to Achieve the Growth Outlook

Inadequate Infrastructure: Inadequate infrastructure encompassing power, transport and ports has been identified as the number one constraint limiting the growth potential of the Bangladesh economy.¹² Over the last four decades population, work force, and the size of the economy have expanded significantly. As mentioned above, the increased income per head and rapidly growing economic activity are contributing to a substantial increase in demand for power and transport infrastructure. In a well-managed economy, such demands create opportunities for investment, jobs and more domestic demand contributing to a further acceleration of growth¹³. However, a secular decline in public sector investment in infrastructure over a number of years and the absence of supportive government policies to encourage private investment in infrastructure have contributed to severe infrastructure bottlenecks that threaten the growth potential of the Bangladesh economy.

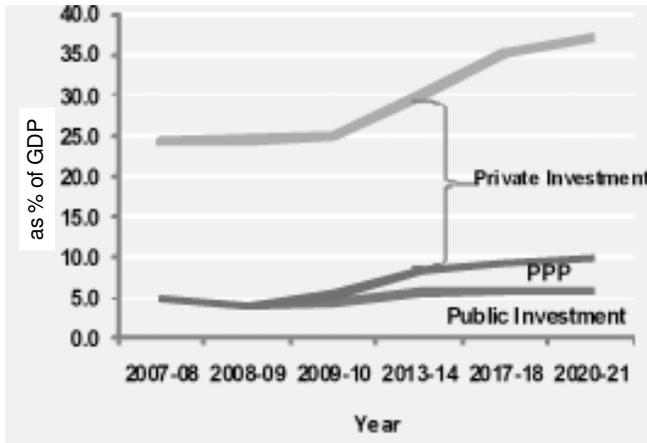
Table 2: Comparative Infrastructure Indicators, 2007

Indicators	Bangladesh	India	South Asia Average	China	Vietnam	East Asia and Pacific Average
Access to electricity (per cent of population)	20	43	29	99	76	63
Electric power consumption (kwh per capita)	100	380	210	987	374	1230
Improved water source (per cent pop with access)	74	86	76	77	85	75
Improved sanitation facilities (per cent pop with access)	39	33	53	44	61	60

Source: Private Participation in Infrastructure Projects Database. The World Bank Group 2009.

It is clear from Table 2 that Bangladesh lags behind most of its regional comparators in terms of provision of basic infrastructure services. While significant gains have been made in penetration of telecommunications in recent years due to the dominant role of private sector telecom providers, no significant progress was made in other important areas. In particular, generation of power, access to better roads and improved sanitary and sewerage systems call for immediate attention.

Figure 6: Infrastructure Investment in Bangladesh: Project Composition (2008-2021)



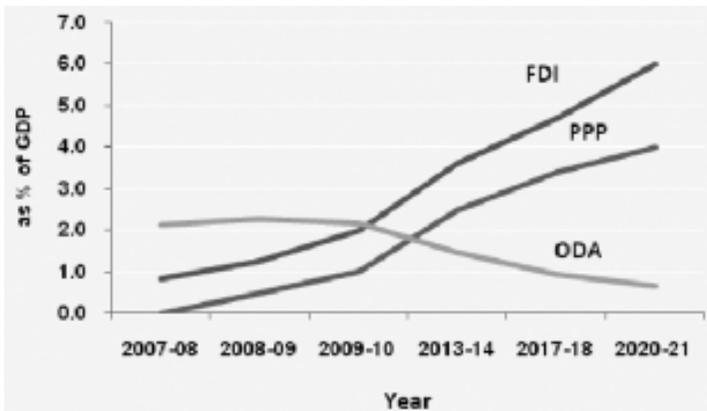
Boosting economic growth to a higher trajectory of 8-10 per cent will require additional investments of about 12 percentage points to 38 per cent of GDP by 2021 (Figure 6). A large part of that additional investment should also go to the infrastructure sector, given Bangladesh's huge investment gap in the infrastructure sector.

The dismal record in infrastructure provision is primarily attributable to: (i) the government's reliance on Annual Development Programme (ADP)-based public sector investment program which has declined steadily in relation to GDP in recent years and (ii) the government's failure to attract private investment in the infrastructure sector. ADP spending has declined almost every year and now accounts for only 4.5 per cent of GDP in 2010-11 (see Annex Figure A1). The secular decline in ADP spending over the years is attributable to two factors. First, Government's limited administrative capacity in implementing the ADP projects even when resources are made available. Second, limited availability of public sector domestic resources, coupled with declining foreign financing for projects, also constrained the size of the ADP in the budget.

To fill the huge current gap in the country's infrastructure—power, port, transport (road, rail, air, urban transport)—a good chunk of projected investment would have to be physical infrastructure. As noted earlier, the ADP framework has proved by and large ineffective. It will also be inadequate to address the enormous challenge that our economy faces in building adequate infrastructure. Bangladesh's private sector, which currently bears the major burden of investment (19 per cent out of 24 per cent) but has played only a small role in building infrastructure, will have to be mobilised to share a larger portion of the future investment in power, port and transport infrastructure. They could be involved in various Public Private Partnership (PPP)¹⁴ modes, such as Build, Own and Operate (BOO) or Build, Own and Transfer (BOT) basis. A. Mansur opined

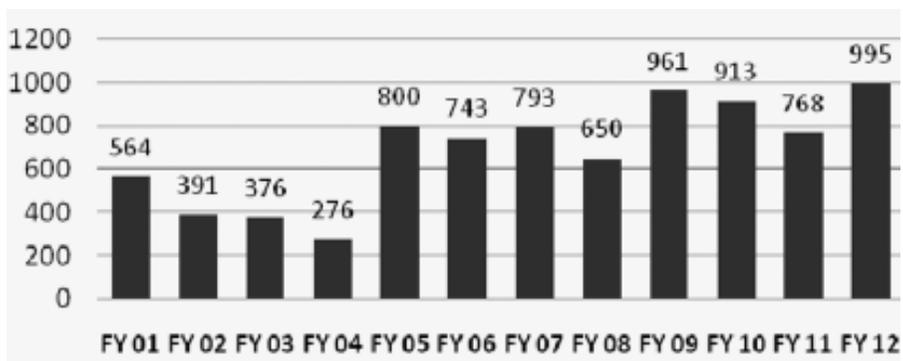
that “whatever may be the form of private sector involvement, FDI will also have to be mobilised by creating a supportive policy environment, since the prospect of any significant augmentation of ODA flows appears bleak. In the Bangladesh context, it would not be reasonable to expect ODA inflows of more than \$2.5 billion a year over the long-term. In this scenario, PPP holds the best prospect both as an effective institution and for mobilising adequate resources for implementing large or small infrastructure projects of the future. Indeed, as PPP framework evolves into an acceptable mode of project implementation in Bangladesh, it would create the right policy environment and financing mix by attracting increasing amounts of FDI.”¹⁵ (Figure 7).

Figure 7: Outlook for PPP, FDI and ODA Financing of Infrastructure to 2021



Foreign Direct Investment: Removal of infrastructure bottlenecks to a large extent premised on the inflow of foreign investment in this area. Review of past trend tends to suggest that Bangladesh will need to find out innovative ways to attract FDI. Inflow of FDI has historically been low in Bangladesh. Data from Bangladesh Bank (i.e., the central bank of Bangladesh) shows that the inflow of

Figure 8: Foreign Direct Investment (Million USD)



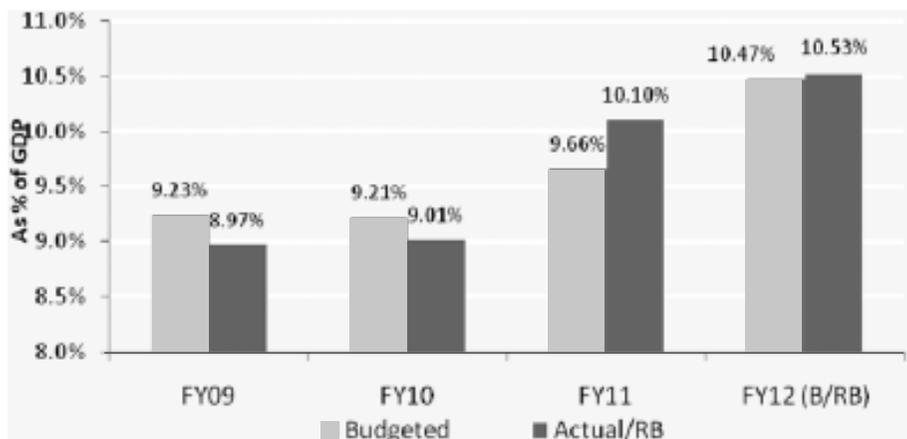
FDI virtually remained stuck between \$600 million and \$900 million between FY05-FY11 suggesting that foreign investors do not find Bangladesh as an attractive destination for their investments (Figure 8). There was a small improvement in FY12, approaching the \$1.0 billion mark.

On the contrary, the average annual inflow of FDI between the 2007-2010 period in Vietnam, Pakistan, India and China was respectively \$4.2 billion, \$2.5 billion, \$18 billion and \$75 billion. On the basis of these opposing trends in FDI flows, it may be argued that inflow of FDI in Bangladesh is not related to the global financial and economic condition. This argument is further validated by the fact that highest FDI inflow in Bangladesh is recorded for FY12, the year the Euro debt crisis happened. So, the pattern of FDI flow to Bangladesh is expected to remain unaffected by European debt crisis and is driven instead by domestic market conditions.

Thus, long-term Perspective Plan considers the following strategic actions to stimulate inflow of FDI: (i) The investment climate will be improved by giving high priority to constraints in infrastructure, regulatory framework, and policy environment. (ii) The general governance situation (and related high transactions costs) will be addressed to improve the country's image. (iii) Special effort will be made to encourage regional investment in emerging and potentially high return sectors (e.g., software development and IT from India and electronics from China). (iv) A string of Special Economic Zones (SEZs) will be established along international borders to stimulate cross-border investments and trade, in line with the successful examples of China and Vietnam (v) The private sector will be encouraged to enter joint ventures and other forms of collaborative investment with Non-Resident Bangladeshis (NRBs) and foreign partners in areas of high potential.

Domestic Revenue Mobilisation: If Bangladesh fails to attract required levels of FDI over the next decade, pressure to mobilise even higher level of revenue would intensify. Analogous to the FDI situation, Bangladesh's performance with regard to revenue mobilisation has been far from satisfactory. Bangladesh has one of the lowest tax-to-GDP ratios in the world, and the ratio has not improved much over the last several decades despite the pickup in real GDP growth rate. While Bangladesh's legal tax rates are not low by regional and international standards, but because of inefficiencies in tax administration, low revenue productivity, high tax evasion and inadequate coverage, the tax-to-GDP ratio has remained virtually stuck at less than 10 per cent level over many years. The introduction of Value Added Tax (VAT) in 1991 boosted revenue performance for several years, but the momentum could not be sustained due to lack of modernisation of tax administration and ad hoc arrangements put in place for political and administrative expediency.

Figure 9: Revenue Performance (Budget vs Estimates)



Certainly this revenue situation must change for Bangladesh in order to realise its ambitious objectives under the Sixth Five Year Plan (SFYP) and beyond as envisaged under the Perspective Plan. In recent years, the government has made attempts to break away from this stagnant economic outlook even though this was clouded by the recent global economic meltdown (i.e., slowdown of external trade narrowing an important revenue base). Despite slowdown of imports, in recent years, National Board of Revenue (NBR) revenues exceeded the targets, and the tax-to-GDP ratio crossed 10 per cent level. This turnaround provides credibility to the Plan's projection for revenue mobilisation. The target is to raise the contribution of direct taxes to the total tax revenue to 40 per cent in 2021 from the current 25 per cent level. The strategies to collect the required public revenues shall include:

- (i) broadening of the tax base and, raising both direct and indirect taxes with appropriate rationalisation and reforms;
- (ii) modernisation of the VAT and income tax administration, including computerisation of tax administration (and much greater reliance on accounts based audit will play central roles in this regard);
- (iii) strengthening the professional and technical capacity of the revenue administration to monitor potential tax payers, countering tax evasion, and making available strengthened and effective services to tax payers to raise tax compliance; and
- (iv) deepening organisational and other reforms of revenue collecting organisations to transform into quality institutions to meet the revenue needs, service requirement of tax payers, and facilitation of productive activities.

Effective Governance: Political instability, low implementation capacity and faltering institutions are also considered as key impediments to attaining higher growth in Bangladesh. Thus, Perspective Plan argued that 'effective governance' is the strongest means to achieving the goals. The administration of justice, good governance, effective institutional structures for development, law administration and legal affairs, national security and public safety are essential for fair contracts, dispute resolution, promotion of entrepreneurship and encouraging businesses and individuals to take risks. Effective governance will employ public resources efficiently in activities with high social returns; strengthen public institutions; take steps to eliminate corruption, terrorism and extortion and encourage citizen compliance and respect for the rule of law.

Conclusion

Growth experiences in Bangladesh during the last decades may be assessed considering two distinct phases. In phase 1, the growth rate expansion was subdued, average per year growth rate less than 4 per cent, which translated into only 2.2 per cent growth in per capita terms. In phase 2, the growth rate expanded significantly leading to over 5 per cent per annum on a 10 year average. More importantly, the growth rates exceeding the 6 per cent mark for a number of years during 2000-09. The rising long-term growth trend gives comfort that even higher growth (i.e., over 6 per cent) is possible provided policy reforms further strengthen the growth drivers.

In phase 1, growth relied much more heavily on inward-oriented and regulated policies encompassing nationalised production, state interventions in terms of licensing and price controls, heavy trade protection and subsidies. In phase 2, the incentive regime in Bangladesh changed rapidly by adopting an outward oriented policy. Private sector production and investment and exports supported by inflow of remittances were the main drivers of growth. In particular, remittances prompted expansion of construction, especially housing, and other service-oriented commercial enterprises. Banking reforms opened new opportunities for financing. A stream of trade liberalisation spurred investment in export enterprises including readymade garments.

From the perspective of supply side, an important feature to note that, in both phases growth was largely fuelled by the expansion of investment, mostly from the private sector, and financed by national saving and by an expanding labour force. Contribution of total factor productivity was very limited.

A comparison of Bangladesh's growth dynamism and the resultant economic transformation with the dynamic East Asian economies may appear pale. The contribution of manufacturing is still low and service sector dominates.

Inspired by the growth dynamism, structural shifts in production and near self-sufficiency in rice production, the policy makers as well as people of Bangladesh

believe that moving into higher growth trajectories of 8-10 per cent over the medium and longer term is an not insurmountable goal. This belief has been aptly reflected in the medium- and long-term plan documents. According to the Perspective Plan (2011-2021), the goal is to transform Bangladesh into a middle income country by 2021. The Perspective Plan targets annual real GDP growth rate to rise to 8.0 per cent by 2015, and further to 10.0 per cent by 2021. Within the three broad inter-linked activities-manufacturing in general and manufacturing exports will be main driver over the next decade.

Factors such as inadequate state of infrastructure ranging from energy to transportation, poor inflow of foreign direct investment along with required technology, dismal revenue efforts, inept implementation capabilities and poor governance have been identified as the impediments to attain the higher growth potentials. There are genuine concerns in Bangladesh that the failures of the last two democratically elected governments in redressing above structural bottlenecks may continue to dominate in the next decade severely limiting our growth potentials, curbing the enthusiasm of the private sector and denting nation's aspiration to graduate to the league of 'middle income' country.

NOTES

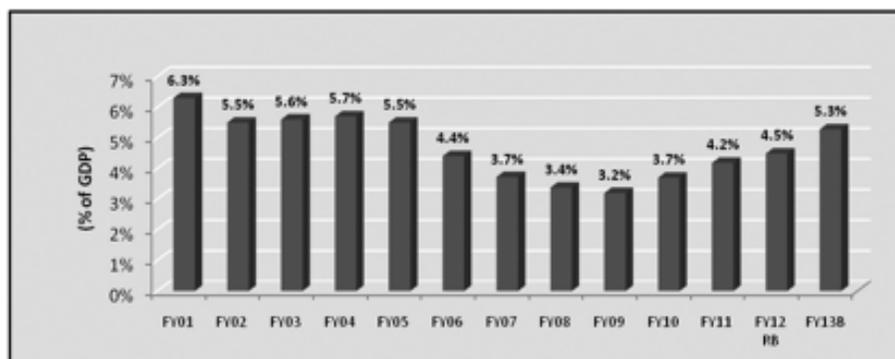
1. Two heavily consulted plan documents are: (i) *Perspective Plan of Bangladesh 2010-2021: Making Vision 2021 A Reality* and (ii) *Sixth Five Year Plan FY2011-FY2015: Accelerating Growth and Reduced Poverty*. The author of this paper was a member of the drafting of these two plan documents.
2. "Sixth Five Year Plan of Bangladesh FY 2011-FY2015: Accelerating Growth and Reducing Poverty", General Economics Division, Planning Commission, Government of the People's Republic of Bangladesh, February 2012.
3. The expansion of growth experienced a break in the wake of the global food, fuel and financial crisis of 2008-10, but this slowdown was fairly moderate by global standards and points to the prudent macroeconomic management by policymakers over a long period.
4. No.2. Indeed much of the gain in average national productivity comes from the conversion of labour from low skills, low return employment in agriculture and informal services to modern manufacturing and organised services.
5. This is in sharp contrast to the experience in India where total factor productivity played a major role in spurring rapid growth.
6. Indeed, this has posed a challenge for macroeconomic management because the national saving rate is now higher than the national investment rate, which is something unusual for a low income economy like Bangladesh.
7. It is well known that in countries like Bangladesh and Pakistan, the share of informal services sector is very high. For example in Bangladesh, it accounts for some 88 per cent of all services. The share of informal services in the economies of East Asia, China, Malaysia, Brazil and even India are far lower.
8. "Perspective Plan of Bangladesh 2010-2021: Making Vision 2021 a Reality", General Economics Division, Planning Commission, Government of the People's Republic of Bangladesh, February, 2012, p.3.
9. Vision 2021 stipulates middle income status for Bangladesh by 2021, reaching annual GDP growth rate of 10 per cent by that year and averaging 9.2 per cent for the period 2011-21.

Fulfilment of this vision requires superior double digit performance for manufacturing taking its share in GDP to 27 per cent by 2021, and that of industry to 37 per cent.

10. Low-cost labour with growing skills gives Bangladesh potential competitive advantage in most labour-intensive activities which will continue to drive manufacturing growth for at least another decade.
11. No.8, p.5.
12. A. Mansur, "Catalyzing Public-Private Partnership in Bangladesh", Mimeo, Policy Research Institute, May 2011.
13. A pertinent example is the proposed Padma Bridge, which would establish faster linkages between the South-West parts of Bangladesh and other regions of Bangladesh. A study by Raihan and Khondker found that operation of Padma Bridge would add an annualised growth rate of 0.33 per cent of national base GDP over a period of 31 years. Compared to national GDP, the average annual increase in SW regional base GDP will be 2.3 per cent. For details see S. Raihan, and B. Khondker (eds.), "Estimating the Economic Impacts of the Padma Bridge in Bangladesh", Bangladesh Bridge Authority and the World Bank, November 2010 Similar figures were also reported for Jamuna Bridge, in a post Jamuna Bridge impact assessment study.
14. PPP describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies. Although it is a relatively new one, the concept of using private capital to provide public facilities is very old. In 18th- and early 19th-century Britain groups of local magnates formed turnpike trusts which borrowed money from private investors to repair the roads, and repaid this debt by charging tolls. Most of London's bridges were also financed by similar bridge trusts until the mid-19th century, and similarly in the late 19th century the Brooklyn Bridge in New York was built with private-sector capital. In France, the construction of canals with private-sector capital began in the 17th century.
15. No. 12.

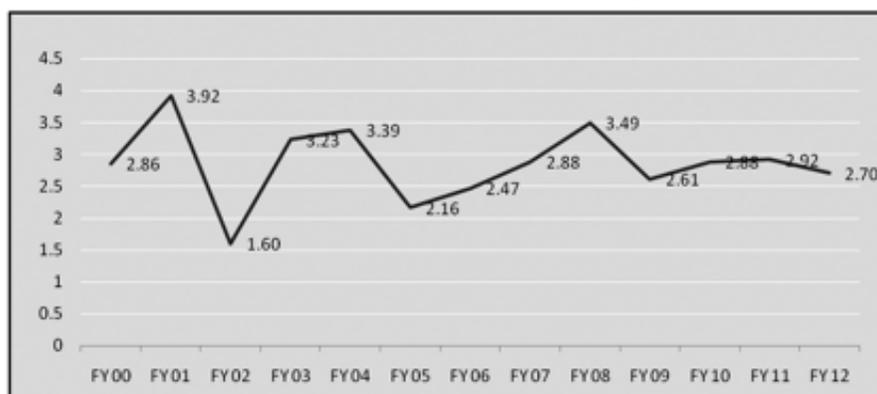
ANNEX

Figure A1: Trend in Annual Development Programme (per cent of GDP)



Source: Implementation Monitoring and Evaluation Division (IMED), Ministry of Planning

Figure A2: Net Commitment of Foreign Assistance (per cent of GDP)



Source: External Relations Division, Ministry of Finance.

Table A1: Tax Efforts in South Asian Countries, 2001-09

(In per cent of GDP)

Countries	FY06	FY07	FY08	FY09	Average Tax Revenue*	Average GDP per Capita US\$	Average Income tax*	Average Value added tax*
Bangladesh	8.5	8.3	9.1	9.0	8.6	586	1.8	2.8
Bhutan	17.6	17.8	17.9	17.8	17.2	1126	4.8	3.4
India	15.9	17.2	17.6	17.2	16.3	755	4.7	4.8
Nepal	12.2	12.4	12.5	12.6	12.5	486	2.5	4.5
Pakistan	10.1	10.5	10.3	10.2	10.6	735	3.0	4.7
Sri Lanka	13.7	14.6	14.2	13.3	13.7	1200	2.6	8.5

Note: Columns with an asterisk indicate the average ratio during 2004-09.

Sources: Ministry of Finance, GoB, Bangladesh Economic Review; IMF, International Financial Statistics; and World Bank World Development Indicators, 2010.

13

Regional Disparity Challenges of Post Civil War Development in Sri Lanka

*Ranjith Bandara**

Introduction

The Sri Lankan economy has been experiencing an average annual growth rate of around 5.2 per cent since the early 1980s, despite suffering from the impact of nearly a three-decade-long civil war. However, the cost of war has significantly weighted down Sri Lanka's economy. For example, in 2007 alone, the Sri Lankan Government borrowed defence loans to the value of US\$ 181,449 from international financial markets, virtually double the amount used in the previous year. In 2008, the government designated \$ 1.5 billion for defence, a 20 per cent increase from previous year's budget. It was US\$ 1.64 billion in 2009, which is equal to 6.4 per cent year-on-year increase. The war has consumed around 30 per cent of the government's budget, and has been estimated to have cost the country over US\$ 200 billion over the years. Nonetheless, the prospects of the long-awaited peace dividend in Sri Lanka look gloomy, as the international financial meltdown impacted the world economy at large, and the export-led economies like Sri Lanka in particular. Economic growth in 2009 onwards seemed satisfactory, and the government of Sri Lanka envisages comparatively higher growth targets and economic boost in the years to come. However, Sri Lanka's economy has a long way to go before it can actually attain long-term sustainable growth, as the damages of the war are still strongly felt throughout the economy. Thus, it is obvious that the government's commitment remains vital to effectively rebuild the national economy of Sri Lanka. Nevertheless, it does not downplay the strong and supportive contribution of the private sector and the international community in rebuilding the economy, and it should be highlighted that their involvement is equally important.

*The editorial help and research assistance of Ms. Tina Solomons is highly appreciated.

In 2011, the Sri Lankan economy recorded an impressive growth of 8.2 per cent, the highest annual rate of growth reported during the last three decades. This was mainly due to improved macroeconomic environment, increased capacity utilisation together with expansion of economic activities in the Northern and Eastern Provinces and enhanced external demand, which underpinned the high momentum of growth. This is quite impressive compared to the performance of several East and South East Asian economies during the same period. Furthermore, this is also considerably remarkable compared to the performance of the Indian economy during the three preceding decades when the average growth logged 3.5 per cent per annum. In terms of per capita income, the improvement has been even more significant: around 20 per cent per annum in the recent period, as compared to less than 5 per cent in the earlier period. In contrast, the growth projections of the global economy showed a downward trend in September 2011 in the midst of growing economic uncertainty. According to the projections, the world economy was expected to grow by 4.0 per cent in 2011, and by the same per cent in 2012, which was marginally lower than the forecast for April 2011 and 2012 by the International Monetary fund (IMF) at 4.4 per cent and 4.5 per cent, respectively. Advanced economies, which were worst hit by the economic downturn in 2009, were expected to grow by 1.6 per cent in 2011 and 1.9 per cent growth in 2012. This modest growth is primarily a result of the weak private domestic demand in advanced economies, mainly due to the prevailing high unemployment levels.

The economy of Sri Lanka was projected to grow at around 8.5-9.0 per cent in 2012.¹ This growth was expected to be broad based with positive contributions from all key sectors of the economy, such as agriculture, industry and other services. However, the services sector, in particular, was projected to expand with positive contributions from all sub-sectors including domestic and foreign trade, tourism, transportation, telecommunications and financial services. Improvement in economic growth and per capita income was expected to translate, at least partly, into reduction in the level of poverty, and disparities in the distribution of income, wealth, accessibility to public amenities and regional development in the country. Moreover, along with economic growth and reduction in poverty, there has been accelerated improvement in various indicators of human development since the early 1970s both in the case of demographic characteristics and social development indicators. During the last two decades, the country has made major strides in the health and education sectors. As Human Development Index (HDI) indicators are already high, Sri Lanka can focus more on economic growth, expecting its community's social development to be adequate to sustain and facilitate the expected economic growth. The economy got diversified significantly and the share of the service sector in employment and incomes improved considerably. While there is a broad consensus on the overall improvement of the economy and quality of life during the period under consideration, there are significantly differing perceptions about the distributional impacts of these gains.

At the time of independence, a considerable difference in economic and social development of different regions of the country existed. The disparity in economic and social development across the regions, and among different segments of society, has been the major consideration for adopting the planning process in Sri Lanka since independence. One of the main objectives of the planning process initiated in the early 1950s was to reduce these regional differences and achieve a regionally balanced development. Various policy instruments including direct public investment in infrastructure by the Centre, guided private investment and building of capacity enhancing institutions have been tried to achieve this objective. These policies continued during the first three decades of planning. While efforts to reduce regional disparities were not lacking, achievements were not often commensurate with these efforts. A considerable level of regional disparities remained at the end of the 1970s. With the initiation of economic reforms in the early 1980s, which culminated in full-fledged deregulation, liberalisation and globalisation in the early 1990s, the role of the government in investment decisions has diminished. This further widened regional disparities. Private investment became the principal engine of economic development. Private investments flowed to regions such as Colombo, Gampaha and Kaluthara, where conditions are favourable to achieve maximum return on investment. As a result, regions with better physical and social infrastructure, adequate forward and backward linkages and other conducive environment attracted the larger share of private investment over the last three decades. The purpose of this paper is to initiate a debate on the various issues involved with disparities in the distribution of income, wealth, accessibility to public amenities and regional development with a view to explore effective corrective measures without any further delay. When the present governmental policy's increased focus on regional development and local development is considered, it is clear that the regional disparities in development have been identified. Therefore, the purpose of this paper is to create a useful discussion on its important aspects.

Poverty in the Context of Middle Income Country Status

According to the Central Bank of Sri Lanka, the incidence of poverty has declined significantly in Sri Lanka during the last few years.² However, when one looks at the situation in 1990s, consumption poverty as well as human poverty has been high in Sri Lanka.³ Consumption poverty remains at a much higher level than human poverty. (Consumption poverty is the inability to achieve a certain minimum standard in consumption.) Considering the spatial pattern of consumption poverty in Sri Lanka, according to the *Household and Consumption Survey 1995/1996*, Department of Census and Statistics, the Western Province records the lowest poverty level while other provinces record higher levels of consumption poverty. With regard to human poverty, the Western Province reports the lowest value of poverty. Other Provinces such as the Sabaragamuwa,

Central, Uva and the North-Western Provinces have higher level of poverty. Over 23 per cent of the population in these regions was experiencing social and economic deprivation. Human Development Report in 1998 pointed out the main reason for the high level of human poverty in those regions as the lack of adequate social amenities such as water, sanitation and electricity.

Though there are differences in the estimates of the percentages of the poor by different sources, there is general consensus about the decline in the share of poor in the population since mid-1990s. As per *Household Income and Expenditure Survey (HIES) 2009/10*, the poverty head count ratio has declined from 28.8 per cent in 1995/96 to as low as 8.9 in 2009/10. Sri Lanka has been able to maintain this downward trend during the war era & the post-war era despite the impact of the war and the global economic crisis (see Table 1).

Table 1: Sectoral Distribution of the Poverty Headcount Ratio

Sector	Survey Period and Poverty HCR (%)				
	1990/91	1995/96	2002	2006/07	2009/10
Urban	16.3	14.0	7.9	6.7	6.5
Rural	29.5	30.9	24.7	15.7	7.7
Estate	20.5	38.4	30.0	32.0	9.2
Sri Lanka	26.1	28.8	22.7	15.2	7.6

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics

The drop of poverty at national level is attributed to the sharp drop in rural sector poverty seen over the years. Further, the survey indicates that poverty fell by two-thirds in the estate sector, as a result of drop in relative prices of food items and an increase of employment and wages. Furthermore, the government's policy to ensure that basic infrastructure is improved at the regional level has had a positive impact on low-income households. At the same time, the high growth registered in the agriculture sector during the last five years has contributed to the significant decline in rural poverty. The Samurdhi social security programme was continued with a view to prevent poor families from falling into the lowest depth of poverty because of unforeseen events such as death, hospitalisation and child birth. The disbursements from the Samurdhi social security programme amounted to Rs. 60.2 million during the period concerned.

However, *HIES 2009/10* did not cover the entire Northern Province, as Mannar, Kilinochchi and Mullaithivu districts were out of reach for the survey. Since 2006/07, all the districts, except Batticaloa and Ampara, reported significant reductions in the poverty headcount ratio. Between the previous survey and the 2009/10 survey, the Nuwareliya district showed the greatest improvement, where three out of every four poor individuals were able to come above the poverty line. Hambantota, which had showed a poverty reduction of as much as 60 per cent between 2002 and 2006/07, showed a 46 per cent fall in the poverty headcount

ratio between 2006/07 and 2009/10. When compared to 2006/07, Badulla, Moneragala and Ratnapura, which were identified as the poorest districts, also showed a 50 per cent improvement. In addition to the Moneragala district, the districts in the Northern and Eastern province continued to be the poorest.

Table 2: The Distribution of Gini Coefficient of the Household Income at the Provincial Government Level

Province	Gini coefficient of household income	Gini coefficient of per capita income	Gini coefficient of income receiver's income
Western	0.45	0.46	0.54
Central	0.51	0.51	0.57
Southern	0.43	0.42	0.50
Eastern	0.33	0.30	0.37
North Western	0.49	0.48	0.53
North Central	0.39	0.39	0.47
Uva	0.41	0.39	0.49
Sabaragamuwa	0.50	0.48	0.57
Sri Lanka	0.47	0.46	0.53

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

The results of *HIES 2009/10* also revealed that the Gini coefficient of the household income of Sri Lanka stood at 0.47, and urban, rural and estate sectors stood at 0.45, 0.46 and 0.44 respectively. While there were no significant variations in the income distributions of the sectors, a significant variation was seen between provinces. The lowest income inequality was seen in the Eastern province, which had a Gini coefficient of 0.33, while the highest income inequality was seen in the central and Sabaragamuwa provinces at 0.51 and 0.50, respectively. Table 2 presents the distribution of Gini coefficient of the household income at the Provincial Government Level in Sri Lanka. As shown in Table 2, the Gini coefficients of household income, per capita income and income receiver's income by sectors and by provinces, there were no significant differences noticed among the income distributions of the sectors, whereas when the provinces are considered, highly varied Gini is shown. The highest Gini was reported from the Central province (0.51) and the Sabaragamuwa province (0.50), while the Eastern province showed the lowest income inequality with 0.33 of Gini.

As shown in Table 3, the urban sector poor face the highest shortfall with the need of Rs. 680 per month to reach the poverty line, and it can be seen that there is a significant increase in the total poverty shortfall faced by the urban poor. However, rural and estate sectors have seen a considerable decline in the poverty shortfall as a total. As a country, the poverty shortfall of Sri Lanka has declined from approximately Rs. 1.3 billion in 2006/07 to Rs. 1 billion per month in 2009/10. This is commendable considering inflation, population growth and increased survey coverage when compared to 2006/07. It is also a reflection of

Table 3: Comparison of Poverty Shortfall Between 2006/07 and 2009/10

Sector	Poverty shortfall (Rs./month)			
	Total in Millions		Average	
	2006/07	2009/10	2006/07	2009/10
Urban	78	108	423	680
Rural	1,041	885	452	578
Estate	138	67	434	569
Sri Lanka	1,257	1,060	448	587

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

the decline in the number of people living below the poverty line from 2.8 million in 2006/07 to 1.8 million in 2009/10.

Disparity of Household Income and Wealth

The most common indicator of the economic development of a society is the per capita annual income generated by it. An important structural change in the economy in the process of development is the decline of income generated by the agriculture sector and the increase in the income generated by the manufacturing sector. The level of poverty or the share of population, which does not have minimum income to meet its basic requirements, is an indicator of the level of economic development, as well as the inequality in the income distribution. Per capita income is a better indicator to understand and compare the country's standard of living over time, as it does not depend as much on the household income and the expenditure, as it does on the household size. However, the per-capita income too varies: reverse to the household income and the household size, and the lower the household size, higher the per-capita income. Per capita income in a domain is calculated by dividing the estimated total household income, by the estimated number of household population in the domain and is also used to measure and compare the wealth status of domains. As per *HIES 2009/10*, the mean and median monthly per-capita income of the country at estate sector, province and district levels in 2009/10, the mean monthly per capita income at national level was Rs. 9,104 and the median figure was Rs. 5,803 during the period under review (see Table 4). Furthermore, the results of this survey also revealed that there is a significantly greater disparity of monthly per capita mean income among sectors than those of median income.

As shown in Table 5, *HIES 2009/10* results revealed that the mean monthly household income in Sri Lanka was Rs. 35,496 in 2009.

When the three sectors are compared, the rural sector, which reports closer mean value (Rs. 34,329) to the national value, was at almost equal distances from the highest mean monthly income value reported from the urban sector (Rs. 46,196), and the lowest value reported from the estate sector (Rs. 25,649). Table 5 shows that the median monthly household income in Sri Lanka was

Table 4: Mean and Median Monthly Per Capita Income by Sector and Province

Sector and Province	Mean (Rs.)	Median (Rs.)
Sri Lanka	9,104	5,803
Urban	11,225	6,925
Rural	8,916	5,758
Estate	5,782	4,161
Western	11,106	7,278
Central	8,980	5,446
Southern	7,995	5,647
Eastern	4,520	3,938
North Western	8,487	5,550
North Central	9,642	7,098
Uva	6,710	5,006
Sabaragamuwa	8,595	5,271

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

Table 5: Distribution of Average Monthly Household Income

Sector/Province	Mean (Rs.)	Median (Rs.)	Household Size
Sri Lanka	35,496	24,106	4.0
Sector Level			
Urban	46,196	31,312	4.1
Rural	34,329	23,641	3.9
Estate	25,649	17,879	4.3
Provincial Level			
Western	44,955	30,414	4.0
Central	35,100	22,733	3.9
Southern	31,940	22,231	4.0
Northern	*	*	*
Eastern	19,710	17,433	4.4
North Western	32,120	22,371	3.8
North Central	35,235	27,564	3.7
Uva	27,739	21,187	4.1
Sabaragamuwa	33,865	21,676	3.9

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

Rs. 24,106 in 2009, which means one-half of the households in the country, received more than Rs. 24,106 per month, per household in 2009. When the provinces are compared, the Western province which reported the highest household income level, is nearly 2 times higher than the values reported by the Eastern province, which reported the lowest values for both the median and the mean income.

As shown in Table 5, the mean household size in Sri Lanka has come down to 4.0 persons per household in 2009/10. As per the findings of *HIES 2009/10*, with the gradual increase of the household size from about 3 persons to about 4.5 persons, there is the increase of the household income across the first to tenth decile group in Sri Lanka, and in all the three sectors as well. The distribution of median and mean per capita income, share of income and household size by income decile is calculated using the mean per capita income. Furthermore, median per capita income in Sri Lanka is reported as Rs. 5,803, which is remarkably lower than the mean value. When considering the share of income, approximately 54.1 per cent of the total income has been distributed among the richest 20 per cent of the population in the country.

Table 6: Percentage Share of Income Received by Poorest to Richest Households by Sector

Sector	Share of income			
	Richest 20%	Poorest 20%	Middle 60%	Poorest 40%
Urban	53.3	4.7	42.1	13.7
Rural	53.8	4.5	41.7	13.4
Estate	49.4	5.9	44.7	16.4
Sri Lanka	54.1	4.5	41.4	13.3

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

Over and above, only 35 per cent of the total income is left to be shared by the lower income receiving 70 per cent (first seven deciles). In other words, the richest 20 per cent (9th and 10th deciles groups) was receiving nearly 54 per cent of the total household income of Sri Lanka, while the poorest 20 per cent (1st and 2nd deciles groups) was receiving only 4.5 per cent in 2009/10. Considering the poorest 40 per cent, in Table 6, the corresponding figure was 13.3 per cent.

Table 7 presents household income by sources of income, and sector distribution based on the findings of *HIES 2009/10*. As shown in Table 7, 85 per cent of the total household income of the country was received as monetary income, and it was Rs. 30,191 out of Rs. 35,496 on average at national household level. The major part of the monetary income, Rs. 12,130 or 34.2 per cent of the total household income, is sourced from wages and salaries. The income from agricultural activities is the least contributor among the three major employment categories. The employment income, in addition to the wages and salaries earned by employees, includes income gained by employers and own account workers, engaged in both agricultural and non-agricultural sectors in the country. The estate sector shows the highest proportion (47.1 per cent) of household income received as wages and salaries alone, and recorded the lowest proportion received from other sources of employment income.

Table 7: Household Income by Sources of Income and Sector Distribution

Source of income	Sri Lanka		Urban		Rural		Estate	
	(Rs.)	(%)	(Rs.)	(%)	(Rs.)	(%)	(Rs.)	(%)
Total Income	35496	100.0	46196	100.0	34330	100	25650	100
Monetary Income	30191	85.1	37117	80.3	29520	86.0	22474	87.6
Wages/salaries	12130	34.2	16569	35.9	11393	33.2	12077	47.1
Agricultural activities	4673	13.2	1402	3.0	5436	15.8	1202	4.7
Non agricultural activities	5146	14.5	6920	15.0	5051	14.7	1948	7.6
Other income	4960	14.0	7516	16.3	4592	13.4	4043	15.8
Windfall income	3282	9.2	4710	10.2	3048	8.9	3204	12.5
Non-Monetary Income	5305	14.9	9079	19.7	4810	14.0	3176	12.4
Income in kind	2018	5.7	2145	4.6	1992	5.8	2009	8.2
Estimated value of owner occupied housing	3287	9.3	6934	15.0	2818	8.2	1077	4.2

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

Literacy Aspect in Human Development

Along with faster economic growth and reduction in poverty, there has been accelerated improvement in various indicators of human development since the early 1980s, whether it is in the case of demographic characteristics or social development indicators. During the last two decades, the country has made major strides in the health and education sectors. The economy got diversified significantly, and the share of the service sector in employment and income improved considerably. While there is a broad consensus on the overall improvement of the economy and quality of life during the period under consideration, there are significantly different perceptions about the distributional impacts of these gains. The level of literacy is, perhaps, the most important index of development in a society. Invariably, male literacy is higher than female literacy in any society. Often there may be a significant gender gap in literacy. The true index of development in a society is the level of female literacy, which can be considered as the bottom-line as far as literacy is concerned. Sri Lanka's population has a literacy rate of 92 per cent, the highest literacy rate in South Asia, and in overall one of the highest literacy rates in Asia. Table 8 summarises gender aspects of literacy in Sri Lanka.

Table 8: Gender Aspects of Literacy in Sri Lanka

Aspect of Literacy	Survey Period	Gender/Ratio	
		Male	Female
Literacy (15 years and over)	1999-2007	92.7	89.1
Youth (15-24 years) literacy	2004-2008	97	99
Gross primary school enrolment	2005-2009	101	102
Net primary school enrolment	2005-2009	99	100
Secondary school enrolment ratio	2005-2009	86	88

Source: http://www.unicef.org/infobycountry/sri_lanka_statistics.html

The findings of *HIES 2009/10* provide a better insight into the success in providing universal access to primary and secondary education by the Sri Lankan education system. Table 9 summarises the percentage distribution of the population aged five years and above by their level of education.

Table 9: Percentage Distribution of the Population (age 5 years and above) by Level of Education and Sector

Sector	Educational Attainment					
	No schooling	Up to grade 5	Passed grade 6-10	Passed GCE (O/L)	Passed GCE (A/L) and above	Attended/ attending to special education
Urban	2.7	21.0	39.3	21.0	15.8	0.1
Rural	4.4	24.0	44.7	15.8	11.0	0.1
Estate	8.8	43.2	38.1	5.7	4.2	0.0
Sri Lanka	4.4	24.7	43.5	16.0	11.3	0.1

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

The highest percentage of the pertinent population is reported to be in the educational attainment group grade 6-10 at the national level (43.5 per cent), and every sector confirms the same. The last column of Table 9 shows that nearly one out of every 1,000 persons of the relevant population is receiving special education. Table 9 also shows that the most educated group of the population choose to live in the urban sector; thus, the urban sector holds the highest percentage (15.8 per cent) who have passed G.C.E (A/L) or higher level examinations, and the lesser educated groups are confined to the rural and estate sectors. In the estate sector, only 4.2 per cent has attained beyond G.C.E. (A/L), and 8.8 per cent has never attended any school. Education in Sri Lanka has a history of over 2,300 years. A standard system of schools begun by the British was based on the recommendations of the Colebrook Commission in 1836: this is regarded as the beginning of the modern schooling system in the island. After independence, the number of schools and the literacy rate of the people substantially increased. According to the Department of Census and Statistics, today there are approximately 9,830 public schools serving about 4,030,000 students island wide. These schools include National Schools, Navodya Schools and other Provincial Schools amounting to 3.3 per cent, 4.7 per cent and 92.0 per cent of the total, respectively.

As per *HIES 2009/10*, school education is the affirmative characteristic of the education system in Sri Lanka. The enrolment ratio in primary education in 2008 was 98.8 per cent, according to the Ministry of Education. This survey also collected information related to school attendance of children in the age group 5 to 19 years, where it was found that more than four in every five (more

Table 10: Percentage Distribution of Population (aged 5 to 19 years) by School Attendance Status and Sector (2009)

Sector	School Attendance (as a % of 100)		
	Currently attending (%)	Never attended (%)	Attended in past (%)
Urban	83.5	4.1	12.4
Rural	83.6	3.9	12.5
Estate	83.3	2.7	14.1
Sri Lanka	83.5	3.9	12.6

Source: *Household Income & Expenditure Survey*, Department of Census & Statistics.

than 83 per cent) children in this age group, in every sector in Sri Lanka, were attending school. Furthermore, within this population segment, nearly one out of every 25 persons (4 per cent) had never attended school, and almost one out of every eight children (12.6 per cent) had left school prematurely. This situation is somewhat unexpected as primary education in Sri Lanka is compulsory for all children in the age group of 5 to 14 years; therefore, it is mandatory for a child to attend school until he/she is 14 years old. This survey reveals that out of 2.96 million children in the 5-14 years age group, 2.94 million children were attending schools (99.4 per cent), 0.4 per cent have attended in the past and dropped out and 0.2 per cent have never attended school.

Regional Disparity Challenges

An important cause for political tension, which leads to popular agitations, public uprisings and militant activities, is the regional disparity in economic and social development, which has been visibly existing within and among the provinces. Sri Lanka is yet to establish a proper system of “regions” delineated for development purposes. It is the administrative districts that have been used as units for planning, coordinating and implementing development activities and central government policies at sub-national level. With the 13th amendment to the constitution in 1987, Provincial Councils were established for the first time as an intermediate layer of government with considerable development powers.

As a result, development planning in the country now concentrates at two different levels of administration, that is, Provinces (regional development planning) and Districts (local level planning). Thus, provinces involve as “regions” in the regional development planning in Sri Lanka. However, many have questioned the suitability of the present provinces as appropriate territorial units for promoting socioeconomic development, as they have been created for the purpose of political and administrative control of the country. Therefore, these areas are not geo-economic development regions that have been demarcated based on the advantages of different regions, and the socioeconomic and geographical realities.⁴ When the economic disparities of different regions are considered,

developmental planning can be better channelled through establishing developmental regions, based on the level of development, which would facilitate the process of attempting to achieve uniform development throughout the country and reduce regional disparities in development.

However, it should be noted that a number of efforts have been made to improve the socioeconomic conditions of people, particularly in the least developed regions in the country, by every successive government since independence. These efforts include the introduction of national development plans with a specific timeframe; large-scale multi-purpose development programmes; introduction of a decentralised administrative system to promote development at regional and local level; setting up of Free Trade Zones in promoting direct foreign investment; theme-specific development efforts such as roads, housing, agriculture, irrigation, drinking water and rural electricity and decisive development programmes at district or regional levels, such as Southern Development Programme, Nagenahira Udanya and Uthuru Wasanthaya. In spite of these efforts, Sri Lanka is still experiencing increasing disparities and widening income inequalities between regions. Economic development, physical and social infrastructure are unevenly spread in the geographical space. The most developed region in the country lies in the Western Province. Industry, trade, commerce and services are the main economic activities of this region. All towns in the country are connected to Colombo city directly rather than other regional centres. As a result, regional disparities exist in most of the remaining areas in the country.⁵

Although the situation has now improved to some extent, still high concentration of population, industries and employment in the Western Province in general and Colombo Metropolitan Region in particular has become a major problem of the economic space in Sri Lanka. Therefore, dominance of the Colombo Metropolitan Region is the main issue, which reflects the spatial imbalance in development. Karunanayake points out that dominance of the core region has led to the so-called “core-periphery dichotomy”. This situation has created a dualistic pattern of economic growth and has widened the core-periphery differentials in the country.⁶ This implies that contrary to the expectations of the government, the benefits of growth that concentrated in the Western Province have not been spread to other regions of the country. The socioeconomic gap between the Western Province and the other regions has become an important indicator, which shows inter-regional economic disparity. Table 11 presents various aspects of socioeconomic conditions of the population by province.

As discussed elsewhere in this paper, ability to generate income at the local and regional economy levels has become an important factor, which determines the spatial development of a region. Differential economic growth rate is the main reason that widens the economic gap among regions. Economic growth rate in the Western Province between 1992 and 2010 was on average 11 per cent, while in most of the other Provinces it was around 6 per cent. This is

Table 11: Socioeconomic Conditions by Province

Item	Western	Central	Southern	Northern	Eastern	North Western	North Central	Uva	Sabaragamuwa
Housing Conditions (% of household)									
Own house	90.5	76.4	94.9	63.3	91.5	95.1	97.6	85.4	90.6
Brick/cement block /cabook walls	90.4	86.2	85.1	83.6	77.1	82.1	80.1	81.7	80.0
Prepared clay/mud floor	2.4	22.3	13.1	15.6	13.2	13.5	30.0	33.6	18.6
Cement /terrazo /tiled floor	94.0	75.5	81.9	82.2	80.9	82.7	66.2	64.5	78.0
Thatched roof	1.4	2.3	2.9	15	15.1	14.5	8.9	4.9	2.2
Tiles/asbestos roof	86.1	59.3	91.2	75.8	76.5	78.0	76.0	71.0	77.7
Availability of electricity									
% of households	92.4	72.7	78.4	63.6	65.6	68.5	62.0	56.7	64.7
Water supply and sanitation (% of household)									
Pipe borne water	57.2	51.2	40.4	11.4	19.6	17.6	16.4	37.3	36.6
Water-seal toilets	89.6	74.4	88.3	45.6	49.4	86.4	72.9	74.7	81.8
Own well (dub/tube)	30.8	16.1	32.5	36.7	45.1	43.2	37.7	24.1	22.7
Without toilets	1.0	5.0	3.4	14.4	29.2	4.6	7.3	4.6	2.7
Availability of household equipment (% of household)									
Radio	84.1	78.1	79.4	68.9	62.7	78.1	75.7	76.6	78.2
Television	85.8	70.6	67.7	43.9	49.2	72.6	65.7	57.3	67.6
Telephone /cellular phone	45.3	17.1	18.3	19.7	13.9	23.1	13.9	9.1	13.4
Bicycle	39.4	16.7	55.5	86.7	73.8	71.2	80.1	31.5	19.7
Motor cycle/scooter	19.9	6.6	14.8	20.3	16.1	27.2	20.9	6.5	9.4
Motor car /van	12.1	3.5	2.8	3.1	2.7	5.5	3.8	2.3	2.7
Sewing machine	58.4	38.8	45.7	25.6	23.8	44.1	36.9	28.5	39.9
Refrigerator	53.6	21.8	24.1	12.8	16.9	27.6	19.4	11.1	18.9
Washing machine	17.8	5.5	3.7	0.8	5.4	4.3	2.4	2.0	2.2
Personal computer	9.9	2.6	2.5	2.8	1.2	2.5	1.2	0.5	1.6

Source: Sri Lanka Socioeconomic Data 2011, XXXIV, Central Bank of Sri Lanka.

Table 12: Provincial Distribution of Employment by Sector (as % of total)

Item	Western	Central	Southern	Northern	Eastern	North Western	North Central	Uva	Sabaragamuwa
Agriculture, Forestry and Fishing	9.3	43.8	39.8	25.9	36.1	28.5	50.9	63.7	44.9
Mining and Quarrying	0.6	0.3	0.6	0.9	0.5	0.7	1.0	0.4	6.1
Manufacturing	26.9	12.1	16.8	8.5	11.3	21.4	8.8	6.1	12.5
Construction	0.9	0.5	0.6	0.5	0.6	0.1	0.5	0.3	0.2
Electricity, Gas and Water	7.5	6.1	6.1	7.8	4.2	10.3	5.2	2.4	8.6
Wholesale and Retail Trade	20.6	14.1	14.0	19.3	20.1	15.8	11.6	9.9	12.0
Transport, Storage and Communication	11.0	5.8	5.4	6.0	6.9	6.9	4.9	4.0	4.2
Other Services	23.2	17.3	16.6	31.2	20.2	16.3	17.1	13.3	11.5

Source: Sri Lanka Socioeconomic Data 2011, XXXIV, Central Bank of Sri Lanka.

indeed due to high concentration of economic activities in the Western Province. For instance, the manufacturing industry, in 2010, accounted for over 76 per cent, while the service sector accounted for 49 per cent in the Colombo Metropolitan Region.⁷ Moreover, the problem of low prices for agricultural products further weakened the rural economy over the years. As a result, educated and more dynamic people as well as surplus labour are being pushed to the cities, or they remain and find employment in the low-productive regional economies. Ultimately, the core or large cities advance in development, while peripheral areas become economically backward. Table 12 clearly shows the provincial distribution of employment by sector.

Uneven contribution to the GDP is another important factor that shows the regional imbalance in Sri Lanka. Table 13 summarises the estimates of the provincial GDP shares between 2006 and 2010. As shown in the table, dormancy of urban growth in Sri Lanka remains significant, which was mainly the outcome of the colonial administration and its economic interest in the past. Most of the urban centres are located in raw material supply routes that are linked to the main administrative centres in Sri Lanka.

Table 13: Provincial GDP (at Current Market Prices) shares

Province/Year	% of National GDP				
	2006	2007	2008	2009	2010
Western	50.1	46.5	45.4	45.8	45.1
Central	8.8	9.6	9.8	9.8	10.0
Southern	10.0	10.5	10.5	10.5	10.7
Northern	2.8	2.9	3.2	3.2	3.4
Eastern	4.9	5.2	5.6	5.8	5.9
North Western	9.1	9.9	9.9	9.6	9.4
North Central	4.0	4.0	4.7	4.6	4.8
Uva	4.3	4.9	4.5	4.5	4.5
Sabaragamuwa	6.1	6.4	6.4	6.1	6.3

Source: *Sri Lanka Socioeconomic Data 2011*, XXXIV, Central Bank of Sri Lanka.

However, even today it is difficult to identify a change in the distribution pattern of the present urban centres. Most of the urban centres are located in the Wet Zone, which corresponds to the South Western quadrant of the country, comprising about three-fourths of the total urban population. Large concentration is in and around the city of Colombo. Therefore, the main urban cluster of the country is in the Colombo District with polarisation of Colombo city. After independence too, this nature of the distribution pattern has not changed. It is obvious that significant differences exist in the number, size, growth rates and the level of urbanisation among provinces of the country. It is known that except the Western Province all the other provinces are still experiencing slow urban growth and a low level of urbanisation. Policies implemented by successive

governments after independence had a more positive impact on urban growth of the Western Province. Urban-based projects such as urban development and housing programmes and the establishment of the Free Trade Zone in the Greater Economic Commission Area have increased the number of towns in the Western Province. Expansion in public and private sector investments within the early phase of the liberalised economic policies of 1978 and generation of more employment opportunities in the Western Province led to a faster growth of towns, attracting more rural-urban migrants. Considering this situation, it has been pointed out that geographical coverage of lower-order central places, which can accelerate the rural economy in the interior of the country, is inadequate.⁸

Priorities in the Improvement of Infrastructure for Regional Development

The absence of adequate infrastructure facilities has been recognised as one of the major barriers for regional development in Sri Lanka. The pattern of major investment, industries, commerce and economic activities in the past were highly influenced by the availability of physical infrastructure. The road network, in particular, can play an important role in linking regions, in terms of movement of people and products. Therefore, every regional plan should pay attention to expanding physical infrastructure and promoting economic growth. Inadequate coverage and poor quality of the road network are the major constraints inhibiting economic production in many regions in Sri Lanka. Since 2005, the government has given priority in its development agenda to the development of economic infrastructure at the provincial level to attract new investments, improve accessibility to markets, create new employment opportunities and alleviate poverty. A number of key infrastructure development projects launched by the government during the last few years have now been completed or are at the final stage of completion. The Norochcholai Coal Power Plant was completed, and the electricity generated was added to the national grid. The first phase of the Southern Expressway was opened for traffic, thereby substantially reducing travel time between Colombo and Galle. The first phase of the Hambantota Port Development Project has been completed. The Upper Kotmale Hydro Power Plant has been commissioned, the Maththala International Airport and the first phase of the new Colombo South Port have opened. The construction work relating to the Colombo Outer Circular Highway and Colombo Katunayake Expressway are also in progress. These projects, once completed, will address the inherent infrastructure bottlenecks and help to sustain high economic growth.

According to Central Bank,⁹ the current growth momentum in the telecommunications sector is expected to continue. In 2009-2011, the total number of fixed access telephones increased by 2.2 per cent to 3.6 million, while total mobile connections increased significantly by 14.5 per cent to 18.2 million,

compared to the same period in 2010. The growth in fixed access and mobile connections was due mainly to the expansion of network coverage by service providers, including Northern and the Eastern Provinces. The telephone density (telephones per 100 persons), including mobile phones, increased to 104.4 by end-June 2011 from 100.8 at end-2010. The mobile phone density alone stood at 87.1 by end-June 2011. The demand for electricity increased at a healthy rate of 7 per cent to 6,577 GWh during the first seven months in 2011, largely supported by the expansion of economic activities. During this period, hydropower generation increased substantially by 31 per cent to 3,480 GWh, due to increased water levels in the reservoirs, during the first few months of the year. Accordingly, thermal power generation decreased by 12.3 per cent to 3,030 GWh during this period. Reflecting the expansion in economic activities, electricity consumption in the domestic, commercial and industrial sectors increased by 5.8 per cent, 7.2 per cent and 5.9 per cent, respectively, during the first half of 2011.

Road development in the country has been given priority under the infrastructure development programme of the Government. Simultaneously, the government was continuously involved in rural road development under the “Maga Neguma” programme. Furthermore, emphasis has been placed on the development of the road network in the Northern and Eastern Provinces. Under the Conflict Affected Region Emergency Project (CAREP), improvements to the Paranthan-Pooneryn Road (26 km) and Mankulam-Vellankulam Road (38 km) are being made. Under the Northern Road Connectivity Project (NRCP), the rehabilitation of 170 km of National Highways in the Northern and North Central provinces is being done. The Kandy-Jaffna (A9) road has also been renovated.

Public passenger transportation showed mixed performance over the last few years. However, the total number of buses owned by the Sri Lanka Transport Board (SLTB) stood at 7,836, while the operated average number of buses per day was 4,347 on average in 2010. The number of buses owned and the average bus fleet operated by private operators increased to 19,968 and 15,974, respectively, during the first half of 2011. The rolling stock position of the Sri Lanka Railways was strengthened with the addition of six Diesel Multiple Units (DMUs) during the first half of 2011. These six DMUs were received under the Southern railway upgrading project, and were utilised for services on the coast line and main line. With the view of facilitating goods transportation, 122 wagons were added to the rolling stock. With the view of developing the country as a regional aviation hub, the expansion project of the Bandaranaike International Airport focuses on the construction of a new terminal facility, capable of handling an annual passenger capacity of around 6 million. The second international airport at Maththala has opened. Recognising the importance of the development of domestic airports, priority has been given to the development of airports at Ratmalana, Ampara, Koggala, China-Bay and Jaffna. Ratmalana airport will be developed as a “City Airport”, while Koggala will be developed with the Koggala lagoon functioning

as a water aerodrome. The construction work of the new port projects continued with the construction work of the new Colombo South Port Project. This was given priority to address capacity limitations at the existing port.

Conclusion

In spite of Sri Lanka's achievements in certain areas of human development, when compared with other developing countries, the data presented in the earlier sections and the analyses so far clearly establish that there are considerable disparities in socioeconomic development in relation to major sectors, that is, urban, rural and estate, or among the regional or at the provincial level. The efforts through the planning process during the first three to four decades of independence had only partially succeeded in reducing regional disparities. The accelerated economic growth since the late 1970s, with increased participation by the private sector, appears to have aggravated regional disparities. The ongoing economic reforms in early 2000s under the regaining Sri Lanka policy package with stabilisation and deregulation policies as their prime instruments, and a very significant role for the private sector, seem to have further aggravated the inter-provincial/regional/sectoral disparities. A marked dichotomy between the forward and backward groups of provinces/regions/sectors has been emerging. The forward provinces/sectors are characterised by better demographic and social development, higher per capita incomes and more developed economies, lower level of poverty, higher level of revenue receipts and higher per capita resource flows and private investment and significantly better infrastructural facilities. In contrast, the backward provinces/region/sectors are characterised by lower level of demographic and social development, lower per capita incomes and backward economies, higher level of poverty, lower level of revenue receipts and lower per capita resource flows and private investment and underdeveloped infrastructural facilities.

The pressing requirement of the backward provinces/regions/sectors is more investment in their social and infrastructural sectors. This is clearly evident in the fast economic growth of East Asian economies in the recent decades, which made higher levels of investment in human capital development in the preceding decades. Further, it is argued that equitable sharing of the gains of economic growth in the East Asian societies has been facilitated by the universal literacy and better health standards attained by all the citizens in those countries. Improvement in the basic infrastructural facilities like power, irrigation, transport and telecommunication in the backward provinces/regions/sectors is a precondition for improving the quality of life of the people and ushering in sustainable economic development. Availability of an assured power supply, developed transport system and modern telecommunication facilities are important factors to attract private investments into these states. Similarly, development of the irrigation sector will go a long way in improving the productivity of agriculture and fully engaging

the underemployed rural labour productively, which in turn will improve the rural incomes substantially and reduce the rural poverty significantly.

There is need for higher-level investment in social services and infrastructure in backward provinces/regions/sectors, as compared to forward provinces. The provincial governments of backward provinces are fiscally weak, and as such they are unable to find enough resources to meet these investment requirements. Forward provinces are better off in fiscal terms, and need to improve their comparatively better social and economic infrastructure further. These provinces are able to attract considerable amount of private investment, both domestic and foreign, to further improve their development potential, because of the existing favourable investment climate, including better socioeconomic infrastructure. In contrast, the backward provinces are unable to attract private investments because of unfavourable investment climate, including poor infrastructure. They are unable to improve the investment climate, by improving the existing poor infrastructural facilities, due to lack of resources. Their lack of resources is in turn linked to their poor development. Thus, it is truly a vicious circle. The solution lies in breaking this vicious circle through economic integration. As stated elsewhere, regional disparities in economic development is a crucial developmental issue in Sri Lanka. Lessons from developed nations show that success lies not only in equitable economic growth, but also in instituting policies that allow for a more uniform standard of living across the country.

NOTES

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14

Foreign Capital and India's Growth after Liberalisation

C.P. Chandrasekhar

It is now well documented that the balance of payments crisis of 1991, which saw the government turning to the International Monetary Fund (IMF) for emergency finance, provided the grounds for a policy shift, marking a new phase in India's relationship with foreign capital. But, as Chart 1 shows,¹ while liberalisation did increase inflows into the country, large capital flows, which were substantially in the form of portfolio capital, were a later development. Till 1993-94 total net inflows amounted to less than a billion dollars. Subsequently, foreign investment flows rose sharply to US\$ 4.2 billion in 1993-94 and averaged about US\$ 6 billion during the second half of the 1990s.

However, there were more significant changes subsequently. During the first decade of this century, these inflows rose to US\$ 15.7 billion in 2003-04, and then rose to an average of around US\$ 65 billion during 2009-12 (Chart 2). This increase would not have been possible without the relaxation of sectoral ceilings on foreign shareholding and the substantial liberalisation of rules governing investments and repatriation of profits and capital from India. But liberalisation began rather early in the 1990s, whereas the boom in foreign investment flows occurred much later. Thus, till 2002-03, the maximum level of net foreign investment inflow was US\$ 8.2 billion in 2001-02. This rose to US\$ 15.7 billion in 2003-04 and soared thereafter. That change provides the basis for distinguishing between two phases in the post-liberalisation years. One till 2003-04, and the other thereafter.

The other feature that is noteworthy is the change in the nature of capital inflows during the 1990s. After India's own version of the debt crisis in 1991, debt inflows remained more or less stagnant in nominal terms, resulting in a decline in the debt to Gross National Income (GNI) ratio from 33 per cent in 1991 to 21 per cent in 2002. However, as noted above, there was no decline, but an increase, in foreign capital inflows into India after the 1991 crisis. This was

Chart 1: Foreign Investment Flows (\$ bn)

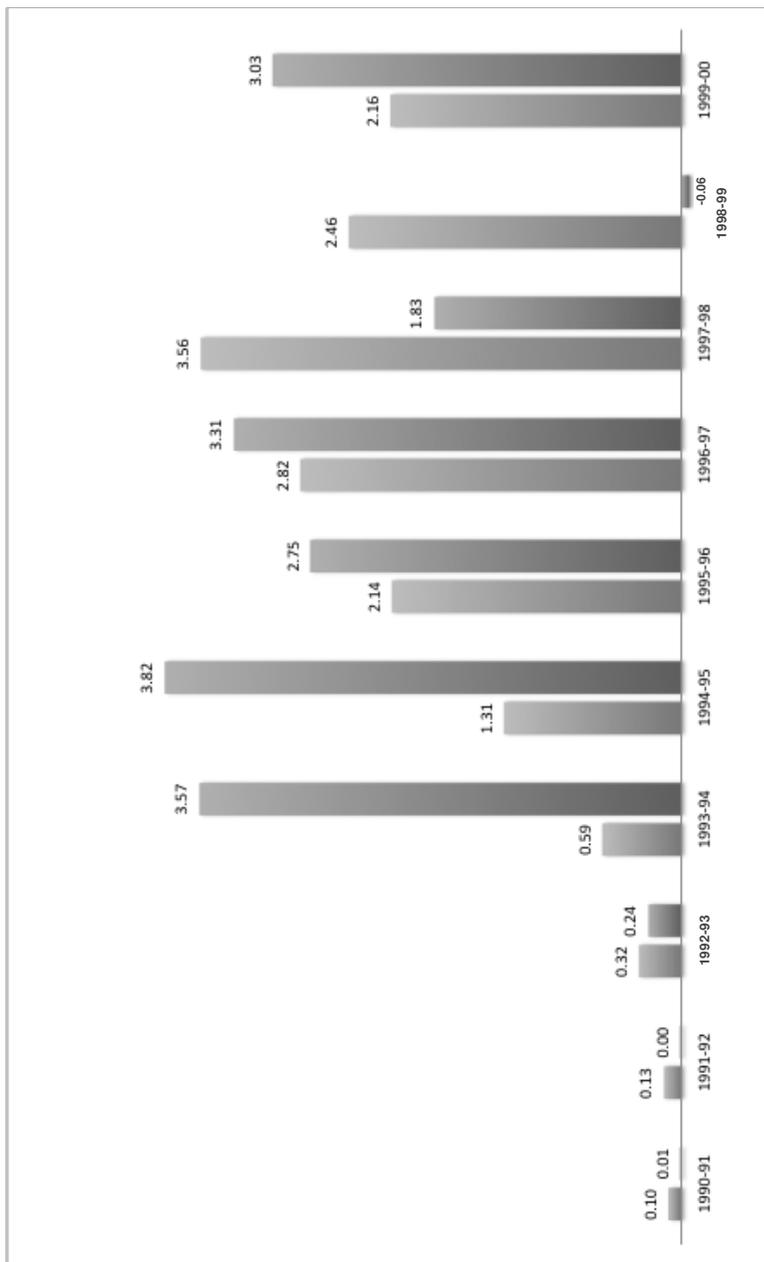
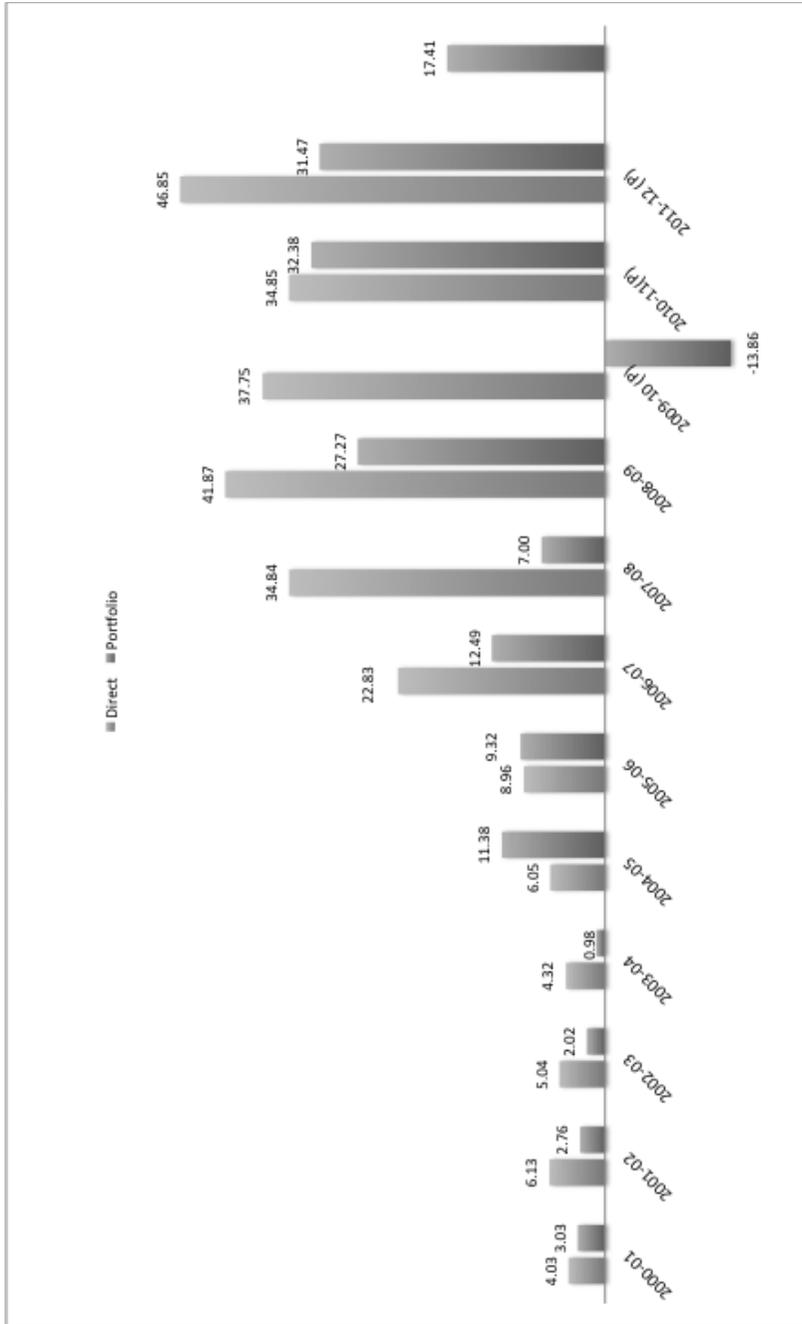


Chart 2: Foreign Investment Flows: 2001-2012 (\$ bn)



because of a significant increase in non-debt inflows, especially portfolio and direct investments. In sum, while the 1991 crisis froze debt inflows into India, liberalisation ensured access to a significant amount of non-debt inflows.

The Regime of Accumulation

This persistence of access to foreign exchange influenced the regime of accumulation as well. The 1990s were characterised by growth rates similar to that recorded in the 1980s. However, the stimuli driving manufacturing growth were now changing. Though in the course of the crisis and its immediate aftermath industrial growth fell sharply, it soon recovered, and India experienced a mini-boom during the 1994-1997 period and a year of reasonable growth towards the end of the decade. A number of factors combined to generate these trends.

The first is, of course, public expenditure, which was extremely unstable during the 1990s. That instability was due, *inter alia*, to the following three factors: (i) variations in the government's degree of adherence to its irrational fiscal deficit targets; (ii) a sudden burgeoning of public expenditure towards the end of the 1990s because of the implementation of the Fifth Pay Commission's recommendations; and (iii) the influence of the political business cycle, which results in a ramping up of public expenditures of certain kinds in the run-up to an election. However, on an average, it appears that government spending had ceased to be as much of a stimulus to growth as during the 1980s, with fiscal conservatism leading to an overall deflationary trend in the system. Unstable government expenditure, while contributing to instability in industrial growth, has not been a long run influence in raising the trend rate of growth.

The second factor influencing manufacturing growth during the post-liberalisation years was the increase in the production of domestically assembled or produced import-intensive manufactured goods. This form of industrial growth was stimulated during the mid-1990s by the release of the pent-up demand in the upper income groups, for a range of import-intensive consumption goods. Such demand had been limited for long because of restrictions on the imports of both the commodities themselves and of the technology, capital equipment and intermediates needed to produce them domestically. Liberalisation of trade and foreign collaboration rules removed restrictions on the imports of technology, equipment and intermediates while maintaining restrictions on imports of the final product. As a result, domestic production of these commodities registered a spurt to cater to the pre-existing demand. This, however, was a once-for-all market. Once the requirements generated by the release of pent-up demand was exhausted, the market had to expand if growth had to be sustained. This required the percolation of this demand to new segments of the income spectrum. That

did not occur, and so the boom came to an end with fears by the late 1990s that Indian industry was experiencing a recession.

Finally, manufacturing growth was stimulated by a new feature resulting from financial liberalisation, which was a growing role for retail lending in the portfolio of the commercial banks. What followed was an unusual way in which that market for manufactures has been expanded, especially in urban India, during the years of neo-liberal reform: through a boom in housing and consumer credit. One consequence of financial liberalisation and the excess liquidity in the system created by the inflow of foreign financial capital has been the growing importance of credit provided to individuals for specific purposes such as purchases of property, automobiles and consumer durables of various kinds. This implies a degree of dis-saving on the part of individuals and households. It also implies that financial institutions, which are willing to provide such credit without any collateral, are betting on the inter-temporal income profile of these individuals, since they are seen as being in a position to meet their interest payment and amortisation commitments, on the basis of speculative projections of their earnings profiles. These projections are speculative because with banks and other financial institutions competing with each other in the housing and consumer finance markets, the tendency is towards an expansion in the universe of borrowers, with individuals being able to easily take on excess debt from multiple sources, without revealing to any individual creditor their possible over-exposure to debt.

One implication of the expansion of the market for manufactures, through these means, is that the occurrence and the extent of such expansion depend crucially on the 'confidence' of both lenders and borrowers. Lenders need to be confident of the future ability of their clients to meet interest and repayment commitments. Borrowers (excluding those consciously involved in fraud) need to be confident of their ability to meet, in the future, the commitments that they are taking on in the present. This crucial role of the 'state of confidence' in triggering this form of demand is what is captured in the oft-used phrase: 'the feel good factor'. Since there is a strong speculative element involved in lenders providing credit and borrowers increasing their indebtedness, the state of confidence of both parties matters. When such confidence is 'good', we can experience growth or even a boom. When such confidence is low among either borrowers or lenders, we can experience recessionary conditions. The exogenous, supply-side influenced surge of capital inflows into India has not merely increased liquidity in the system but bolstered confidence. The result is the growth debt-finance demand. This too played a role in boosting growth during the 1990s.

To summarise, even though the rate of overall and industrial growth during the 1990s was not very different from that in the 1980s, there was evidence of an incipient change in the regime of accumulation. There were two aspects to this change. The first was that private consumption expenditure on manufactured consumption goods, and private investment in housing, was beginning to play

a more important role (relative to public expenditure) in driving demand and growth. And second, associated with this, were signs that debt-financed private consumption expenditure was displacing debt-financed public expenditure as a leading stimulus for growth.

One fall out of these changes was that the growing importance of services in driving GDP growth was enhanced. First, the role of government revenue expenditure in driving services growth continued, though to a lesser extent than before. Second, increases in private expenditure, especially of the upper-middle and upper income groups, were directed to a host of new services, contributing to the growth of that sector. Third, with a growing role for non-debt inflows of foreign capital, including Foreign Institutional Investor (FII) investments into India's liberalised capital markets, the importance of financial services was increasing. Fourth, with the growing importance of private debt in the growth process, areas like banking were registering rapid growth. And, finally, in the run up to year 2000, the boom in India's IT and IT-enabled services sector had begun, adding to the expansion of services. Put together, this substantially accelerated services growth during the 1990s. Developments mediated substantially by India's changed relationship with foreign capital were beginning to influence the regime of accumulation.

The Years Since 2003

The year 2003 marked another turning point. As noted earlier, this was when foreign capital inflows into India surged. Over the next few years, India was receiving far more capital inflows than it needed. To start with, since the beginning of the decade (2000-01), over the 41 quarters till first quarter 2010-11, there were 16 in which India actually recorded a current account surplus. Further, since the beginning of financial year 2003-04, when there has been a capital flow surge into most emerging markets, the inflow of capital has fallen short of the current account deficit only in 7 out of 29 quarters, with the ratio of net capital inflow to the current account deficit being below one (Chart 3: negative figures are because of a current account surplus or negative deficit).

As a result, cumulatively there has been a huge excess of capital inflow into the country, when compared to its current account financing needs. In fact, if we take the cumulative sum of the excess of the capital inflow, relative to the current account deficit, this has increased consistently since the first quarter of 2001-02 to the fourth quarter of 2008-09, and since then has more or less remained near that level despite the exit of capital associated with the global crisis (Chart 4).

There are two reasons why capital inflow has been in excess of India's balance of payments financing requirements. The first is that right through this decade, India had experienced an excess of capital inflows over outflows in all quarters excepting one (third quarter 2008). A host of factors combined to ensure this

Chart 3: Ratio of Net Capital Inflow to Current Account Deficit

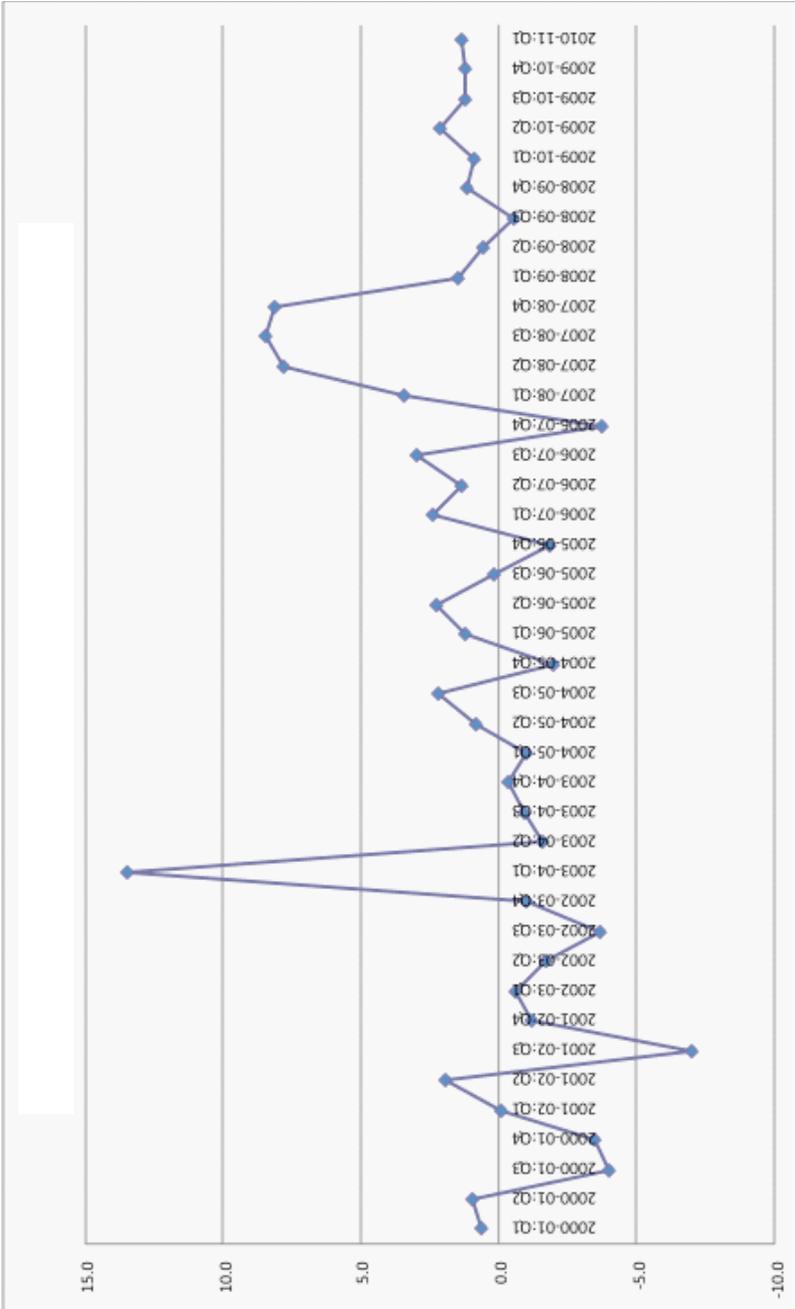
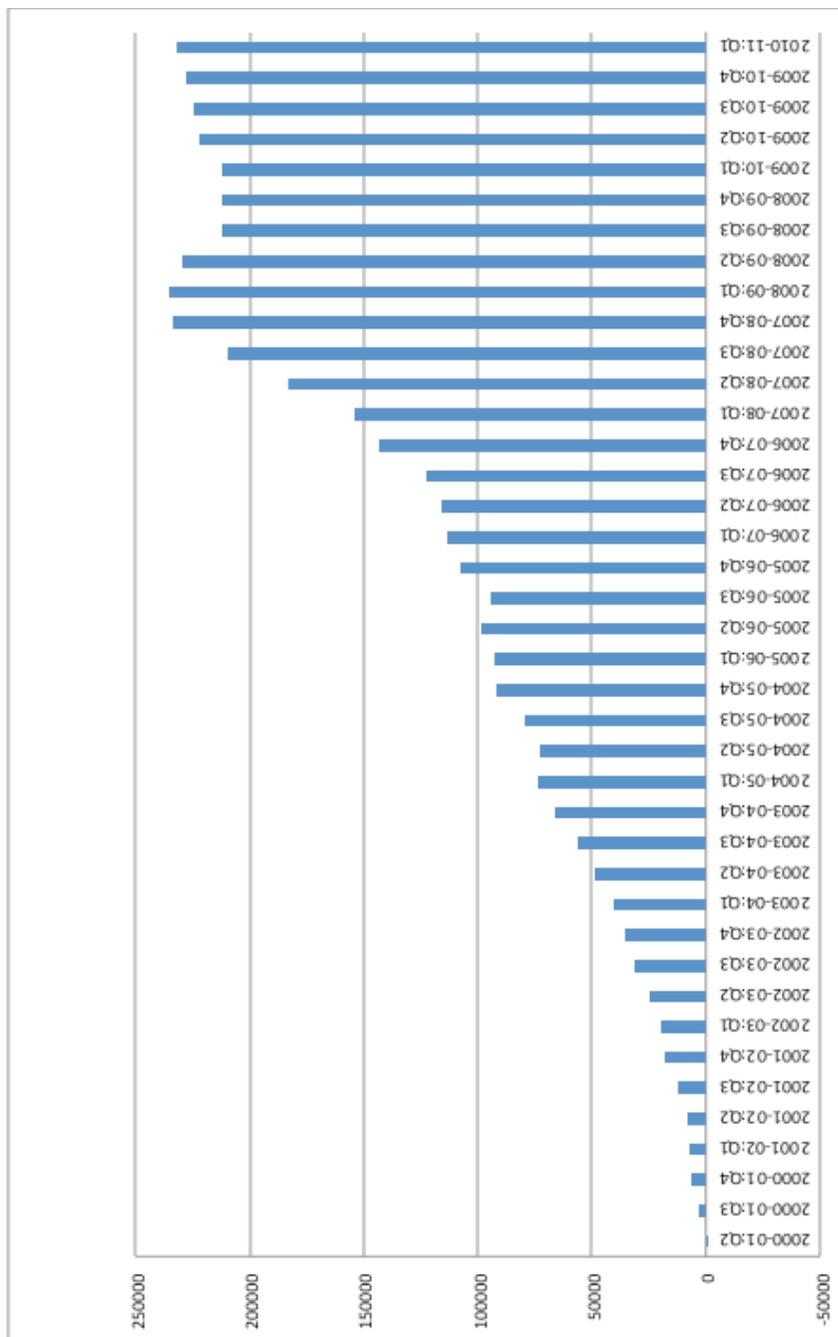


Chart 4: Cumulative Excess of Capital Account Inflow over Current Account Deficit (\$ mn)



result. First, India has been a favoured destination for foreign financial investors. Foreign direct investors turned to India after liberalisation to benefit from the large and growing domestic market. And Indian firms have borrowed heavily abroad, given the much lower interest rates in foreign markets, and the liberalised conditions relating to external commercial borrowing. The second reason why capital inflows have been in excess of India's balance of payments financing needs is that services exports and remittances from workers providing services on location abroad have substantially covered the country's merchandise trade deficit. As Chart 5 shows, the net inflows on account of Software and Business Services and Remittances have exceeded the merchandise trade deficit during the first half of this decade and more or less equalled it subsequently.

Given the liberalised exchange rate system that India has, the resulting excess supply of foreign exchange creates conditions for an appreciation of the currency. If that appreciation has not occurred, it is because of the intervention by the Reserve Bank of India (RBI), that has resulted in the large reserves that it holds.

However, one important implication of these trends is that capital inflows rather than current account surpluses explain India's comfortable reserve position. In the muted celebration to mark the completion of two decades of reform, one statistic often referred to was the size of India's foreign exchange reserves. Nevertheless, we must not forget that these reserves have income and capital payment commitments in foreign exchange associated with them. They are borrowed and not earned.

Impact on Growth

Enhanced capital inflows during the last decade have, as before, had important implications for the regime of accumulation. The inflow of foreign exchange had as its counterpart an increase in the overhang of liquidity in the domestic economy. Based on that overhang, a liberalised banking system has been creating new credit assets at a rapid rate. The ratio of bank credit outstanding to GDP had remained at around 22 per cent for a decade starting 1989-90. However, this figure began to rise after 1999-2000, doubled (to 44.4 per cent) by 2005-06 and then rose further to 56 per cent by 2011-12 (Chart 6).

There were also significant changes in the sectoral distribution of credit. Overall, there were two sets of sectors that gained in share. The first comprised of the so-called "sensitive sectors", consisting of the stock market, commercial real estate and commodity trading. The exposure of banks to the stock market occurs in three forms. First, it takes the form of direct investment in shares, in which case, the impact of stock price fluctuations directly impinge on the value of the banks' assets. Second, it takes the form of advances against shares, to both individuals and stockbrokers. Any fall in stock market indices reduces, in the first instance, the value of the collateral. It could also undermine the ability of

Chart 5: Ratio of Net Inflows from Software and Business Services and Remittances of Merchandise Trade Deficit

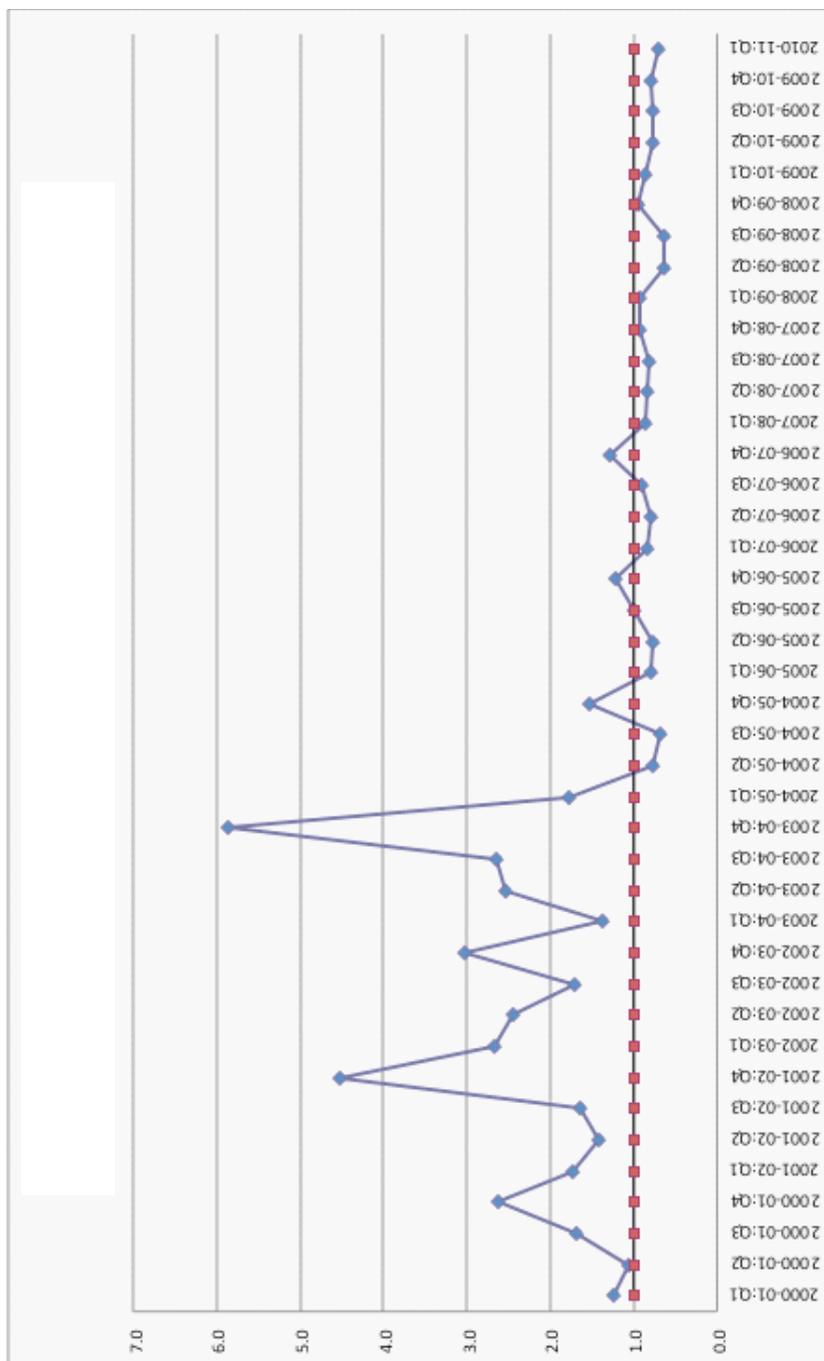
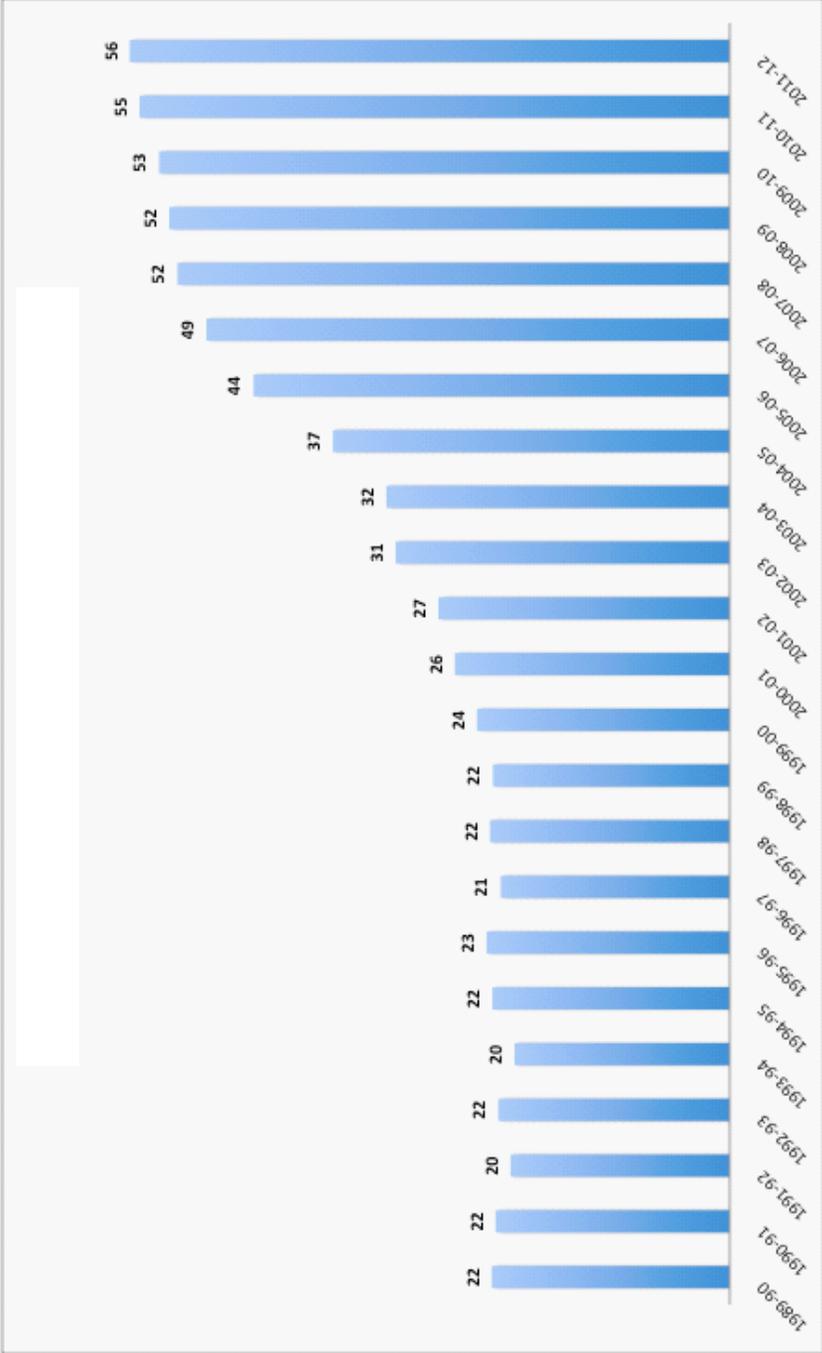


Chart 6: Ratio of Bank Credit Outstanding of GDP (%)



the borrower to clear his dues. To cover the risk involved in such activity banks stipulate a margin, between the value of the collateral and the amounts advanced, set largely according to their discretion. Third, it takes the form of “non-fund based” facilities, particularly guarantees to brokers, which renders the bank liable in case the broking entity does not fulfil its obligation.

The effects of this on bank fragility become clear from the role of banks in the periodic scams in the stock market since the early 1990s, the crisis in the cooperative banking sector and the enforced closure-cum-merger of banks such as Nedungadi Bank and Global Trust Bank. However, this evidence only begins to reveal, what even the RBI has described as “the unethical nexus” emerging between some inter-connected stock broking entities and promoters/managers of banks. The problem clearly runs deep and has been generated, in part, by the inter-connectedness, the thirst for quick and high profits, and the inadequately stringent and laxly implemented regulation, that financial liberalisation breeds.

The second area that gained from the change in the sectoral distribution of credit, was retail advances. The share of personal loans increased from slightly more than 9 per cent of total outstanding commercial bank credit, at the end of March 1996, to more than 22 per cent by end-March 2007 (Table 1).

Table 1: Personal Loans as per cent of Total Outstanding Credit of Commercial Banks

	1996	2000	2007
State Bank of India and associates	9.5	10.7	22.0
Other Nationalised Banks	9.1	10.9	15.8
Foreign Banks	8.8	17.1	24.8
Regional Rural Banks	10.5	18.8	20.5
Private Sector Banks	9.7	7.9	37.3
All Scheduled Commercial Banks	9.3	11.2	22.3

Of the components of retail credit, the growth in housing loans was the highest in most years. The rate of growth of housing loans gathered momentum at the end of 1990s, and remained at extremely high levels right up to 2006-07. As a result, the share of housing finance in total credit rose from 5 per cent in 2001-02 to 12 per cent in 2006-07. The increase is often attributed to the low level of penetration of the mortgage market in India, standing at 7 per cent in 2006, as compared to 12 per cent in China, 17 per cent in Thailand, 26 per cent in Korea, 29 per cent in Malaysia and a huge 80 and 86 per cent in the US and UK, respectively. But these differential penetration rates have to be seen in the light of differentials in per capita income and the degree of income inequality, both of which do not favour a significantly large mortgage market in India.

This has resulted in the accumulation of loans of doubtful quality in the portfolio of banks. Addressing a seminar on risk management in October 2007,

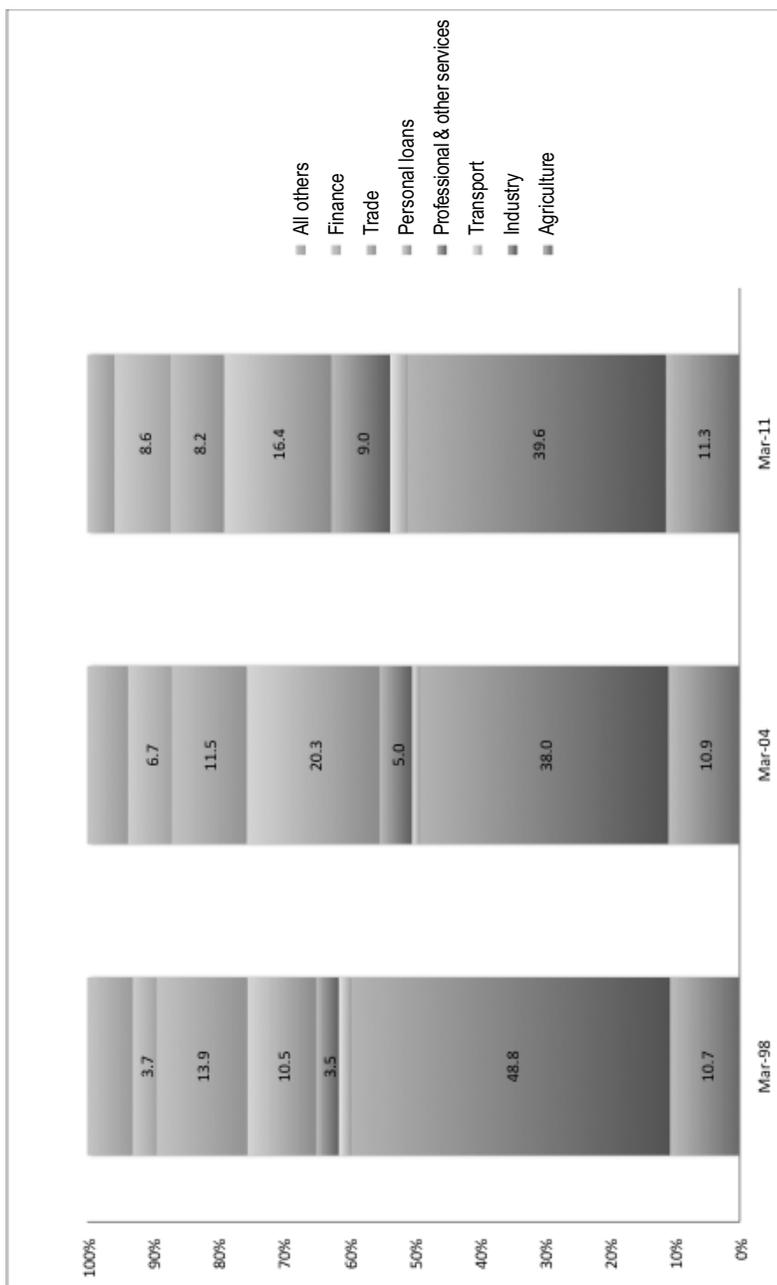
when the subprime crisis had just about unfolded in the US, veteran central banker and former chair of two committees on capital account convertibility, S.S. Tarapore, warned that India may be heading towards its own home-grown sub-prime crisis². Even though the suggestion was dismissed as alarmist by many, there is reason to believe that the evidence warranted those words of caution at that time, and are of relevance even today. Besides the lessons to be drawn from developments in the US mortgage market, there were three trends in the domestic credit market that seemed to have prompted Tarapore's comment.

The increase in retail exposure was also reform related. Financial liberalisation expanded the range of investment options open to savers and through liberalisation of controls on deposit rates, increased the competition among banks, to attract deposits by offering higher returns. The resulting increase in the cost of resources meant that banks had to diversify in favour of more profitable lending options, especially given the emphasis on profits even in the case of public sector banks. The resulting search for volumes and returns encouraged diversification in favour of higher risk retail credit. Since credit card outstandings tend to get rolled over and the collateral for housing, auto and consumer durable loans consists essentially of the assets whose purchase was financed with the loan concerned, risks are indeed high. If defaults begin, the US mortgage crisis made clear, the value of the collateral would decline, resulting in potential losses. Tarapore's assessment clearly was and possibly remains, that an increase in default was a possibility, because a substantial proportion of such credit was sub-prime, in the sense of being provided to borrowers with lower than warranted creditworthiness. Even if the reported incomes of borrowers do not warrant this conclusion, the expansion of the universe of borrowers brings in a large number with insecure jobs. A client with a reasonable income today may not earn the same income when circumstances change.

These factors notwithstanding, the expansion in retail credit served as a form of autonomous demand for manufactured goods. Credit served as a stimulus to industrial demand in three ways. First, it financed a boom in investment in housing and real estate and spurred the growth in demand for construction materials. Second, it financed purchases of automobiles and triggered an automobile boom. Finally, it contributed to the expansion in demand for consumer durables. This infusion of autonomous demand, though unsustainable in the medium term, was an important factor explaining the revival of industrial growth during the mid-2000s.

But this was not the only role that credit expansion played. As Chart 7 illustrates, the growing importance of these sectors has resulted in a stagnation in the share of credit going to agriculture (at around 11 per cent) between 1998 and 2011, and a decline in the shares of trade (from 14 per cent to 8 per cent) and industry (from 49 to 40 per cent). However, what is interesting is the distribution of the credit going to industry, which at 40 per cent of total bank

Chart 7: Sectoral Deployment of Gross Bank Credit (%)



credit outstanding was still substantial. The share of infrastructural lending in the total advances of scheduled commercial banks to the industrial sector rose sharply, from less than 2 per cent at the end of March 1998 to 16.4 per cent at the end of March 2004, and as much as 31.5 per cent at the end of March 2012 (Chart 8). That is, while the share (though not volume) of lending to industry in the total advances of the banking system has fallen, the importance of lending to infrastructure within industry has increased hugely. Four sectors have been the most important here: power, roads and ports, telecommunications and, more recently, a residual ‘other’ category, reflecting in all probability the lending to civil aviation.

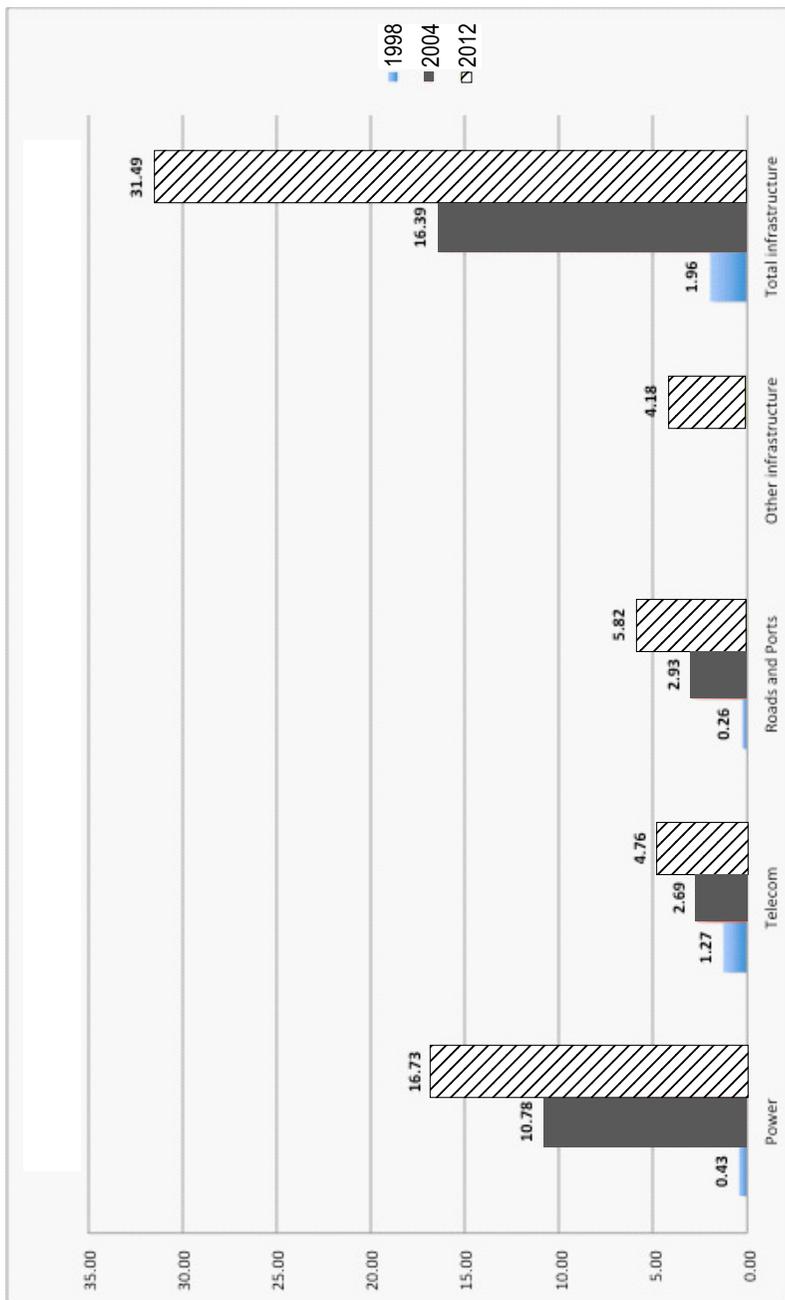
The government was clearly using the banking system as an instrument to further an aspect of its larger liberalisation agenda, which was the entry of the private sector into core infrastructural areas involving lumpy capital intensive investments in power, telecommunications, roads and ports and sectors like civil aviation. Under normal circumstances banks are not expected to lend much to these areas as it involves a significant maturity and liquidity mismatch: banks draw deposits from savers in small volumes, with the implicit promise of low income and capital risk and high liquidity. Infrastructural investments require large volumes of credit and do involve significant income and capital risk, besides substantial liquidity risk. So what is required for supporting infrastructural investment is increased equity flows from corporate or high net worth investors, and the expansion of sources of long-term credit like a bond market.

Neither of these, especially the latter, occurred in adequate measure. Rather, the development financial institutions with special access to lower cost financial resources, which were created as providers of long term-finance, had been shut down as part of liberalisation. Hence, besides recourse to external commercial borrowing, many infrastructural projects had to turn to the banking system. As is to be expected, private banks have been unwilling to commit much to this risky business. So it is the public banking system (besides a couple of private banks) that has moved into this area, possibly under government pressure.

However, as the exposure of the banks to these sectors has increased, the folly of “dragging” the private sector into infrastructure, with concessions and cheap credit is becoming clear. The shake-out has begun in civil aviation, with possibly only one airline able to show profit after many years of liberalisation. But there are other sectors like power generation, power distribution and ports and roads where returns have been below expectations or negative.

The result is the prospect of default on loans provided to these ventures by the banks. This has presented banks with a serious problem. If they press for payments, they invite default of the large volume of debt they have already provided. The impact on their balance sheets can be damaging. So they are under pressure to restructure debt, offer better terms, extend repayment periods, and provide more credit to keep the unit afloat. But they are doing so with the

Chart 8: Share of Infrastructure in Commercial Bank Lending to Industry (%)



knowledge that unless the government uses taxpayers' money in some form to bail out the unit, this is merely sending good money after bad.

Thus, for example, in 2010 the banks had got together and under the Corporate Debt Restructuring (CDR) scheme of the RBI, restructured debt to the tune of Rs. 77.2 billion owed by Kingfisher Airlines. By 2012, with the debt of the airline having increased by another Rs. 10 billion or so, it had been forced to suspend operations, with no hope of repaying the banks unless the impossible happens.

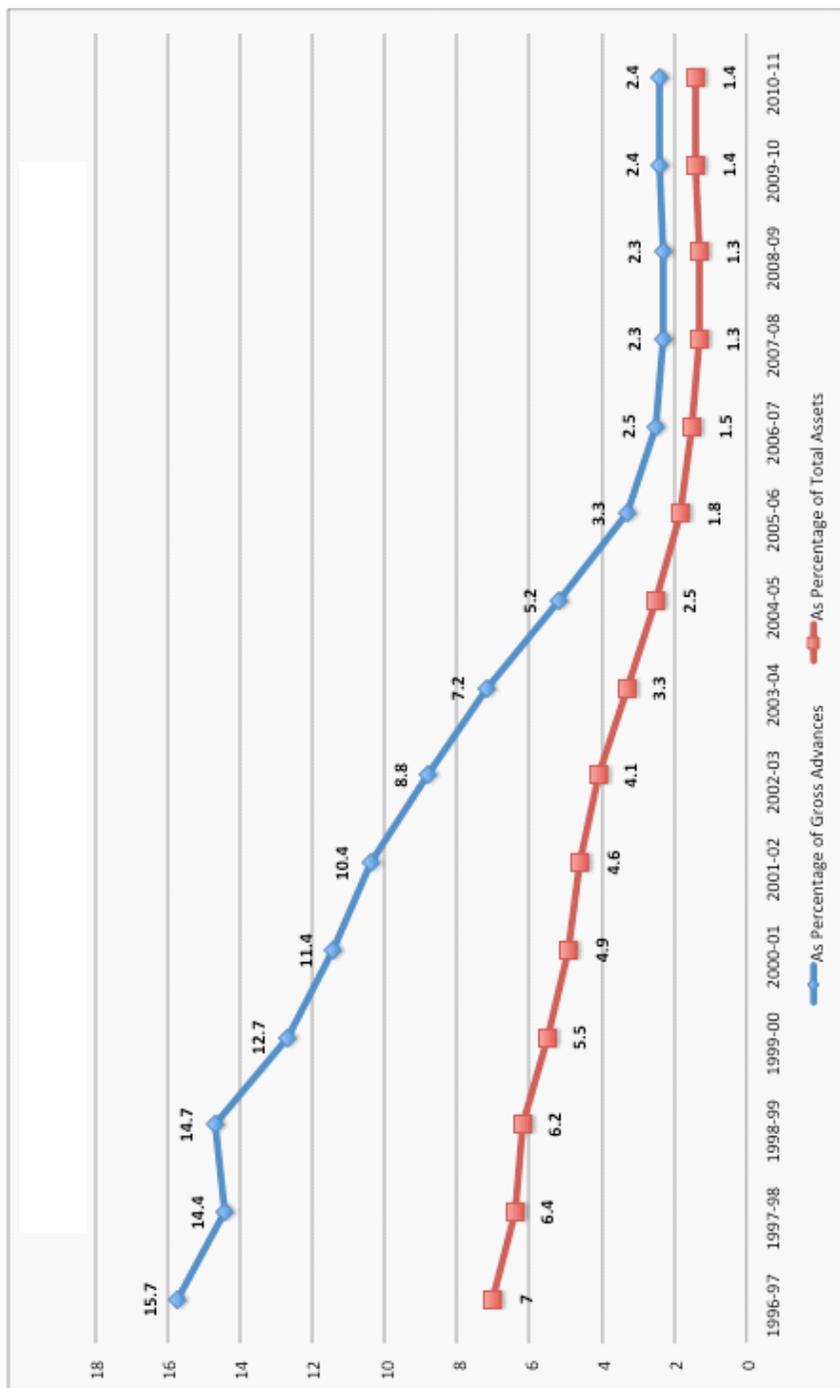
Table 2: Trends in Restructuring

	<i>Mar-09</i>	<i>Mar-10</i>	<i>Mar-11</i>	<i>Mar-12</i>
Gross Advances (Rs. Crore)	27,53,365	32,27,287	39,82,954	46,55,271
Restructured Standard Advances (Rs. Crore)	75,304	1,36,426	1,37,602	2,18,068
Restructured Standard to Gross Advances Ratio (%)	2.73	4.23	3.45	4.68
Gross NPAs as a % of Gross Advances	2.44	2.5	2.35	2.9

The implication of this comes through from Chart 9 and Table 2. While the government has been priding itself that the non-performing assets of the commercial banking system have come down quite significantly post-reform (Chart 9), this has been accompanied by a significant increase in the ratio of restructured assets that are treated as standard assets to gross advances. While the ratio of gross Non-Performing Assets (NPAs) to gross advances by banks has increased only marginally over the three years ending March 2011 from its comfortable low level, the ratio of restructured (and, therefore, still "standard") advances to gross advances has risen from 2.7 per cent to 4.7 per cent. Expectations are that with a rush of borrowers to the CDR cell, this figure is likely to rise sharply. Thus, while sustaining and intensifying the credit-financed boom in household investment and consumption, and private corporate investment in infrastructure, the banking system is being rendered increasingly fragile.

It must be noted that the period between 2003-04 and 2007-08 was also one in which the government finally implemented its self-imposed resolve to substantially reduce its fiscal deficit. This implied that the high growth era was one in which the stimulus offered by debt-financed public expenditure was on the decline. What seems to have been occurring was a substitution of this stimulus provided by debt-financed private investment and consumption. Though there are signs that this process cannot be sustained, it does seem to have contributed (along with the continued, self-reinforcing growth of services) to the short-term realisation of a high growth trajectory. Thus, associated with the recent phase of India's post-Independence engagement with foreign capital was a surge in inflows

Chart 9: Gross Non-performing Assets of Scheduled Commercial Banks (%)



of debt and non-debt forms of foreign capital that triggered in turn a whole new regime of accumulation.

Capital Under the New Regime

One question that remains is the factors that endowed lenders and borrowers with the confidence that sustained this regime of accumulation through the 2000s. The answer lies possibly in the fact, that the period was special also because investment was fuelled by a mechanism that had profit inflation at its core. The sectors that were growing (in both manufacturing and services) were ones characterised by a sharp increase in valued added per worker—influenced by technology in the case of organised manufacturing, and by the nature of the activity in the case of modern services. The result was an increase in the private sector's ability to garner higher profits.

Consider trends emerging from the official Annual Survey of Industries relating to the organised manufacturing sector depicted in Chart 10. To start with, since the early 1990s, when liberalisation opened the doors to investment and permitted much freer import of technology and equipment from abroad, productivity in organised manufacturing has been almost continuously rising. Net value added (or the excess of output values over input costs and depreciation) per employed worker measured in constant 2004-05 prices, rose from a little over Rs. 1 lakh to more than Rs. 5 lakh. That is, productivity, as measured by net product per worker adjusted for inflation, registered a close to five-fold increase over the 30-year period beginning 1981-82. And more than three-fourths of that increase came after the early 1990s.

Unfortunately for labour, and fortunately for capital, the benefit of that productivity increase did not accrue to workers. The average real wage paid per worker employed in the organised sector, calculated by adjusting for inflation as measured by the Consumer Price Index for Industrial Workers [CPI(IW) with 1982 as base], rose from Rs. 8,467 a year in 1981-82 to Rs. 10,777 in 1989-90 and then fluctuated around that level till 2009-10 (Chart 11). The net result of this stagnancy in real wages after liberalisation is that, the share of the wage bill in net value added or net product (Chart 10), which stood at more than 30 per cent through the 1980s, declined subsequently and fell to 11.6 per cent or close to a third of its 1980s level by 2009-10.

A corollary of the decline in the share of wages in net value added, was of course a rise in the share of profits. However, the trend in the share of profits is far less regular than that of the other components in net value added. Between 1981-82 and 1992-93, the ratio of profits to net value added fluctuated between 11.6 per cent and 23.4 per cent. During much of the next decade (1992-93 to 2002-03), it remained at a significantly higher level, fluctuating between 20.4 per cent and 34.3 per cent, but showed clear signs of falling during the recession years 1998-99 to 2001-02.

Chart 10: Profits, Wages and Productivity in Organised Manufacturing

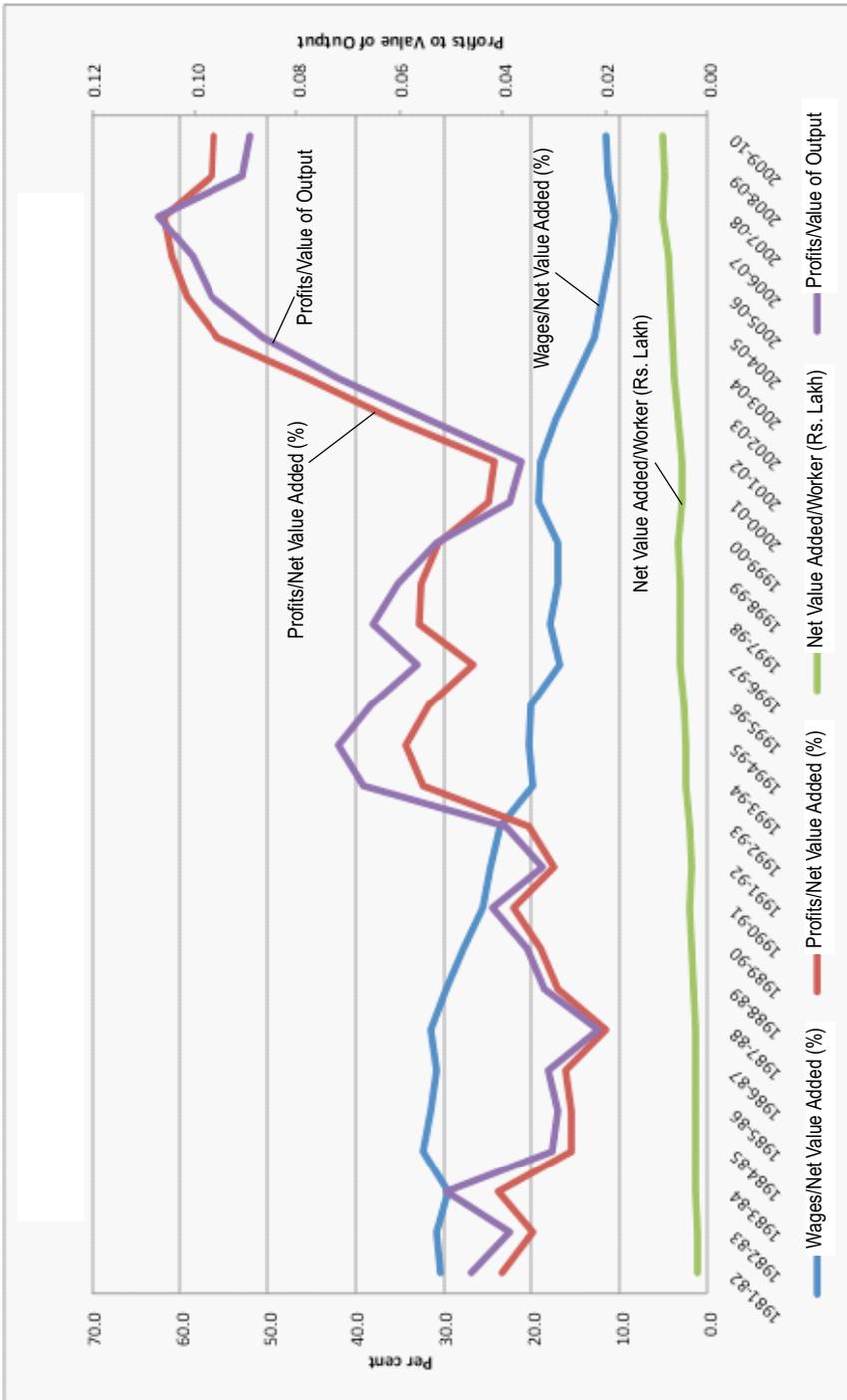
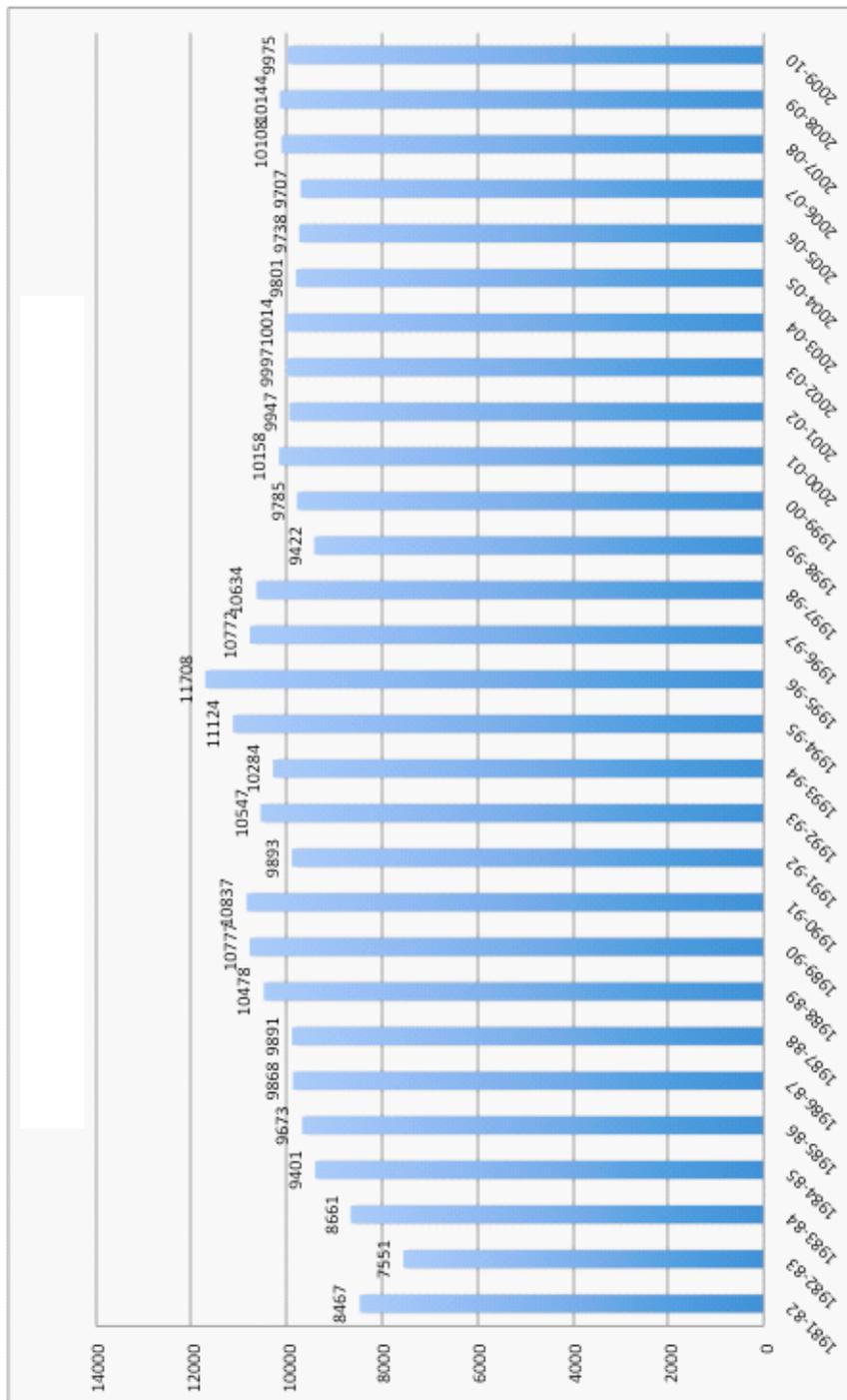


Chart 11: Average Real Wage (Rs per year in 1982 prices)



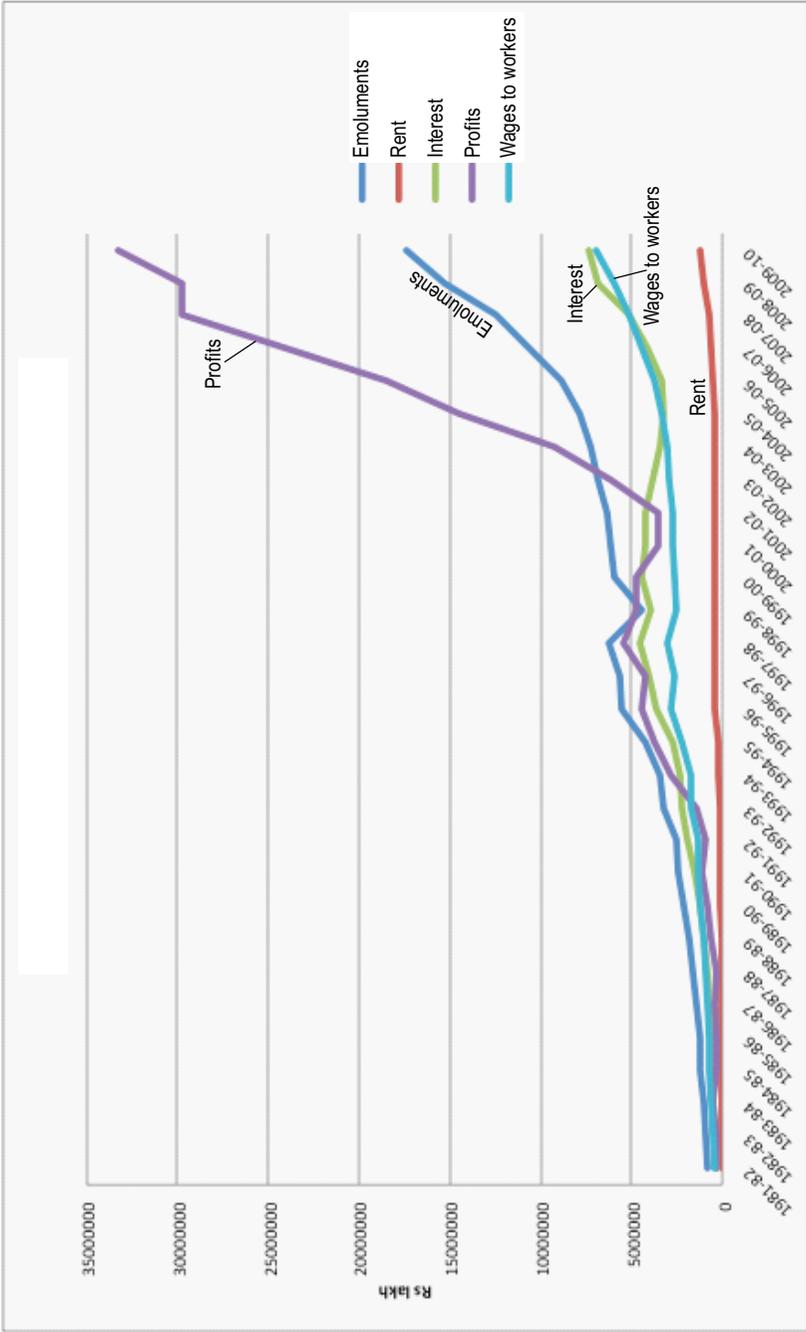
However, the years after 2001-02 saw the ratio of profit to net value added soar, from just 24.2 per cent to a peak of 61.8 per cent in 2007-08. Unfortunately for manufacturing capital, the good days seem to be at an end. There are signs of the profit boom tapering off and even declining between 2006-07 and 2009-10. But this latter period being short, we need to wait for more recent Annual Survey of Industries (ASI) figures to arrive at any firm conclusions.

As of now, what needs explaining is the remarkable boom in profits, at the expense of all other components of net value added. An interesting feature that emerges from the chart is that the ratio of profits to value of output, or the margin on sales, tracks closely the irregular trend in the share of profits in value added described above. Increases in profit shares have clearly been the result of a rise in the mark up represented by the profit margin to sales ratio, or the ability of capital to extract more profit from every unit of output.

Interestingly, the periods in which the ratio of profits to the value of output has risen, leading to sharp increases in profit shares, were also the years when the two post-liberalisation booms in manufacturing occurred. The first of those was the mini-boom of the mid-1990s, starting in 1993-94 and going on to 1997-98, which was fuelled by the pent-up demand in the upper income groups, for a range of goods, that had remained unsatisfied prior to the liberalisation of imports and foreign investment rules. The second was the stronger and more prolonged boom after 2002-03, led by new sources of demand. That boom lasted till the global financial crisis in 2008-09. The coincidence of the rise in profit margins and profit shares and the output booms suggests that, in periods of rising demand, the organised manufacturing sector in India has been able to exploit liberalisation in three ways. First, it has been able to expand and modernise using imported technologies, raising labour productivity significantly in the process. Second, it has been able to ensure that the benefit of that productivity increase accrues almost solely to profit earners, because of the conditions created by the "reformed" economic environment. As a result, the mark up rose significantly or sharply in these periods and delivered a profit boom. Third, to ensure this to the dramatic extent depicted, it has obviously used a range of concessions from the state to inflate profits. Through means varying from tax concessions to access to cheap or near-free assets and resources, the state has virtually transferred income and wealth to the private sector to boost private profitability.

An interesting feature is the way in which this process feeds on itself. As Chart 12, depicting trends in the different components of net value added, shows, while the nominal value of rent, interest and wages rose only marginally over a long period, the increase in emoluments, which include managerial salaries was substantial. Profits of course soared as noted earlier. The increase in non-wage salaries and incomes not only directly drives manufacturing demand but also provides the basis for the expansion of credit-financed investment and

Chart 12: Components of Net Value Added



consumption expenditure. Thus, the boom creates conditions that also help prolong it.

Seen in this light, there are reasons to believe that certain recent developments could be constraining growth in the manufacturing sector. The first is the fear of a reduction and even reversal in foreign capital inflows into the country, as a result of both global and domestic uncertainty. This is putting pressure on the government to reduce its fiscal deficit and the level of public debt, which has a deflationary impact. The second is the large credit overhang and the uncertainty arising from increased debt defaults in the retail and infrastructural lending markets, which is reducing the volume of credit, and hence the volume of debt-financed investment and consumption. Finally, there has been an increase in allegations of large scale corruption. The instances to which such allegations relate are many: varying from the sale of 2G spectrum and the mobilisation and/or disposal of land and mining resources to purchases made as part of large and concentrated public expenditures (as in the case of the Commonwealth Games). What this has done is increase the reticence and limit the ability of the government to openly favour private capital with concessions that deliver high and rising profit margins.

When the effects of such developments combine, they could restrict demand and dampen investment considerably leading to a reduction in the rate of growth of manufacturing. They are also possibly reducing profit margins and profitability, so that we may well be at the end of the period of profit-inflation led growth.

The issue of sustainability aside, the import of the above argument is that as India's relationship with foreign capital has shifted from muted hostility to one of attracting and winning its confidence, the nature of the regime of accumulation has changed as well. These changes had indeed taken India onto a higher growth trajectory by activating mechanisms that were very different in the 1980s, 1990s and 2000s. The long period of relatively high growth created the impression that these three phases were in fact only one, and that the high growth was now irreversible. The argument above seeks to establish that these were not only three different phases, but that each was in its own way unsustainable. Thus, the regimes of accumulation themselves were fragile, besides the fact that growth driven by dependence on financial flows is vulnerable, because of the possibility that such inflows could stop and capital outflow could occur for reasons unrelated to circumstances in the host country.

NOTES

1. All charts and tables are based on data available from the websites of the Central Statistical Organisation or the Reserve Bank of India.
2. Tarapore's statement in a speech in Mumbai was backed with estimates by M.G. Bhide and is cited in "Sub-Prime Crisis Brewing Here, Warns Tarapore", *Business Line*, Wednesday, Oct 17, 2007, at <http://www.thehindubusinessline.com/todays-paper/article1672236.ece> (Accessed December 20, 2011).

15

Economic Growth in Nepal: Need for Reforms

Bishwambher Pyakuryal

Nepal's entire period of planned development history beginning from 1956 until 2013 is not very encouraging. The country has experienced continued swings in economic activities. The Rana's rule lasted for 104 years (1846-1950). The Nepali Congress (NC) experimented with democratic socialism for the shortest period (1959-60). For 11 years, King Mahendra experimented with a party-less autocratic Panchayat system (1960 to 1971). King Birendra continued his father's experiments with a party-less democracy for a long period of 19 years (1971 to 1990).

After reinstating democracy in 1990, the King was made the constitutional head and the majority government constituted by the Nepali Congress (1990-2006) initiated economic liberalisation, globalisation and privatisation rather aggressively. Intra-party conflict within the Nepali Congress brought the minority communist party of Nepal, the United Marxist-Leninist (CPN UML) into power in 1994. The people's war led by Maoists began in 1996 and continued for a decade until the Comprehensive Peace Agreement (CPA) was signed between the Maoists and a seven party alliance in 2006. In February 2005, King Gyanendra dismissed the Parliament and imposed direct rule. After the 12-point agreement between the NC, the CPN (UML), and the Maoists, the King reinstated the Parliament on 24 April 2006.

For the first time in Nepal's history, the election of the Constituent Assembly (CA) was held in 2008. The new constitution was supposed to be completed by 2010. However, problems in building consensus on key issues necessitated the extension of the CA for two more years. Unfortunately, the CA was dissolved by the prime minister on 27 May 2012 without any agreement between the key players—the Maoists, the NC, the CPN (UML) and the Madhesis.

On the basis of the recommendations of four party alliances, the Supreme Court (SC) Chief Justice (CJ) Khil Raj Regmi was appointed the Chairman of

the Interim Electoral Council of Ministers, by the President of Nepal Ram Baran Yadav on March 14, 2013. The objective of appointing the CJ was to end a political deadlock as Baburam Bhattarai did not resign even after the dissolution of the CA. He also failed to hold the CA election, which was scheduled for 22 November 2012. The new date for the election is 19 November 2013.

The intra-party conflict necessitated that the Maoists split into two groups, one led by Pushpa Kamal Dahal, also known as Prachanda and the other by Mohan Baidya. Baidya has called for an all-party round table conference to resolve the current political impasse. He considers that the 11-point agreement and the 25-point agreement on removing the constitutional hurdles reached among the major parties were conspired by the four-party 'syndicate' and therefore, they should be scrapped.

As a result, the country is experiencing political uncertainties and economic instability. The state is functioning through ordinances. The issue of raising income and narrowing down income inequality to facilitate inclusive growth has become a distant dream. The need is therefore, to develop a consensus-based economic model keeping in mind the prolonged political instability and economic uncertainties. For a chronology of political events since 1950 see Annex 1.

Macroeconomic Indicators

The paper contains an average annual data covering the period of FY 2011–12 (Mid-July).

The real GDP at basic price grew by 4.5 per cent in 2011–12. The ratio of total savings to GDP was merely 9.98 per cent in the review period. The industrial growth was not satisfactory. The growth in agriculture is less than the estimates by the Central Bureau of Statistics given in 2012.

The annual average consumer price inflation in 2011–12 remained at 8.3 per cent. The y-o-y inflation as measured by the consumer price index increased by 11.9 per cent in mid-August 2012, as compared to 7.7 in the corresponding period of the previous year (based on the First Month's Data of FY 2012–13 of Nepal Rastra Bank). During the first two months of the FY 2012–13 the inflation on the average has remained at 12.5 per cent. The hard hit commodity was the food and beverage group where the yearly average price index of vegetables remained at 24.2 per cent.

Total trade deficit went up by 16.7 per cent to Rs. 387.41 billion in the FY 2011–12. Trade deficit with India came down to 14.3 per cent, against the growth of 23.4 per cent in the previous year. Exports to India have gone up by 14.4 per cent, compared to the growth of 8.4 per cent in the previous year, and the growth in imports from India is 14.3 per cent, compared to its growth of 20.6 per cent last year. Trade deficit with China on the other hand has been growing at an average rate of 27.1 per cent annually over the last seven years, while the overall trade deficit has increased by 21.9 per cent.¹

The overall BOP recorded its highest ever surplus of Rs. 127.70 billion in the review year, compared to a surplus of Rs. 2.18 billion in the previous year. The reason for such growth was the substantial rise in the growth of remittances and the improvement in the service account. Under transfers, workers' remittances surged by 41.8 per cent to Rs. 359.55 billion compared to a growth of 9.4 per cent last year.² The performance in capital expenditure was very poor. Against 86.9 per cent in the recurrent expenditure, the capital expenditure stood at 56 per cent of the annual budget estimate.

Decades of Underperformance

Six and a half decades of development plans remained underperformed. Nepal has the lowest average growth rates in South Asia. Nepal's economic history from 1990 until 2012 represents continuous swings. After the declaration of the Republican State in 2008, the second phase of uncertainty began with five prime ministers at the helm.

After 2004 (WTO), Nepal's trade deficit has increased four fold and the share of export in GDP decreased to 5 per cent from 10 per cent. Imports tripled between 2003–04 and 2010–11—from Rs 133 billion to Rs 388 billion. However, exports rose slightly from Rs 55 billion to merely Rs 69 billion—a 25 per cent increase.³ In the World Bank's *Doing Business* Report, Nepal's trade ranking is 161. The trend shows structural problems inherent in the execution of Nepal's economic policy. A thorough review of economic implications is therefore necessary from the liberalisation perspective.

The declining incidence of poverty is not linked to narrowing down income inequality and creating employment opportunities. Therefore, although poverty is gradually declining, data shows the richest quintile of the population have incomes nearly 10 times those of the lowest quintile. The diagnostic study⁴ refers to a recent World Bank study, which suggests that the same level of GDP growth could have reduced poverty by as much as 13 percentage points if the income inequalities had not worsened.

Growth will have its meaning only when it helps in increasing investments and creating gainful employment opportunities, to raise income and contribute to national revenues. Various reforms and strategies were designed to open up development opportunities. These measures included fiscal incentives (tax concessions, cash grants and specific subsidies), improvements in domestic infrastructure, programmes for enhancing the skills of domestic workers, commitments for strict compliance of regulatory measures and governance reforms. However, the pace of development was exceptionally slow. Reasons for this include political uncertainties, absence of locally elected representatives, declining capital expenditure and a deteriorating security situation. An overview of the last two decades' trends in the GDP growth rate is given below:

Figure 1: GDP Growth Rate (Percentage)



Source: *Economic Survey* (various issues) and *ADB Outlook* (2009).

Figure 1 above shows that after the 1990s, the highest growth was achieved in 1994 (7.4 per cent) and the lowest in 2002 (0.12 per cent). Nepal was the only country in South Asia whose real GDP growth rate declined during 2003–2008 (3 per cent) compared to 1997–2003 (4 per cent). The projection of the average growth rate for 2010–2013 equals to the last 36 years' average (of 3.8 per cent).

Nepal's economic issues are on the backburner. The current situation is deteriorating due to the mistrust, disagreements and enmity between the major political parties. The revenue situation is relatively better but people suspect it's accelerated erosion because of the weak economy on the one hand, and the need for additional expenditure requirements, especially in integrating former Maoists combatant into the Nepalese army, and non-budgetary expenses in the interim government's populist programmes on the other.

The executive organ is run by the most controversial interim government, the legislative wing is vacant after the dissolution of the CA and the Supreme Court is being run by less than 50 per cent of the judges. The major constitutional bodies are either vacant or going to be vacant very soon or are functioning with inadequate members, such as the Commission of the Abuse of Authority, which is vacant, and the Election Commission which is going to be vacant. The past achievement in economic performance was mixed, the present situation is just status-quo if not deteriorating and the future looks unpredictable and scary with a possibility that Nepal would be a failed state very soon.

Binding Constraints to Growth

Poverty

According to the Nepal Living Standard Survey II (NLSS) 2003–04, poverty declined to 30.8 per cent (11 percentage points) in 2003–04 from 42 per cent

in 1995–96. Between 2003–04, 2009–10, an astonishing 18 percentage point decline was recorded, which remained at 13 per cent. Millennium Development Goals (MDGs) mid-term evaluation (2008) shows the incidence of poverty remaining at 25 per cent. The World Bank has an estimate of 55.10 per cent but again in the Multidimensional Poverty Index (MPI) by Oxford, poverty remained at 64.7 per cent. The MPI considers the income-based poverty measures of 109 countries and also reflects multiple deprivations, focusing on three critical dimensions of poverty- health, education, and standard of living. Such variations in the poverty index need to be harmonised by developing appropriate and realistic methodology.

Table 1 below presents the poverty index (head count rate) for different castes and ethnic groups. The information offers some insights on caste and ethnicity related deprivations.

Table 1: Poverty Index and Selected Indicators by Caste and Ethnic Group, Nepal, 2010–11

Caste and Ethnic group	Head Count Rate	Per Capita Income (Rs)	Per capita Consumption (Rs)	Employed (Percent)
Hill Bahun	10.34	63,234	49,059	75.57
Hill Chhetri	23.40	46,079	35,944	80.09
Tarai castes	28.35	32,473	28,488	74.00
Dalit				
Hill origin	43.63	27,225	24,179	85.02
Kami	37.87	29,240	25,216	85.81
Other hill origin	48.88	25,404	23,232	84.29
Tarai origin	38.16	24,241	21,450	80.94
Janajati	24.61	43,561	37,114	79.83
Newar (hill origin)	10.25	73,170	63,439	70.32
Other hill origin	28.05	38,644	32,684	81.98
Magar	31.69	33,581	27,739	83.75
Tamang	28.34	39,426	33,541	82.24
Rai	22.01	38,544	34,679	83.09
Gurung	21.74	62,852	47,195	70.46
Limbu	25.27	29,489	29,728	83.41
Sherpa, Bhujel, Bhote, Thakali etc.	16.15	51,111	45,999	79.64
Kumal, Sunuwar, Majhi, Chepang etc.	40.40	30,003	24,055	85.88
Tarai origins	26.64	33,491	28,092	82.19
Tharu	23.57	35,546	28,591	82.57
Other Tarai origins	32.89	29,162	27,079	81.37
Other (Muslim etc.)	18.78	30,231	30,063	67.70
Total	25.16	41,659	34,829	78.28
Correlation Coefficient.		-0.78	-0.82	0.66

Source: Calculated from NLSS III (2009–10), CBS.

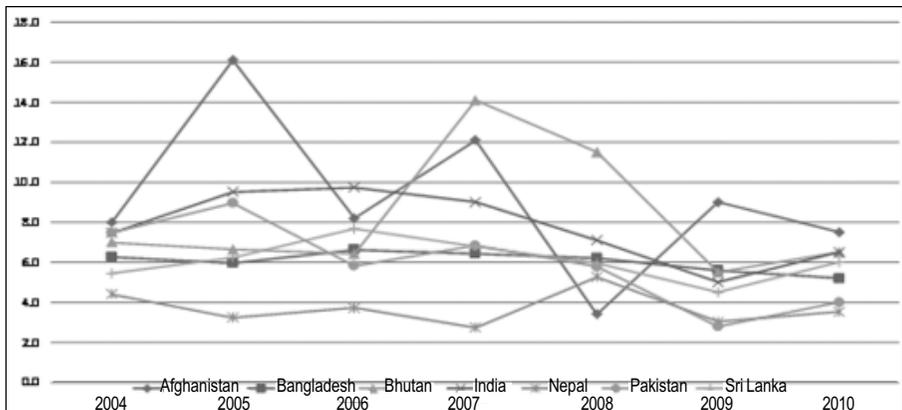
The National Planning Commission shows that poverty line income has increased from Rs 10,105 in NLSS II to Rs 14,430 in 2009–10 (NLSS III). However, if the exchange rate fluctuations are considered, the poverty line income at the rate of USD1.25 for the year 2012 has to be significantly increased. Therefore, in the absence of factoring in inflation and exchange rate fluctuations, the result from income parameter needs to be taken with caution. For example, the exchange rate between USD and NRs in January 2008 was Rs 63.85 and the exchange rate in January 2012 was Rs 85.59. This means an additional Rs 21.74 per day and Rs 652.2 per month will have to be increased for 01 January 2012.

The bottom line is that in Nepal and many other South Asian countries, growth is not usually linked to employment. Therefore, the policy fails to reduce inequality. Unless a long-term vision in growth, distribution and income generation is considered, even the double-digit growth will have no meaning because growth alone is not the sum total of human life. Furthermore, the lesson lies in taking other safeguard measures for reducing poverty and narrowing down income inequality.

Some interesting examples can be provided to respond to such dilemma i.e., incidence of poverty and poverty line income. The glaring example of Yemen can be stated here. 53 per cent of the population of Yemen is poor, but only 18 per cent live on less than the \$1.25 a day standard. In Ethiopia, the disparity is even more extreme. For instance, 90 per cent are MPI poor, while just 39 per cent live on less than \$1.25 a day.⁵

The following Figure 2 shows the GDP growth rate in the South Asian nations to point out the comparative state of growth in the region:

Figure 2: GDP Growth Rate in South Asia



Source: ADB Outlook (2009).

World income in real GDP has increased sevenfold since the end of World War II, but economic growth has not been shared evenly. The Nepal Living

Standard Survey II⁶ also reveals growing inequality being reflected in the widening gap in income, as well as the wealth holdings of the rich and the poor. Therefore, the time has gone to remain content with a growth-only approach, and this needs to be translated into pro-poor growth or growth-with-equity.

Agriculture

Shifting traditional agriculture from subsistence to commercial agriculture has been a long-felt problem. Nepal's agriculture suffers from inadequate funds to purchase agricultural inputs; climate change, natural disasters, and unpredictable weather conditions; continuous decline in productivity, and an average annual growth of population more than the agricultural growth rate.

Farm productivity is the lowest by global standards and is less than its South Asian neighbours. Agriculture is largely based on low-value cereals and subsistence production with a mere 13 per cent of output traded in markets. The average farm size is 0.9 hectare per holding, where 43 per cent of marginal farmers operate in only 11 per cent area. This is the reason why investment in land improvement is less than 3 per cent of household income.⁷

The shortfall in domestic production is the major factor for food insufficiency.⁸ The use of chemical fertilizer in Nepal is only 31 kg per ha. As a result, the annual productivity of cereals is merely 2.2 mt/ha. The average amount of food deficit is 47 kg per capita in mountain regions and 32 kg in the hills.⁹

There is a huge gap in the agricultural productivity within different ecological divisions of the country. The government has failed to address the problem of environmentally unsustainable land in Nepal. Increasing agricultural productivity and technological innovations have not been very satisfactory, because of insufficient resources and the government's changing priorities. The visible constraints within Nepal's agricultural regime are small farm size; use of low quality inputs and traditional technology; removal of subsidies and poor institutional support services; high cost of production; limited access to year-round irrigation facility; lack of access to marketing and credit facilities, and under-investment because of low returns from land and labour.

Changes in the agriculture sector are linked to stabilisation and structural adjustment policies. Failure in establishing linkages between macroeconomic policy reforms and the specific changes observed in the agrarian sector, which ultimately affect poverty reduction, should be the issue for a policy dialogue. The reason why examining such linkages is important is because macroeconomic stability cannot guarantee growth in agricultural income.

Foreign Direct Investment (FDI)

Increased FDI has not played a very significant role in the growth of the Nepali GDP in absolute as well as in relative sense. Complex government procedures and restrictions on most capital transactions have put much of Nepal's economy

off-limits to foreign capital. Nepal is at the bottom in attracting FDI compared even to Afghanistan, North Korea and Bhutan. The FDI stands at \$35 million in 2010. The highest FDI ever recorded was \$111.47 million in 2007–08.

At a time when more than half of the global FDI inflows came to developing and transition economies, FDI commitment in Nepal declined by 48.35 per cent in 2010–11, according to the Department of Industry. FDI to almost all Least Developed Countries (LDCs) increased during 1990–2008, but it declined in Nepal, Burundi, Eritrea, Samoa and Timor-Leste. The UNCTAD's World Investment Report 2011 places Nepal at the 134th position.

The following table shows that the size of GDP is not the determinant for increased FDI.

Table 2: FDI Inflows into Three Asian Landlocked Countries, 1989-2000

Country	Per capita GDP, 2010 in \$ million	FDI (1995-2000) \$ million	FDI Stock
Lao, PDR	8298	72.2	1180 (2007)
Mongolia	8558	25.6	1326 (2007)
Nepal	18884	11	35 (2010)

Source: UNCTAD 2001 and UN Report.

During 1989–2000, Nepal's total GDP was three times larger than that of Lao, and more than five times that of Mongolia, but the FDI receipt of Nepal remained about seven times less than Lao, and less than half of Mongolia. In 2010, the FDI in Nepal was 34 times less than that of Lao and 38 times less than that of Mongolia respectively.

During 2011–12, the number of Joint Venture Projects (JVPs) increased by 8.6 per cent, while the investment amount has decreased by 28.9 per cent. In 2010–11 (mid-October), with Rs 32390.31 million (48 per cent) investment, India topped the list by giving employment opportunities to 56407 individuals. China stood at second position with Rs 7036.17 million contribution by employing 23325 persons. However, during the FY 2011–12 (mid-July), of the total 227 projects approved during the review period, the largest number were from China (77) followed by India (24), USA (24) and South Korea (21). These projects were expected to generate direct employment opportunities for 9,050 peoples only.¹⁰ The country-specific structural change in investment and employment generation is a matter of future study.

Infrastructure

Due to the difficult and rugged topography, the road network in Nepal is one of the poorest in South Asia. There is high regional disparity in the distribution of

road network. Although total road length is less in the far western region, it is the least in the mid western region. In the mid western region in Karnali, there is virtually no road. This explains the very low road density in the region. Population to road ratio is the highest in the western development region i.e. in this region more people use less road.

Table 3: Region-wide Distribution of Road

Region	Total length of roads (km)	Population influenced Per km. of road (nos.)	Road density (km./100 sq.km)
Eastern	6983	1384	25
Central	7910	1302	29
Western	3898	1288	15
Mid Western	3013	1256	7
Far Western	1665	1634	9

Source: Calculated from DDC profile, 2012.

Besides the small road network, the quality of roads is another problem. Out of the total road length, about 80 per cent of the road has not been black topped yet. Similarly, about 85 per cent of the local roads are earthen roads,¹¹ which are operational only during the dry season.

Strengthened rural road networks have been greatly influencing agricultural productivity. Telephones and other means of communication are being improved rapidly, but their coverage is still lower than in other South Asian countries. Therefore, one of the important reasons explaining Nepal's unrealised growth potential is the wide infrastructure gap.

Due to its land locked nature, Nepal's transportation cost is very high. It is estimated that land locked developing countries have to bear, on an average, 50 per cent higher international transport costs than their neighbouring coastal countries.¹² The under-resourced region with rugged topography has not enjoyed the opportunities created by domestic, regional and global trade practices. Nepal's infrastructure is not only inadequate in its quality, but is also deteriorating each year, which is explained by its global infrastructure ranking. Weak infrastructure has made Nepal less competitive among the 144 global economies and the country is ranked 125 with a score of 3.5 in the Global Competitiveness Report 2012–13. The projected infrastructure rank of Nepal for the year 2013 is the lowest.¹³ This suggests the need for devising a long-term policy, based on the diagnostic study.

To find out how important road network is for private investment, a study of Central Bureau of Statistics, Nepal, shows that 55 per cent people reported the condition of roads to be fair, while 33 per cent people reported it to be bad, and just 12 per cent considered it good.¹⁴ It has been found that roads are the second biggest infrastructure problem, but lagging far behind electricity. In a

report, 56 per cent firms reported electricity as the major infrastructure problem, while only 12 per cent firms reported roads as the major problem.¹⁵

As shown by available literature, lack of efficient supply of electricity is the binding constraint to growth in Nepal. In comparison to electricity, availability of road networks did not appear to be a major problem. However, inadequate rural roads have been the constraint in integrating rural markets with urban centers, to take comparative advantages of connectivity.

Electricity

The Nepal Electricity Authority's (NEA's) study showed that their cost of service per kWh stands at NRs 7.40 against the revenue of NRs 6.70 per kWh. After adjusting 0.28 per kWh from miscellaneous incomes, the NEA still suffered a loss of NRs 0.42 for every kWh of energy saved by it.¹⁶ The government policy to allow the NEA to adjust the tariff for addressing the increased cost of operation is not effective. The Electricity Tariff Fixation Commission (ETFC) has to recommend any tariff adjustments to the Ministry of Power and the NEA. After this happens, the Ministry of Power can make an announcement with regard to the changes in tariff. This has not happened for more than a decade, largely because of the political interest of the ruling governments and misunderstanding between the ETFC and the NEA, regarding inadequate and unclear terms of reference between these organisations.

The NEA's accumulated loss is too high to recover if the existing policy is pursued. Until 2011, the amount had reached Rs 27 billion and the government had written off the loss. As a result, it stood at Rs. 8.55 billion in the fiscal year 2011–12.¹⁷ According to the NEA's record, the electricity consumption and the number of consumers have been increasing at a rate of approximately 9 per cent per year. Increased household consumption during the evening peak period has created additional problems in the regular supply of electricity.

Cost and time over-run has been a regular event in Nepal. Ongoing hydro projects have been suffering because of increased labour problems. This has ultimately stagnated the possibility of creating additional power generation capacities in the near future. From a policy perspective, other constraints such as recovery of accumulated losses, loss reduction, creation of a hydropower fund, and adjusting to inflation have been meaningful challenges. The import through trading of power from the Indian short-term market remains inadequate to offset the imbalance between the demand and supply.

Fiscal Federalism

Based on the four-party political decision made on 10 May 2012 (based on interparty consensus before dissolving the CA on 27 May 2012), Nepal is supposed to have 11 states under the new federal system. The boundary and

names for the proposed states will be decided at a later stage. However, because of the dissolution of the CA and stalemate in arriving at a consensus on the structure of the states, finalisation of the CA or general election etc., the political scenario may change. Therefore, one could expect changes again in the exact numbers of the states before finalising the constitution.

From the perspective of federalism, one of the challenges the country will face is that of fiscal management and revenue sharing in the changing political context between the centre and local governments. This is important especially in sustaining development activities and reducing poverty. Unless the working of the center and the local units is properly studied, the right-size physical structure, and the burning question of fiscal implications under the new federal structure cannot be investigated. Increasing security expenses, declining development expenditure, contraction in revenue source, ineffective aid utilisation, and declining foreign direct investment are some of the factors that have made public expenditure management extremely difficult in Nepal.

There are huge differences in per capita income, income inequality, HDI etc among Nepal's development districts. A unitary system and an inappropriate resource allocation system from the centre has eroded the capacity to raise income by local governments. With regard to the allocation, for example, the share of central level expenditure in 2008–09 was around five times higher than that of the district level. Similarly, with regard to the contribution of revenue, 32 per cent of Nepal's development districts make less than 5 per cent of the net expenditure, whereas the revenue for 60 per cent of the districts is less than 10 per cent of the net expenditure. In 21 districts (28 per cent), the revenue is between 5–10 per cent of the net expenditure. See table below.

**Table 4: Contribution of Revenue in Net Expenditure
Challenges—Fiscal Federalism**

Development Region	Revenue is less than 5% of the net expenditure		Revenue is between 5-10% of the net expenditure		Revenue is less than 10% of the net expenditure		Total Districts	
	District	% of total districts	District	% of total districts	District	% of total districts	District	% of total districts
Eastern	1	6.25	8	50	9	56.25	16	100
Central	3	15.79	3	15.79	6	31.58	19	100
Western	2	12.5	8	50	10	62.5	16	100
Mid-Western	12	80	1	6.67	13	86.67	15	100
Far Western	6	66.67	1	11.11	7	77.78	9	100
Nepal	24	32	21	28	45	60	75	100

Source: Pyakuryal et al (2009).

Most of the proposed states (i.e. 11 states) have negative revenue- a social expenditure gap, implying that the total revenue of these states is inadequate

even to meet their social expenditure requirements. However, the size of the gap and the degree of horizontal imbalances are unequally distributed among the states. On an average, the share of social services expenditure is 10 per cent for each state. If income and expenditure grow by the usual trend, a disproportionately huge amount of the central grants may be necessary to make the weaker states financially viable and economically sustainable. Additionally, a recent study conducted by the author reveals that out of the proposed 11 states, only four states with positive gap are able to meet current social services expenses from their own revenue, whereas other states need additional resources.

Therefore, in an economic restructuring exercise especially designing the fiscal federalism, the unanswered question is *how to make local governments economically viable units*. Merely empowering the local governments in each of the proposed states in the forthcoming federal constitution will not solve the problem.

Priorities

Despite the fact that hydropower, tourism and agriculture are Nepal's development priorities, which have comparative advantages in the region the unpredictable and prolonged political instability has limited the scope for inter-party consensus building. This has constrained devising a common minimum agenda and designing an economic model.

Nepal's Interim Plan (2007–08, 2009–10 and 2010–11, 2012–13) document states that the objectives of the government are to enable people to feel change in livelihood and quality of life through employment centric inclusive and equitable growth, poverty alleviation and sustained peace. To achieve this objective the goal is to improve the quality of life by generating honourable and gainful employment opportunities, reducing economic inequalities, mitigating regional and social deprivations, and bringing down poverty to a level of 21 per cent by sustained economic growth.

The objective and goal is unchallengeable, but the million-dollar question is how. To discuss the full-fledged development model and rules of implementation is beyond the scope of this paper. However, an attempt to briefly identify priorities has been made in the following paragraphs, which may complement the stated goals in the planning document.

At the outset, the immediate priority should be to revitalise agriculture by facilitating the absorption of excess labour from agriculture to industry and the services sector. Second, the main drivers of growth lie in the industrial and services sector, which can even compensate for a slowdown in agriculture. Third, restructuring the security arrangement; fourth, formulating immediate, short-term and long-term implementable employment policies (by especially addressing vulnerable age groups, helping internally displaced populations from conflict, and supporting freed but unemployed bonded labors); and fifth, revisiting poverty

alleviation policies, which can help in building the assets of the poor, should be the other equally important priorities.

A review of the government's policy announcements shows that there are additional areas where development assistance is desired to enhance competitiveness in priority sectors for widening growth opportunities. These sectors include data processing, software development and computer consultancy services, generation and transmission of electricity, manufacture of paper and paper products, manufacture of motorcycles and scooters and parts thereof, and establishment and management of educational and health institutions.¹⁸

The expectation of uninterrupted resource allocation, efficiency and competitiveness from a market economy is asking for too much as firms possess miserably weak capabilities. The best way to play within the framework of a free market game is to take control of and protect ones own market. This is where a need and priority-based policy is recommended, where the local beneficiaries are the principal actors of development planning and execution.

The challenge is therefore, to sustain growth for one decade at least, through medium-term programmes, to reduce the risk of conflict from re-occurring. Efforts should be made to transform fragile institutions with illegitimate power structures into institutions that intend to promote economic and social interactions among all the actors of development.

Nepal, with a diverse population structure (70 languages and dialects and more than a hundred caste and ethnic groups) has one of the world's highest ethno-linguistic fractionalisation. This necessitates emphasis on administrative and political decentralisation to adequately recognise local preferences, needs and constraints.

Conclusion

The fundamental challenge of development is to achieve growth with equity. In other words, the task in the new Nepal is to strike a balance between income distribution, and efficiency in allocation and economic growth. The challenge is to devise strategies and instruments of growth, and a redistribution policy to ensure that the benefits of growth trickle down to the poor. Despite the fact that there is increased awareness among the underprivileged groups, socioeconomic benefits have disproportionately benefited the poor.

Many countries have experienced a growth collapse. Dani Rodrik through econometric evidence observes that the reason it happens is largely because of the domestic institutions of conflict-management and the fact that conflicts interact with external shocks.¹⁹ The sharpest decline in growth is linked to those with divided societies as measured by inequality, ethnic fragmentation, and the like and with weak institutions of conflict management, i.e. the quality of governmental institutions, rule of law, democratic rights, and social safety nets.

New dimensions on inequality have come out that necessitate additional work to find out the causes and the impact of inter-country or intra-country malfunction in economic management. For example, although the level of uncertainty in the estimates is significant, the trend of global income and consumption inequality is extreme over time, based on the state of economy of 124 countries in the world. The result shows that such inequality is primarily due to the differences in average incomes across countries rather than due to intra-country inequality.²⁰ The fact that the negative impact of low economic growth has far outweighed modest improvements in within country income inequality is substantiated by literature.²¹

As PPP exchange rates are higher than the market exchange rate, literature shows that the per capita income gap between the richest and the poorest global population quintiles is reduced when PPP exchange rates are used. However, if we use market exchange rates, the review of income distribution in 141 countries shows that the richest population quintile gets 83 per cent of global income with a single percentage point in the poorest quintile. It would take more than 800 years for the bottom billion to achieve 10 per cent of global income under the current rate of change.²²

A review of global literature on income inequality poses a question on the efficacy of the global development model under the market-based economic liberalisation programme. The question is development for whom if we fail to place equity at the center of the development agenda.

To conclude, under the existing institutional and governance framework, the expectation of development outcomes from usual policy interventions may not materialise. Therefore, while it is most likely that the non-beneficiaries will have strong reservations, the government should initiate affirmative action programmes, especially for the targeted groups and for the weaker or under-resourced region by directing targeted investment in infrastructure improvement; health clinics; and transportation networks to link non-dominant areas. The modalities should be agreed upon based on inter-party consensus before finalising the federal constitution.

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ANNEX 1

Table 1: Chronology of Important Events

1950-51	Rana's fall; King Tribhuvan regains control over army and administration; interim constitution enacted.
1952	King Mahendra Bir Bikram Shah Dev ascends throne.
1956	First Five-Year Plan of economic development initiated.
1959	King Mahendra enacts new constitution; first general election brings the NC to power with B.P. Koirala as the Prime Minister.
1960	King Mahendra dismisses the democratic government and imprisons B.P. Koirala and other NC leaders.
1962	New constitution is promulgated, which establishes one-party Panchayat system.
1963	First elections held to National Panchayat.
1972	King Birendra Bir Bikram Shah Dev ascends throne.
1980	Panchayat System continues through the thin margin in national referendum.
1982	The death of B.P. Koirala.
1989	Stalemate in India-Nepal relationship—failure to renegotiate trade and transit treaties disrupts Nepal's economy.
1990	Democracy is restored and new constitution promulgated.
1991	Elections are held to Parliament; NC leads the government.
1994	The rift in the NC leads to the dissolution of the parliament. After the mid-term election, CPN (UML)'s minority government is led by Manmohan Adhikari.
1995	After nine months rule, CPN (UML) is ousted and NC leads the coalition government.
1996	Maoist insurgency begins.
2005	King Gyanendra's direct rule, with the dismissal of Parliament; lifting of State of Emergency; the 12-point agreement between NC, CPN (UML) and Maoists to end King's rule.
2006	King agrees to reinstate Parliament; a Comprehensive Peace Agreement (CPA) with Maoists is made for establishing the Federal Republic of Nepal.
2007	Maoists join interim government; abolition of monarchy.
2008	Maoists win majority seats in CA election; Nepal officially becomes a Republic.
2008-2012	CA dissolved on 29 May 2012; peace-building; constitution-making; and state restructuring remains incomplete.
2012	The beginning of political and economic uncertainties.
2013	Formation of interim government led by the Chief Justice of Supreme Court to hold CA election; New dates for CA election, 19 November 2013.

Source: Nepal: Chronology of Important Events, Mongabay and authors own sources

16

Economic Development in Afghanistan: Challenges and Prospects

Mohammad Sulaiman Akbari

Introduction

The withdrawal of foreign troops from Afghanistan in 2014 is much publicised these days and there are fears that Afghanistan might once again witness a civil war. However, the progress made during the last decade has been often overwhelmingly neglected. Year 2014 and the start of the ‘Transformation’ decade is certainly a test of history for Afghanistan. While there is the probability that Afghanistan may not be able to sustain the developments made during the last decade, some see it as an opportunity for Afghanistan to shift to a new model of development rooted in the private sector as the main generator of jobs, economic growth and development, the start of a decade of gradual shift from aid dependency to self-sufficiency. The paper outlines the developments in Afghanistan so far, the challenges and the prospects of developments post-2014. The structure of the paper is as follows. The first section of the paper briefly discusses the developments made in the past decade in economic, social and political spheres. The second section explains the positive factors affecting developments. It also discusses the barriers for economic growth and development of the country. The third section discusses the way forward for development in Afghanistan and especially for the years post-2014. It also analyses the prospects for regional cooperation and trade integration for Afghanistan. The fourth section lays out the conclusion of the paper.

The Milestone

Years of conflict destroyed the economy, disrupted trade, left the country with virtually no assets in terms of means of production and human capital, and led to the emergence of a ‘shadow economy’ including profiteers, businessmen engaged in illicit activities, drug traffickers, and truck drivers.¹ Moreover, women’s

participation in the economy was zero, school enrolment had fallen, mortality rate was extremely high and people had no access to basic healthcare.

Since 2001, the economy has taken off considerably. The economy has been growing at an average rate of 9 per cent² during the course of the last decade, and the per capita income has increased five-fold. Inflation which was characterised as 'hyperinflation' prior to 2002 is now in single digits. The average core inflation for the period 2007-08 to 2012-13 was 7.95 per cent.³ The financial sector has rapidly increased; the total assets of the banking sector which were less than US\$ 300 million in 2004 soared to US\$ 5.3 billion in December 2010. An estimated US\$ 8.9 billion has been invested by the private sector, in different sectors such as agriculture, agri-businesses, services and industries.⁴ The volume of trade amounts to over \$9 billion.⁵ The trade deficit which was over 60 per cent of GDP in 2005 has declined to 43 per cent.⁶ Besides, the mortality rate has decreased to 111 in 1000,⁷ people have access to basic healthcare facilities and primary health care coverage expanded from 8 per cent in 2001 to 68 per cent in 2008.

Huge investments have been made in education and the number of children going to school has significantly increased to 7.9 million out of which 38 per cent are girls. So far about 14,500 schools, 69 government and private universities, 62 vocational and medical institutes have been established⁸ or in some cases rebuilt. Women now take part in social, political and economic activities of the country. The participation of women in all spheres of public life is essential for the development and advancement of women. Studies suggest a strong correlation between a country's gender gap and its national competitiveness. Women account for one-half of a country's potential talent base, therefore, a nation's competitiveness depends significantly on whether and how it educates and utilizes its women.⁹ Furthermore, rural development programmes, such as the National Solidarity Programme (NSP), have delivered basic infrastructure, including protected water sources, micro-hydropower plants, and improved irrigation to tens of thousands of villages. The country's road network has been extensively rehabilitated, and travel time between major centres has reduced up to 75 per cent. Rebuilding the electricity sector has also brought about substantial improvement, with operational capacity expanding 2.5 times between 2002 and 2011.

In spite of the presence of the international community and an aid flow of over a \$100 billion, Afghanistan lags behind many other low-income countries in social and physical infrastructure. The country still suffers from an unstable economy and has a high unemployment rate of 40 per cent. The country is not yet capable of financing its budget and is dependent on aid. In addition, high illiteracy rate, terrorism and insurgency pose serious threats to the economic development of the country.

Factors Affecting Development

In the past decade, some factors have positively contributed to the growth and development of Afghanistan and they need to be strengthened further. Some factors have however, impeded the growth of the country. Positive factors that have contributed to the country's development are discussed below, followed by barriers to the development process.

Market-Based Economy

Following the overthrow of the Taliban in late 2001, and the adoption of a new Constitution in 2004, the Afghan economy also underwent a structural change. The new Constitution acknowledged 'market economy' as the preferred economic system and guaranteed the promotion and protection of private investment. Considering the role of private investment in the economic development of the country, the government laid down favourable policies to promote and support private investment in the country. Afghanistan now ranks 28th in starting a business in *World Bank Doing Business 2013*¹⁰ Report and charges the lowest tax in the region. Since 2001, several industrial parks have been developed and a few others have been planned to be built and developed over the course of next five years in major cities.

Despite the uncertainty about the transition in 2014, the investment outlook remains highly favourable towards Afghanistan. Afghan-US Strategic Partnership Agreement and the strong support in Partnership Agreements (EU, France, Germany, Italy, and India) for private sector development and promotion of private investment helped in addressing some of the uncertainties for the future, ensuring political stability in the long run. As per the officials at Afghanistan Investment Support Agency (AISA), investment is up 20 per cent in the first nine months of 2012 compared with the year before.¹¹

Trade Liberalisation

In the last decade, the economy has been highly liberalised and the government has focused on private sector-led growth. Afghanistan remains one of the most open economies to trade and investment among the Least Developed Countries (LICs). It has the lowest tariff rates in the region, both among the South Asian and Central Asian countries. Since 2002, the government has tried to lower the tariff and legal trade barriers, and this process was intensified after it agreed in 2006, to receive financial support from the IMF, under the Poverty Reduction, Growth Facilitation Programme (PRGF).¹² To further strengthen trade relations, Afghanistan became a member of regional economic cooperation organisations such as South Asian Association for Regional Cooperation (SAARC) and Economic Cooperation Organisation (ECO), and has signed SAARC's Agreement on South Asian Free Trade Area (SAFTA) in 2008. Exports now amount to nearly \$2.61 billion and constitute over 13 per cent of the GDP.¹³

It should be noted that while trade liberalisation has contributed positively to the economy and has increased the GDP in the short-run, it has also negatively affected the investments in the country. The flaws will be discussed later in this section.

Private Sector Development

Recognising the role of private sector in growth of the economy, policies were laid to improve the development of private sector in the country. Several state-owned enterprises were privatised, and a number of public private partnerships were created. The number of private companies which were a few hundred rose to over 36,000 in 2013.¹⁴ Charging the lowest tax in the region, ease of starting a business, 100 per cent foreign ownership, no barriers on remittances, no restriction on profit or other cash repatriation are some of the factors that makes the country a favourable destination for investment. Foreign investment now accounts for one third of the total investment in the country.

Economic, Political and Social Infrastructure Development

Reconstruction and rehabilitation of roads, operationalisation of the railroads (in some parts), increased access to electricity and enhancement of its capacity, development of industrial parks, improved financial system, transportation, telecommunication, etc. are some of the developmental activities of the last decade. Besides these changes, other reforms that took place since 2001 included the restoration of the rule of law, draft and approval of the new Constitution, institutional developments, enhancement of social justice, and establishment of various civil society organisations and improvement in health and education services.

Foreign Aid

According to the World Bank data, over the period 2000-2009 Afghanistan was the sixth largest recipient of official aid in terms of proportion to GDP. The average aid Afghanistan has received amounts to 35 per cent of the country's nominal GDP, which currently stands at \$19.8 billion.¹⁵ Regardless of the criticism about how the aid would be more effectively used if it had been channelled through the government budget, economic recovery achieved since 2001 has been based on large-scale international aid, recovery of the agriculture and industries sector, and substantial growth in the services sector.

While the aforementioned factors have positively contributed to the economy of Afghanistan and its progress in development, the barriers to the development in the country are discussed below.

Political Uncertainty and Security Concerns

A decade after the military intervention of the international community, Afghanistan still faces insurgency, lack of security and political stability. Empirical studies have found that political instability and political tensions increase macroeconomic instability and may affect long-term growth either directly, or indirectly through inducing economic volatility.¹⁶ Security concerns not only cause social unrest, but are also a hurdle to the economic development of the country. Intensification of violence in recent years has raised serious questions about the ability of the government to fight terrorism and insurgency post 2014. Security threats are also a barrier to the investment in the country. Closure of Afghanistan Investment Guarantee Facility (AIGF) in 2011 and burdensome procedures of Multilateral Investment Guarantee Agreement (MIGA) of the World Bank discourage those who are keen to invest, due to fear and political uncertainty. There is a need for an agency to guarantee risk mitigation in case of any unforeseen circumstances.

Weak Institutions and Corruption

When institutions are weak, the negative impact of exogenous shocks on the economy is amplified, and resources in the economy are expropriated by political elites. Undoubtedly, Afghanistan is an institutionally-weak country which has lost its entire institutional infrastructure, during its more than two decades of political crisis. Poor rule of law, inefficient judicial system, widespread corruption, government inefficiency, absence of property rights, high degree of political instability, and absence of egalitarian and democratic rights are some of the most important institutional deficiencies in Afghanistan.¹⁷ Low administrative capacity of governmental institutions, existence of parallel organisations, an ad hoc system of governance, non-existence of monitoring and evaluation mechanisms to gauge the effectiveness of the plans and policies adopted, implementation of programmes based on the experiences of other countries without tailoring it to the needs of Afghanistan, etc. all affect the economic growth and development of the country.

Corruption is indeed another result of the weak institutions. Kabul Bank crisis¹⁸ is probably a small example of the degree of corruption that exists in Afghanistan. According to Transparency International, Afghanistan ranks amongst the five most corrupt countries in the list of the world's most corrupt nations. Corruption exists at various levels in the country. Despite frequent pledges of the government to fight the widespread corruption, it has failed to do so, possibly because of the involvement of high-ranking officials in corruption, as well as the involvement of their relatives and the people in power. Though during the Tokyo Conference in 2012, the government, once again, pledged to tackle corruption in the country, there has not been much progress in dealing with it. The problem is deeply embedded in the system, and a fundamental change is required, along with a political will to bring about such change.

Inefficient Government Policies

The Afghan economy is highly exposed to external shocks, particularly to terms-of-trade shocks. In 2008, world commodity price shocks pushed domestic inflation to 43 per cent in May, and within 12 months the Consumer Price Index (CPI) inflation dropped to -12 per cent, indicating a strong deflation. On the other hand, the growth rate has fluctuated between 3.2 per cent and 20 per cent in the last decade, which was primarily due to fluctuations in agriculture output, induced by climatic shocks. Agriculture production in Afghanistan is largely dependent on rain-fed cultivation, and the lack of a proper irrigation system makes agriculture output dependent on the mercy of the climate. Therefore, macroeconomic volatility is significant in Afghanistan due to the economy's high exposure to external shocks and to climate shocks.¹⁹

Macroeconomic volatility is a serious concern for developing countries. It has significant costs in terms of welfare loss and it increases poverty and inequality. Appropriate structural policies have not been undertaken in Afghanistan to decrease the economy's exposure to external shocks, reduce its vulnerability to climatic shocks, and to bring about macroeconomic stability in the country, which is a necessary condition for growth and development.

The excessive liberalisation policy undertaken by the Afghan Government in the last decade did not favour growth of domestic industries. Lack of government support to local industries and the dumping policies of import partners, especially the neighbouring countries have severely hampered the growth of local businesses. Afghanistan remains one of the most open economies in the region. This is a positive characteristic according to mainstream economic theory. However, the current level of trade deficit does not seem to be sustainable, especially for the next 5 to 10 years. In the last 12 years, the huge trade deficit which currently stands at 43.1 per cent²⁰ has been offset in the current account by large foreign aid inflows, and thus the balance of payments has been in equilibrium and the exchange rate is stable. However, a decline in foreign aid, which is likely to happen in the medium term, will severely destabilise the economy by enlarging the current account deficit. Therefore, the Afghan Government needs to bring down its trade deficit to a sustainable level, while preserving its trade openness and even increasing its volume of trade, by boosting exports. The government needs to encourage domestic production and boost exports through export promotion policies and attracting FDI (Foreign Direct Investment). Agriculture and natural resources are the two sectors that give Afghanistan the potential to decrease its macroeconomic volatility, diversify the economy, generate economy-wide growth, boost exports and thus reduce the trade deficit.

The Way Forward

Political Leadership is Crucial

There is little disagreement about the fact that the year 2014 is a crucial point of time for Afghanistan's future, as the country faces military withdrawal, i.e. military transition, decrease in the aid flow, economic transition and most importantly, elections and political transition. The International Crisis Group has warned that the Kabul Government could fall apart after the withdrawal of NATO troops', particularly if the Presidential elections are plagued by fraud. The transparency and credibility of the elections are of paramount importance.

Uncertainty over sustainability of the decade long development, dependence on the inflow of aid, volatility and inconsistency of growth, insecurity and insurgency, ethnic and fractional fragmentation are some of the critical problems facing the Afghan economy. Political leadership has never been more crucial than it is now. It can either undermine all the efforts since 2001 to make Afghanistan a self-sustaining economy, or it can lead the country down the road to transformation and beyond. One of the main lessons drawn from other countries is that successful transitions require political consolidation and strong national leadership. Therefore, the international community and the Afghanistan Government must now concentrate more on the institutionalisation of democratic polity and the promotion of democratic political culture and good governance in Afghanistan.

The Effect of Withdrawal and Declining Foreign Aid

Foreign aid has undoubtedly contributed to development in Afghanistan. However, most international spending on Afghanistan is not spent in Afghanistan, as it leaves the economy through imports, expatriated profits of contractors, and outward remittances. The local content of 'external budget' aid is estimated at only 10–25 per cent, compared with around 70–95 per cent for 'on-budget' aid. With the bulk of aid (88 per cent) going through the external budget, its local economic impact is limited.²¹ Another study finds that the bulk of US assistance goes into security-related activities.²² Since 2001, more than half (57 per cent) the total US assistance has gone to the Afghan Security Forces Fund (ASFF) followed by economic, social and political development, which account for 31 per cent of the total aid. The main provider for these programmes is United States Agency for International Development (USAID).²³ A third element of assistance – humanitarian aid represents about 4 per cent of the total aid. Counter-narcotics programmes account for about 8 per cent of the total aid.

A study by the World Bank suggests options for the government, and the international donor community, to manage and mitigate the adverse impacts of transition, like declining aid, while exploiting the opportunities to improve aid effectiveness. Donors need to reduce future aid flows gradually to avoid major

disruptions. Several risks arise from a faster withdrawal of aid, including a rapid depreciation of the *Afghani*, high fiscal imbalances and associated adjustment costs, and potentially destabilising effects on labour markets (such as higher underemployment, lower wages, and loss of household income opportunities). The private economy and the government need time to find substitutes for official aid flows.

Prospects for Growth and Development

As per the projections of the World Bank, GDP growth of Afghanistan was expected to fall from 9 per cent a year between 2000-10, to around 6 per cent a year during 2011- 18 and further to 5 per cent a year over the longer term.²⁴ This projection assumes that the Aynak (copper) and Hajigak (iron ore) mines produce as expected, the investment climate improves moderately, agricultural productivity increases, and aid declines only gradually, to 23 per cent of GDP by 2018, and 10 per cent by 2025. The report also suggests that the most severe adverse impact of transition will be on the fiscal situation. Afghanistan could face a projected financing gap of 25 per cent of GDP by 2021/22, even higher in some of the intervening years. To close this financing gap, the report suggests that Afghanistan must rely on continuing international funding to pay for most security costs. It will be essential that the government, working closely with donors, ensures that the core civilian budget does not become a casualty of high security expenditure and falling aid. A reasonable approach could be for domestic revenues to cover the civilian operating budget and part of the security costs (at the current level of 3 per cent of GDP). Donors would finance the remaining bulk of security costs, plus a more highly prioritized core development budget.

The policies of the government thus need to be streamlined in a way to minimise the economic shocks that the country may face because of the declining aid. Stimulating output in key sectors (agriculture and natural resources), diversifying the production structure, promoting strong, efficient and democratic institutions and, developing a sound financial sector could be some of the measures that can be considered for addressing the causes of economic instability in the country. Stimulating output in agriculture ensures sustainable economic growth, significantly decreases poverty, reduces exposure to terms-of-trade shocks and the impact of supply-side shocks, while stimulating output in natural resources increases fiscal revenue and improves fiscal sustainability, reduces unemployment, improves Balance-of-Payments position and increases foreign exchange reserves.²⁵

The Role of Agriculture and Extractive Industries

Empirical evidence shows that involvement of the private sector is crucial for ensuring the development of the economy. An estimated \$8.9 billion has been invested in the country. In spite of its direct impact on reduction of poverty and increase in employment, private investment in agriculture has been considerably

small. Thus encouraging government policies to promote the sector and attract investment are required. Government policies should be streamlined towards promoting investments in improved agricultural practices, investments in irrigation systems, investment in value-adding industries, agribusinesses and export-oriented industries.

Natural resources, on the other hand, are valuable for Afghanistan to become a self-reliant economy. Mineral deposits of Afghanistan have been estimated to be between \$1 trillion and \$3trillion by the United States Geological Survey (USGS) and Afghan Government, respectively. These natural resources are Afghanistan's hope for the long-run. Thus building the required infrastructure, implementing a transparent system of contracting, monitoring the proper utilisation of the generated income from this sector, and adopting measures to ensure avoidance of a resource crunch are crucial for Afghanistan.

The Role of Private Sector

The private sector is a key player in sustaining and aiding further growth of economy in Afghanistan post-2014. An estimated amount of \$8.9 billion has been invested in the country since 2001 mostly in the services sector, because of high yield in short-run. Some recent investments have been made in mining projects. However, the government needs to align its policies towards attracting investments in sectors like agriculture, agribusinesses and industries, because not only do these sectors employ over 80 per cent of the workforce, but they also have direct impact on the low income segment of the population.

Afghanistan needs to improve the business climate and streamline its policies towards promotion and support of private investment in the country. A good starting point for implementing this could be focusing on the business indicators of the *World Bank Doing Business* Report in which Afghanistan ranks 168th. Streamlining policies towards improvement of the financial sector, ensuring the enforcement of law, and building infrastructure play an important role in attracting the investor. Furthermore, political risk insurance of Multilateral Investment Guarantee Agency (MIGA), Overseas Private Investment Corporation (OPIC) and other credible agencies can guarantee investors protection in the country, in which according the aforementioned report, Afghanistan ranks 185th.

Administrative Reforms

The bureaucracy has been a major hurdle to the development of the country and a major factor in growth of corruption. This is mainly because of the lack of capacity, technological backwardness, uneven and unsystematic salary system and existence of parallel organisations. Transition provides an opportunity to rationalise the terms and conditions of externally funded staff, bring them into a coherent framework of government capacity, and integrate them with the regular civil service over the longer term—all putting government functioning and service

delivery on an affordable, sustainable path. Furthermore, transition offers a compelling opportunity for the government to review its dependence on technical assistance, in its development strategy, and to consider the extent to which it can afford to absorb current costs in the future.

The World Bank points to two lessons learned, from the past 10 years and puts forward suggestions for reform in the civil services. The first lesson is that reforms within the government must be led by the relevant reforming institution, rather than being imposed from outside. These reform plans will encourage the development of achievable but challenging service delivery, and process reform targets. The second key lesson is that capacity building should be grounded on existing ministry structures and should not create parallel institutions.

This intervention of the World Bank has four main advantages. First, it will enable the government to offer competitive salaries in a heated labour market, increasing accountability of the local staff and reducing reliance on externally funded staff. Second, the reforms will help set up a cadre of senior professional staff to execute reform of key departments in ministries and agencies. Third, it will work toward institutionalising civil service management capacity, marking a shift from ad hoc capacity injection to more sustainable management positions. Fourth, by emphasising comprehensive reform throughout ministries, the action plan will stress capacity to enhance service delivery substantially through better planning, coordination, and use of resources.²⁶

Education and Capacity Building

The root cause of most of the problems in Afghanistan whether insurgency, violence, backwardness or unemployment, is the lack of access to education. The illiteracy rate is still very high in men and even higher in women, 61 and 88 per cent for males and females, respectively²⁷ In spite of some degree of achievement, the international community and the donors have failed to address this vital issue. Rather than focusing on fundamental changes in the education system with a long term orientation, the focus has been on short-term vocational training and capacity building programmes. Though the number of schools and universities has increased the quality of education remains very low, and is incompatible with the requirements of the employers.

According to a survey, there is widespread concern over the quality of education being imparted in schools owing to the poor qualifications of some teachers, lack of a standardised curriculum, lack of evaluation standards, and lack of sufficient basic school supplies. Statistics collected in 2009–10 by a national teacher registration system indicate that only 27 per cent of the 162,000 registered general education teachers are educated at a grade 14 level, which is the official minimum requirement for teaching, or for applying for higher positions.²⁸ The government thus needs to put more emphasis on quality education, as indicated in the National Priority Plans (NPPs), and on drawing up policies to ensure the

quality and standards of education and on standardizing the curriculum. Only an educated population can transform Afghanistan into a prosperous country.

Prospects for Regional Cooperation and Trade Integration

The South Asian region has historically served as a hub of interlinking trade routes at the crossroads of Europe, Asia, and the Middle East through which ideas, goods, and people passed from one continent to another. However, for all its economic potential, the region remains one of the least economically integrated areas of the world. According to the World Bank²⁹, though South Asia has experienced a long period of robust economic growth, averaging 6 per cent a year over the past 20 years, it is the least integrated of global regions, and barriers to trade, investment, and movement of people are very high in this region. In 2010, South Asian countries' trade with one another amounted to only 4 per cent of their trade with the world. This is very low compared with intraregional trade rates of 26 per cent for ASEAN members and 64 per cent for EU countries within the same year.³⁰

South Asia has the potential to accelerate growth and reduce poverty if the region can exploit four under-utilized spatial features of the area: 1. geography, 2. transportation, 3. mobility, and 4. scale economies. Regional cooperation can be a powerful tool for increasing growth, reducing the gap between leading and lagging regions, and reducing vulnerabilities for the poor.

Geo-strategic Location of Afghanistan

Situated at an important geo-strategic location, Afghanistan is usually referred to as the 'bridge' between South and Central Asia. Afghanistan plays an important role in linking South Asian countries to the markets in Central Asia, and at the same time can be a passage for transferring energy resources from the oil and gas 'rich' countries of Central Asia to the South Asian countries, India and Pakistan in particular. The recent agreements on the Trans-Afghanistan pipeline and the construction of a cross-border electricity transmission line are examples of Afghanistan's role in regional cooperation.

The \$7.6 billion Trans-Afghanistan Pipeline (also known as Turkmenistan–Afghanistan–Pakistan–India Pipeline or TAPI) developed by the Asian Development Bank will transport Caspian Sea natural gas from Turkmenistan through Afghanistan, into Pakistan and then to India. The TAPI pipeline will have a capacity to carry 90 million metric standard cubic meters (mmscmd) per day of gas for a 30-year period and is likely to become operational by 2018. The Afghan Government is expected to receive 8 per cent of the project's revenue. Projections suggest the country would receive nearly \$400 million in annual transit fees, as well as 14 million standard cubic meters of natural gas per day.

In 2012, Pakistan, Afghanistan, Tajikistan and Kyrgyzstan signed a deal estimated at \$1 billion to construct a dedicated cross-border electricity transmission line. The contract is for 30 years and the project is expected to be commissioned in 2016. Under the Central Asia, South Asia (Casa-1000) electricity trade, the construction of the link is essentially aimed at supplying 1,300 megawatts of surplus hydropower available during the summer months from Kyrgyzstan and Tajikistan, to Pakistan and Afghanistan. Pakistan will import 1000MW of surplus electricity while Afghanistan will import 300 MW. It is estimated that in Pakistan, the typical business loss is 5.6 per cent in annual sales revenue, owing to power outages, against a reported loss of 2 per cent by its Chinese counterparts.

Given the increasing demand for energy resources in the South Asian economies, particularly in the emerging India, and the proximity of resource-rich Central Asian countries, Afghanistan attains an important role in such a geostrategic context. Afghanistan can play an important role in regional cooperation in South Asia, and in inter-regional trade and economic cooperation with Central Asia. But it mutually benefits from trade integration and regional cooperation, particularly in South Asia.

Importance of Trade Integration for Afghanistan

Being a landlocked country and acknowledging the role and the importance of regional cooperation, Afghanistan has chosen to move towards trade integration with regional economies. It is now a member of regional economic cooperation organisations such as SAARC (South Asian Association for Regional Cooperation) and ECO (Economic Cooperation Organisation), and has signed SAARC's Agreement on SAFTA (South Asian Free Trade Area) in 2008. The South Asia region is expected to grow as an increasingly important trading partner for Afghanistan, especially with the introduction of the South Asia Free Trade Agreement (SAFTA) and Afghanistan-Pakistan Transit Trade Agreement.³¹ While 27 per cent of the country's imports are from South Asian countries, Afghanistan exports 60 per cent of its goods and services to the South Asian region. Integration in trade will result in lowering the cost of trade and will contribute to the development of the countries across the region.

In addition to the large volume of trade between Afghanistan and the South Asian countries, Afghanistan's extractive industries are yet another reason for enhancing regional cooperation. Recently, a private Indian-led consortium of investors secured a bid on 1.8 billion tons iron ore in the Hajigak while a Chinese company secured the bid on Amu Darya oil basin. A few years earlier, a Chinese firm secured mining rights to Afghanistan's Aynak copper mine reserves.

The expected increased volume of trade between Afghanistan and the South Asian countries reinforces the idea of the New Silk Road Initiative.³² An Afghanistan connected to the South and Central Asian region through the revitalisation of the ancient Silk Road, will not only help re-establish Afghanistan

as a land-bridge, but also help sustain its economy by facilitating and connecting the transit of goods and energy across the region.

At present while intra-regional trade accounts for only around 15 per cent of total trade, the road, rail and power connectivity provided by the New Silk Road Initiative, can boost regional trade significantly. Through maximising the use of transportation and energy infrastructure and actively promoting cross-border collaboration and trade, Central and South Asia can once again become a bustling hub for global commerce. The economic potential of a more open and integrated region, as dynamic as this one, is virtually unlimited. As the New Silk Road vision becomes a reality, it's easy to imagine textiles and tea made in Bangladesh making their way through Afghanistan to Central Asia, while Kazakh wheat and energy moving southward to feed families and light homes in Pakistan and India.³³

The government of Afghanistan thus needs to lay down practical steps to address impediments such as underdeveloped transportation infrastructure, unnecessary bureaucratic practices at the borders, and continued insecurity and instability in the country. Moreover, as suggested by S.L. Bathija, Afghanistan must break down the barriers to regional trade and transit. It must invest in transportation and energy infrastructure to facilitate the growth of transnational economic corridors and must attract foreign investment.³⁴

Conclusion

As the World Bank puts it, it takes a generation for even the fastest institution to undergo transformation. It took the 20 fastest moving countries, an average 17 years to get military out of politics, 20 years to achieve functioning bureaucratic quality, and 27 years to bring corruption under reasonable control.

Afghanistan has come a long way towards development, since the fall of Taliban regime in 2001. The GDP has grown rapidly, the per capita income has increased five fold, domestic and foreign investment, as well as trade, has hugely increased. Further, school enrolment has significantly increased and health facilities have improved. Adoption of the new Constitution has also contributed to various positive changes in the political and social spheres, including the role of civil society organisations, women's participation in different arenas of life, social services, etc. However, on the downside, inefficient government policies, existence of weak institutions, political uncertainty and insurgency have hampered growth and are serious threats, especially after the withdrawal of foreign troops in 2014.

The year 2014 is undoubtedly a critical point of time in Afghanistan's history, as it determines the future of the country. Good governance, prudent economic choices, support of investment in key sectors such as agriculture and mining, and consistent support of the international community (at least for the next one decade) are the tools to transform Afghanistan into an economically self-sufficient,

politically stable and a socially developed country. In addition, regional cooperation and trade integration is another factor that boosts the economic growth in the region. Giving primacy to economic issues and not allowing political differences to stand in the way of regional cooperation, the South Asian region can also be as integrated, as were the East Asian economies. Afghanistan being a land 'bridge' between the resource rich Central Asia and fast growing South Asia, plays a vital role in the region, and doing so, contributes to its own economic growth.

NOTES

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33. No.29.
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17

Strategy of Sustainable Growth in Bhutan

Tenzing Lamsang

In the South Asian region, Bhutan has perhaps recorded the most dramatic economic growth and development, over the last 50 or so years. Real GDP growth averaged 8 per cent per annum in the last decade.¹ A discussion on the modern Bhutanese economy requires a brief historical, political and geopolitical overview as all these factors have contributed to the Bhutanese economy in its current form.

Prior to 1907, Bhutan though an independent and sovereign country of long standing, did not have a strong central authority, post the collapse of the theocratic and temporal authority of the Shabdrung, that had been established in the 17th and 18th centuries. As a result, for around 200 years, there were power struggles between regional feudal lords and noble families, as there were only nominal heads at the centre. These incessant conflicts coupled with its isolation and location, ensured that even when major economies were heading into the modern era, Bhutan still largely remained a medieval economy. As a result, the economy, predictably, was a very basic subsistence agriculture one, with a limited barter trade in some surpluses, primarily with neighbours such as Tibet and India's Bengal region. As in any feudal economy, the people were taxed for basic necessities, like food grains, butter, meat, ash, etc.

Bhutan's foreign policy changed from after the Anglo-Bhutan war in 1864-65 which impacted its trade and economy. This war was Bhutan's first major and close encounter with an expansionist and colonial power, the British Empire, which at the time, was gobbling up or subjugating its neighbouring Indian princely states. Bhutan under the leadership of an influential noble, Trongsa Penlop, Jigme Namgyal—the father of the first King—united all factions in Bhutan against the British. Though Bhutan won some initial battles, the British with their reinforcements and modern technology, eventually won the war. The result was that Bhutan lost large sections of its occupied territory, the Duars-18 in all –

now called Assam and the Bengal Duars. The Duars had earlier been conquered by Bhutan, from its neighbouring princely states.

The economic impact of this defeat was quite significant, as Bhutan lost large tracts of fertile lowlands where large quantities of rice, vegetables and fruits were grown by the local non-Bhutanese Duar residents, under the rule of the Bhutanese government. The agricultural products and taxes from the Duars were a major source of Bhutanese income.

The war, however, also had an impact on domestic politics, and Bhutan's foreign policy of the time, and consequently on Bhutan's trade and economy. On the domestic front, the Bhutanese realised that they needed to unite under one leader; on the foreign policy front, a small Himalayan kingdom that had successfully held off successive waves of Tibetan and Mongol invasions in the 16th and 17th centuries, had to engage with the reality of an aggressive, and expansionist British Empire at its doorstep.

In 1907, to address the leadership issue, all Bhutanese noble families, regional lords, the monk bodies and representatives of ordinary people came together to sign a historic 'Genja' (agreement), that brought forth the monarchy in Bhutan, under the first king, His Majesty Ugyen Wangchuck. This led to the creation of a stable central government with uniform laws, security and stability. As a result trade prospered. Bhutan because of its trade routes between Tibet and India became a trading centre whereby grain, cotton and finished goods were exported from Bengal and Assam to Tibet. Bhutan exported wool, gold and salt from Tibet to India. This was in addition to Bhutan's own exports of grains and other products.

During the reign of the first King, and second King, His Majesty Jigme Wangchuck, political and administrative institutions were put in place, taxes were reduced considerably, trade routes improved and Bhutan's foreign policy effectively positioned Bhutan as a neutral and strategic buffer state, between the British Empire in the south, and the Russian and Chinese empires in the north. The basic structures of modernisation like the first schools, hospitals etc were built. The monarchy in that sense not only provided domestic stability, but also gave Bhutan a beneficial and practical foreign policy, that allowed for cooperation with great powers, without compromising its sovereignty and security. As a result, trade and economic development prospered. It was also during this time, that Bhutan's political diplomacy also became closely intertwined with its economic needs and interests.

Events in the 1940s and 1950s were hugely significant for Bhutan—not only politically but also economically. In 1947, India gained independence from the British, and in 1958, Pandit Jawaharlal Nehru as the head of a democratic and friendly neighbour India, visited Bhutan, and laid the foundation for close and friendly ties between the two nations. In 1959, Tibet with which Bhutan had economic and religious ties for centuries, was invaded by Chinese troops,

leading to the closure of the northern border, which continues till this day. Chinese troop movements near the Bhutan border; Chinese claims to large sections of Bhutanese territory and annexation of Bhutanese enclaves in Tibet; statements such as Tibet being the palm and Bhutan being one of the five fingers; and other such developments, prompted Bhutan to have a southwards orientation towards India. These external events, especially in the 1950s, also impelled Bhutan, like never before, to come out of its isolation, and opt for rapid economic development, to strengthen its sovereignty and security, and take its rightful place at the international stage.

The 1962 Sino-Indian war in turn, made India realise that it needed to secure and strengthen its eastern front and also have a strong, developed and secure Bhutan as a friendly buffer state. The coming together of Bhutan and India, unlike the earlier limited relationship with the British Empire, was based on common strategic, developmental and economic interests. Most importantly, it was accomplished in an environment of respect and friendship, with the encouragement and personal touch of leaders, at the highest levels, in both countries. It was a diplomatic, strategic and economic model, that worked in the interests of both countries. Despite some occasional differences the relationship continues to be a mutually beneficial one.

The Five Year Plans²

With the Bhutanese leadership keen on opening up, and the Indian leadership keen on helping, the first major stage of cooperation, which still continues to this day, consisted of the five year plans. The first four, five year plans from 1961 to 1981 were largely funded by the government of India. These plans allowed Bhutan to modernise effectively, with focus on building highways, schools, hospitals, and mini-hydro electric plants, putting in place administrative structures, and promoting agriculture and revenue generating economic activities, and other social programmes.

India's assistance for Bhutan's planned development has averaged around 30 per cent from the 5th to the 10th plans. Bhutan now, is also able to finance more programmes on its own, apart from getting funds from multiple sources like the United Nations, other countries, international financial institutions etc. But several other capital works such as road construction and hydro power projects, that are jointly undertaken by India and Bhutan are not covered by these plans. The financial expenditure envisaged in the plans has also increased tremendously, from Nu 107 million in 1961 to Nu 147 billion in 2008.³ The draft 11th plan is pegged at Nu 216 billion, of which India is expected to provide Nu 45 billion.

These developments along with other economic activities, increased Bhutan's Gross Domestic Product—at current prices- from Nu one billion in 1977 to Nu 85.5 billion in 2011. The per capita income in Bhutan touched \$ 2,590, placing

it just behind Maldives, and Sri Lanka in South Asia. By 2020, Bhutan is expected to become an entirely self-sufficient economy, with the highest per capita income in South Asia. In terms of the Human Development Index, Bhutan is only below Sri Lanka, Maldives and India, in South Asia. Bhutan has achieved, or is on the verge of achieving its Millennium Developmental Goals. Life expectancy in Bhutan which was 46 years in 1980 went up to 67 years in 2011. There has also been visible improvement in the health, educational, economic and social indicators.

The impact of planned development in Bhutan has been far greater than in any other SAARC country, as it moved from being an isolated and semi-medieval country, to a modern one overnight. In short what took other countries, two to three centuries to achieve Bhutan achieved in less than 50 years, and that too with minimal adverse impact. A key reason for this rapid progress into the modern era, has been the monarchy. The third King, His Majesty Jigme Dorji Wangchuck, the fourth King His Majesty Jigme Singye Wangchuck and His Majesty the King, Jigme Khesar Namgyel Wangchuk, all played an exceptional role in this progress, by providing stable and good governance, and ensuring the optimum utilisation of resources, unlike many other countries in Asia and Africa, where developmental money does not reach the intended beneficiaries. The honest and competent use of funds made Bhutan a model country for donors, thus making it much easier for it to raise developmental funds.

Hydropower⁴

During the recent power blackouts in large parts of India, power generated in Bhutan, enabled some critical public infrastructure to run. Bhutan and India's cooperation in the hydropower sector is a good example of regional cooperation for shared economic benefit in the SAARC region. Bhutan has a total generating capacity of 30,000 MW, and an economically viable total capacity of 23,760 MW, comprising in total of 76 hydro projects of which 1,400 MW have been built, and another 10,000 MW will be constructed by 2020. Most of these remaining projects fall in the medium category i.e. between 25 MW to 150 MW, but there are some larger projects as well. The math here is simple. Bhutan needs the revenue for its long term and sustainable economic development, and India's needs the electricity to push up its economic growth rate, and meet its rapidly rising energy demands. This also needs to be understood in the context of trust, goodwill and good relations between the two countries.

The initial aim of hydropower cooperation between India and Bhutan was mainly to supply Bhutan's own domestic needs, through mini projects, and gradually go for bigger projects thereafter. The first medium sized hydro project was launched in 1961, when a barrage was constructed in Bhutanese territory. Bhutan, apart from getting revenue, also got free power for its southern region. Bhutan was also importing power from India at the time, to meet its developmental

needs. The first hydro plant of 360 kW in Bhutan, built with grant assistance from India, was commissioned in 1967, at Joshina, to supply power to the capital. In 1968, a mini-hydel of 400kW was built at Paro, but was decommissioned in 1986. In 1972, the 750kW Chenari plant was built, along with another 300kW hydel plant at Hesothanka in Wangduephodrang.

The first major commercial hydro project was agreed to by the two countries in 1974, which led to the development of the 336 MW hydropower plant at Chukha. The project completion cost in 1988, was Nu 24.6 bn or about US\$ 500 million. India provided the funds in the ratio of 60 per cent as grant; and 40 per cent as loan, at 5 per cent interest payable over 15 years. On February 18, 1994, Bhutan and India signed another agreement for the construction of the KuriChhu 60 MW plant in Mongar. The project was completed in 2002, at a total cost of Nu 5.637 billion. This project was vital for Bhutan because it was meant to supply electricity to its eastern region. India again funded the project on a 60:40 ratio of grant to loan, at the rate of 10.75 per cent interest repayable over 12 years.

In 1996, the two governments agreed to build the biggest power project in Bhutan, the 1020MW Tala project which would also be India's largest ever foreign investment anywhere at the time, amounting to around a billion dollars on completion. India again funded the project on a 60:40 ratio of grant to loan, at a 9 per cent interest rate, repayable in 12 years. The project when commissioned in 2006, pushed Bhutan's GDP in 2007, to a record 17.93 percent, demonstrating the central role played by hydropower in Bhutan's economy. In fact the key driver of GDP growth is hydropower, which gives a boost to other large sectors like construction, trade, transport and electricity and water.

Table 1: Hydro-power Projects in Bhutan

Sl.No	Projects	Capacity MW	Start Date FY	Completion date FY	Mode
1.	Punatsangchu-I	1,200	2009	2015	Bilateral
2.	Mangdechu	720	2010	2017	Bilateral
3.	Punatsangchu-II	1,020	2010	2019	Bilateral
4.	Sunkosh Reservoir	2,585	2011	2020	Bilateral
5.	Kuri-Gongri	1,800	2012	2020	Bilateral
6.	Amochhu Reservoir	620	2012	2018	Bilateral
7.	Kholongchu	650	2012	2018	JV
8.	Chamkarchu-I	670	2012	2018	JV
9.	Wangchu	600	2012	2018	JV
10.	Bunakha Reservoir	180	2012	2018	JV

In the next phase this project was to generate 5,000 MW by 2020, which was revised by the prime ministers of India and Bhutan in 2008, to 10,000 MW. The approximate investment necessary, at 2008 costs, is Rs 50,000 crores, or

more than US\$10 billion, but this—at a conservative estimate—is expected to go up to Rs 75,000 crores, or US\$15 billion, by the time it is completed.

Of the 10,000 MW projects, 4 are in the joint venture mode between the PSUs of the two countries, which will be owned by the PSUs, with 50 per cent share for Indian PSUs and 50 per cent for Druk Green Power Corporation. The financing structure for the bilateral projects, has also been revised to 70 per cent as loan, at 10 per cent interest, and 30 per cent as grant. Though the loan component has gone up, the wisdom behind it is, that Bhutan will benefit from the volumes generated by the project. Once completed, the combined projects are expected to generate revenue up to Nu 100 billion a year, which would make Bhutan a self sufficient economy. It would also give Bhutan the highest per capita income, and significantly raise the socio-economic status of the people. The other gain for Bhutan will be the ability to supply cheap power to its population, and going in for rural electrification. Bhutan is also leveraging its hydropower and its 'urbanising effect', by distributing it evenly across the country, for balanced regional development.

The projects apart from providing reliable power to India, are also a sound economic investment for India. This is possible because, the electricity tariffs are determined as per, an accepted formula, based on the construction and financing costs. India's grant component while reducing the loan burden on Bhutan, also keeps the tariffs of Bhutan's projects relatively lower. Even in the case of the first mega project, the 336 MW Chukha project where India provided the most favourable financial terms, of 60 per cent as grant or free money, it recovered its investment in a short time. A detailed study on the issue was undertaken in 2008 by, D.N.S Dhakal from the Centre for International Development, Duke University, U.S.A, and Glenn P. Jenkins from Department of Economics, Queen University, Canada. The researchers concluded that India recovered its the investment cost, by 1997, that is just nine years after the project started in 1988. The net economic gain as of 2008, has been US\$ 2,286.51 million for Bhutan, and US\$ 2,521.78 million for India. Taken as a ratio, this means that as of 2008, the gain has been 48:52, marginally favouring India. India's gain was calculated, taking into account what it would have cost India, if it used the conventional means of power production in India, like thermal power, or if did not get the advantage of the lower tariff rates of Chukha. According to the study the whole project was a win-win project for both countries.

The other advantage for India, is that Bhutan's small population, absence of red tape and the very limited social and environmental impact of the projects, ensures that the projects do not face the same delays that they are likely to in India. The key is the location of most projects in deep and uninhabited gorges. Also given the pre agreed formulas and time frame of tariff increases, Indians can count on assured and stable prices. There are, however, a few issues that need to be addressed in the future.

A major problem has been delays in starting projects, with the real possibility that some big projects may not make the 2020 date. Of the 10 or so projects, seven have been delayed by a year. There is thus a need to ensure less red tape and better follow up by bureaucrats in both countries. There are also increasing concerns in Bhutan relating to funding issues, with various reports in the Indian media indicating that the Indian government may be running short of funds, to meet its hydropower commitments in Bhutan.

There are an increasing number of studies, by both private and government agencies in Bhutan, linking the huge hydropower projects, to a rupee shortage, and also the credit crunch that Bhutan currently faces. The rupees for the projects are paid only after a few months, and in the meantime, Bhutan has to spend its limited rupees, creating a shortage. The mega projects have also created a huge auxiliary demand in the economy, whereby Bhutanese contractors and private individuals, have rushed to buy heavy equipment for the projects, further draining the country's scarce rupee resources. The huge loans taken by various contractors and individuals for the equipment, have also contributed to the banks running low on credit.

Though the rupee and credit crisis in Bhutan are due to other reasons, the construction of mega projects is becoming a bigger factor by the day. The rupee deficit phenomena was apparent during the construction of the Tala project, and is being repeated, with the Punatsangchu I and II and Mangdechu projects. The projects in short, are leading to an artificial overheating of the economy, during the long construction period and are also sucking the rupee and credit out of financial institutions, to the detriment of other sectors of the economy. India and Bhutan may need to factor this in while constructing the 10,000 MW projects, so that some solution can be found, to prevent the impact on the Bhutanese economy.

There is also increasing pressure on the government from the Bhutanese private sector, for a bigger share in the hydro project construction pie, that is currently dominated by Indian construction companies. This in part, is due to lack of capacity in the Bhutanese construction sector, but at the same time, it is also a failure to provide Bhutanese construction companies the opportunity to participate, by both governments. As a start in February 2012, 17 Bhutanese contractors joined together to form a hydro power construction company to compete for hydro projects.

In accordance with the 11th plan (2013-2018) Bhutan has to generate 1,40,000 jobs, but the 10,000 MW projects will only generate around 7,000 fulltime operational and maintenance jobs. This is in the face of growing unemployment numbers. The projects should therefore allow for transfer of technology and training, from Indian construction companies, to improve local capacity. Despite far fewer actual hydropower projects, Nepal has better capabilities in hydro

engineering than Bhutan. For example, Bhutan has to send its runners to Nepal for repairs. However, in a positive move, hydro training institutes and workshops are being set up in cooperation with India.

Apart from the 10,000 MW projects, other projects – mainly small and medium—for generating 12,300 MW of electricity have yet to be completed. There is also increasing pressure from the Bhutanese private sector, for participation in owning and running smaller projects in the future. The 2008 Sustainable Development Hydropower Policy allowed FDI in big and small projects. This FDI clause, however, was kept on hold after the Indian government agreed to complete the entire 10,000 MW generation project by 2020, on more favourable terms, than any FDI would provide. The Renewable Energy Policy 2012 allows private and FDI investment in small, micro and medium projects of up to 25 MW. Foreign private investors, however, cannot have a majority stake. The model would be BOOT or “Build, Own, Operate and Transfer” whereby the project is given back the government after 30 years with scope for a 15 year extension.

The issue with these power projects is that being run of the river, power generation is reduced considerably in winter, as rivers run low on melt water. However, to address this, both countries are undertaking two reservoir projects of around 3,100 MW capacity, within the 10,000 MW projects where water can be stored during the monsoon, to generate power in winter. It is clear that these hydro projects, are a win-win for both countries, that need each other’s resources and capacities.

At the regional SAARC level, the Indo-Bhutan hydropower story is a blue print for a region, that according to the Asian Development Bank, will see its energy needs double in 10 years. According to the ADB study, the SAARC region’s strong economic growth, and its increasing population, are generating the world’s fastest growing demand for energy. If left unaddressed, the lack of energy security, may reverse the region’s hard-won gains in poverty reduction.

In the recent years, SAARC more than ever before, has been studying the possibility of a regional energy market, whereby energy can be exploited and traded regionally, for the benefit of all SAARC nations. For example, energy short Bangladesh is interested in Bhutanese hydropower. India’s peak power demand in March, 2012 was 130,006 MW, with a deficit of 15,773 MW (minus 12.1 per cent). Its demand alone, will increase to 2, 83,470 MW by 2021. Bangladesh has a projected demand of 39,000 MW by 2030, but its resources for electricity generation are limited. Nepal has a projected demand for 2,000 MW by 2020, and depends on supply of 340MW in the dry season, and 600 MW in the wet season. New generation projects are constrained by limited evacuation capacity. Pakistan faces a power deficit of 4,000 MW to 5,000 MW, with 65 per cent of its power being thermal generated; and 31 per cent, from oil. Losses and power sector debt amounts to Rs 300 billion. Sri Lanka has a deficit

of 1,868MW growing at 10 percent annually. The scope of further harnessing the hydro potential is limited, because of socio-environmental concerns, while resources for thermal generation are limited. Maldives' electricity demand will exceed supply by 2015, and it lacks space on its main island, Male, for additional generation capacity.

The ADB study suggests the creation of an enabling environment for a SAARC regional energy trade agreement, by harmonising legal and regulatory frameworks, and creating a comprehensive reliable energy database. The report also suggests: expansion of regional power market, building of regional refineries, product transport facilities, regional liquefied natural gas (LNG) terminals, gas transmission expansion and regional power plants.

The SAARC Regional Energy Trade Study (SRETS) among its many recommendations, suggests: the creation of a regional/ sub-regional power market. Such a market would allow trade in any surpluses that a country may have, either over time of day or over seasons, and would exploit the unique characteristic of electricity, which once generated has to be consumed immediately. Establishment of a regional power market for the SAARC countries can offer manifold technical and economic benefits, including optimal exploitation of energy resources. According to the study an Inter Governmental Agreement (IGA) to facilitate multilateral power exchanges/trade, is a pre-requisite for establishing the regional power market.

A GNH Economy

Gross National Happiness (GNH) is Bhutan's umbrella developmental philosophy that governs all government policies and programmes. First coined in 1972 by King Jigme Singye Wangchuk, GNH consists of four pillars. These are: Sustainable and Equitable Socio-Economic Development; Preservation and Promotion of Culture; Conservation and Sustainable Environment Management; and Good Governance. Since then, this simple policy has been elaborated on by Bhutanese and international researchers, think tanks, and policy makers in the former Druk Phuensum Tshogpa (DPT) government, making it a considerably more comprehensive, but also a more complicated philosophy. The four pillars have nine domains upon elaboration. These are: Standard of Living; Health, Education; Time Use; Psychological Well Being; Community Vitality; Cultural Diversity and Resilience; Ecological Diversity and Resilience; and Good Governance. There are a further 33 indicators that elaborate the nine domains. For example, the four indicators in the health domain are: Mental Health; Self Reported Health Status; Disability; and Healthy Days.

Bhutan's Economic Development Policy (EDP) 2010, formulated by the previous DPT government, was heavily influenced by the GNH philosophy. This was also part of the then elected government's efforts to build a green economy,

which apart from economic diversification, encourages green economic activities like hydropower, sustainable tourism, services and other environmentally friendly businesses. Apart from the general tax breaks and incentives for businesses, there are incentives for green businesses in form of tax rebates, custom duties, etc. The core idea of the EDP was to build a Brand Bhutan – that of an ‘organic, environment friendly and sustainable’ hub of economic products and services. These included making Bhutan a health care hub, a financial services hub, an education hub, a high end tourist destination and an exporter of organic agricultural products.

Even Bhutan’s liberalised 2010 FDI policy encourages investment in this green economy. The former prime minister, during cabinet meetings to finalise the FDI Policy in 2010, personally pushed to integrate the GNH philosophy into an otherwise highly prosaic document. Businesses not in tune with GNH ideals – weaponry, pornography, plastics, polluting and toxic industries, and fast food chains like McDonalds are not allowed into Bhutan under the FDI Policy.

GNH indicators are the touchstone for any foreign investment in the country. Service sectors (education, health services, tourism, etc.) perceived to be clean and green get priority and fast track clearance. Guidelines were to be developed to approve or deny licences for non-priority sectors like mining and industries. Under the rules, licences are to be cleared, on a case by case basis, depending on their GNH merit.

In line with this GNH economy, Bhutan recently declared itself a carbon neutral country, implying that it would never produce more carbon than its forests can consume. Bhutan had also taken up the issue of sustainable economic development, and got the United Nations General Assembly to pass a resolution, to have happiness as a developmental goal. The former government in 2009, hired the international consultancy firm McKinsey, to suggest ways to accelerate this green economy growth, and to cut red tape and increase efficiency in the government. The key focus area was tourism, along with other major government ministries like education, health, construction, etc.

Bhutan, under the DPT government, introduced the GNH screening test for all major policies. In this, the 33 indicators of GNH have been summarised into 22 measurable variables or tools. For example, Health and its four indicators, (i.e. mental health, self reported health status, healthy days and disability) are assessed through the one variable of Public Health. Out of a score of four, all policies will have to score at least 3 against all these 22 variables, and a total score of 66 (22×3) is to be accepted as a policy. Using this complex tool, the former government put the question of joining the World Trade Organisation to this test. The result was negative and Bhutan has decided, at least for now, against joining the WTO.

How is Bhutan's Green Economy Doing?

The result, thus far, is not satisfactory, chiefly because the goals were too ambitious in the beginning, and are constrained by fundamental structural weaknesses, in the Bhutanese economy as highlighted in the box. The poor state of the economy was also the main election plank on which the world's smallest Opposition party—the Peoples Democratic Party (PDP) came to power with a landslide win, in the July 13, 2013, general elections replacing the incumbent DPT government.

Table 2: Challenges Before the Economy

Overall Challenges
<ul style="list-style-type: none"> • Economic Growth largely financed through external aid resources • Weak balance of payments situation • Increasing public debt • High fiscal deficit • Small domestic market • High transportation costs • Limited exports and markets • Inadequate infrastructure... etc

Many EDP goals of Brand Bhutan have not taken off. Bhutan's multi-billion Education City project, to make Bhutan into an education hub, has garnered lukewarm response at the best, with many questioning its viability. Far from being a health hub, Bhutan's health system is struggling to cope with patients. Also, Bhutan has given up on being a financial hub, due to GNH concerns of money laundering. Organic agriculture is at an early stage, with the priority now being on producing enough to feed the nation and reduce food imports. One example of a white elephant has been Bhutan's IT Park which has got little or no investment. Tourism numbers have increased, but not enough and there is some controversy over how high end tourists are counted. The earlier system of counting only dollar paying tourists, has been replaced by counting almost all foreigners who fly into Bhutan.

On the FDI front, there were a lot of high expectations, that a liberal FDI policy allowing for higher foreign ownership in virtually all sectors with friendlier terms, would encourage investment. However, the response had been disappointing, with investors staying away from Bhutan. Since the endorsement of the new FDI policy in 2010, only 26 projects have been approved, worth more than Rs 9 billion. Compare this to the completion cost of just one mega project, the Punatsangchu1, 1200 MW project, that is expected to cost Rs 85 to 90 billion. The former economic affairs minister, Lyonpo Khandu Wangchuk in an interview with the local media, himself admitted that Bhutan has been unable to attract enough investments.

The strict GNH based restrictions of the former government have also not helped, as there are more than 100 investment proposals that are either not on the FDI list, or are prohibited by GNH. There was also criticism of the McKinsey initiative, with many pointing out that the economy is yet to feel the effects of the measures recommended by McKinsey. Several questions have also been raised over the negative impact of the government's GNH initiatives, on the growth of the economy by the private sector. Industrialists are of the view that Bhutan's decision to declare itself a carbon neutral country, would limit industrial growth, and make it difficult for Bhutan to fully exploit the cheap energy surplus that would be available due to the mega projects. Another GNH linked initiative that had come under fire from the private sector and ordinary citizens, is the Pedestrian Day initiative introduced on June 5, 2012, the World Environment Day, whereby, people are not allowed to use vehicles on Tuesdays and only highly limited vehicle movement is allowed. The BCCI found that this would result in the loss of 52 working days in a year, affecting economic growth. Though the former government brought this down to just one Sunday in a month, it still caused inconvenience. The new PDP government has done away with Pedestrian Day.

There is some debate in Bhutan about adopting the complex GNH policy accounting measure to approve or disapprove police or projects. Naysayers have criticised the screening test for being too prolonged, bureaucratic and conservative, leading to delays in policies, as in the long delayed mining policy. Critics also say that Bhutan's decision not to join the WTO would reduce its competitiveness would not inspire adequate confidence from investors. However, it must be made clear that GNH, as a core philosophy of four pillars still enjoys tremendous support. The problem lies in its interpretation, application and implementation by the former government in myriad ways, that at times bordered on being intrusive and out of sync with ground realities. The 2013 election verdict, in a sense, was also a vote against the GNH economy as propounded by the previous DPT government.

Bhutan's Financial Crisis

Bhutan is currently in the midst of an unprecedented financial crisis, because of two main reasons. The first is the acute shortage of Indian rupees, and the second and now more serious problem is, the non-availability of credit or a financial liquidity problem.

Rupee Shortage

Bhutan, since the start of modern development, has almost always had both a negative balance of trade and negative balance of payment situation. This is because of the nascent and small nature of Bhutan's private sector and the developmental stage of its economy. Bhutan as a result imports more than it exports. In FY 2007-2008 the current account deficit was Nu 1 billion, which

increased over the years to Nu 18.6 billion in 2010-2011. The majority of Bhutan's imports—76.41 per cent in just 2011—are from India, with whom Bhutan has close trade ties and a free trade agreement. Conversely 75.8 per cent of Bhutan's exports in 2011, mainly electricity, are also to India. However, with a trade deficit of Rs 8.8 billion with India, and Rs 8.3 billion with other countries, in 2011, Bhutan was spending more rupees and dollars than it was actually earning. Moreover Bhutan's donor support is all for capital expenditure such as building bridges, schools etc which again leads to more imports.

The situation by the end of 2011 and beginning of 2012, was very acute, with most banks running out of rupee reserves. By April 2012, Bhutan's rupee borrowings from India had touched Rs 9.7 billion, a record on its own, at simple interest rates varying from of 5 to 10 per cent on various components of the loan. The Central Bank or Royal Monetary Authority (RMA) issued stringent orders to financial institutions to tackle the situation. Steps included stoppage and limitation of rupee issuance to banks, suspending rupee limits for citizens and curtailing vehicle and housing loans. Fixed deposit accounts of Indian border traders in Bhutanese banks worth Rs 2 billion were closed. All rupee payments for essential imports from India like fuel, food, consumer goods, education, health etc were required to go through banking channels. Import of non-essential luxury items from third countries, like furniture etc was also suspended. The rupee crisis, in short, brought the Bhutanese economy and private sector to a grinding halt. It also led to high inflation, as the Ngultrum unofficially lost around 20 per cent of its value to the rupee, which was difficult to get in Bhutan. This has come down to around 10 per cent in the border areas.

A government report on 'Balance of Payments with India and the Rupee Shortage' though accepting some blame for causing the crisis by its expenditure and the RMA through its reserves, put the bulk of the blame on credit expansion and private consumption.⁵ The private sector report by the Bhutan Chamber of Commerce and Industry, squarely put the bulk of the blame on government expenditure, the auxiliary demand of hydropower projects and the RMA's rupee reserve management.⁶

The truth is more complicated, as all major players i.e. the government, private sector, private consumers, RMA and banks have to take their fair share of the blame; but, it was clearly a failure of the fiscal policy of the previous government. The private sector study tracked both government expenditure and also growth of the credit market from 1996 to June 2011. When this information was plotted along a statistical graph there was a clear co-relation between the two, showing that more government expenditure meant more credit and more consumption. The graph also showed that as expenditure went up, the rupee reserves plummeted. Growth in loans were driven by government activity, as for example, contractors have to buy construction equipment like trucks on credit, to implement government construction projects. The study also showed that the

budget which had been balanced till 2008, started showing larger fiscal deficits from 2009 onwards, meaning that the DPT government was living beyond its means.⁷

The DPT government report itself acknowledged that increased government expenditure had an aggregate impact, leading to more disposable incomes and expenditure, and hence more use of the rupee. The study also showed how hydro projects led to more auxiliary demands and imports, tracking the rise in imports, whenever construction activity on a hydro project peaked. While the projects by themselves were fully financed with rupees, Bhutanese contractors imported a lot of construction equipment.⁸ The RMA on its part was faulted for preserving dollars and other foreign currency given as developmental assistance as part of the foreign exchange reserves, and instead spending rupees for the projects. There was a clear co-relation between an increase in dollars reserves and the decrease in rupee reserves. The RMA was also criticised for many ad hoc steps like closing Indian traders' accounts in Bhutan, which caused further loss of rupees. The RMA was also criticised for not taking concrete steps to increase rupee reserves and issuing an early alarm, when it was clear from 1993 itself, that Bhutan was vulnerable to rupee shortages.

Private consumers and the private sector along with growing prosperity, also played a part in the crisis, with ever increasing consumption. In 2000, the consumption at constant prices was Nu 9.4 billion, which increased to Nu 19.7 billion in 2011. In terms of capital formation of machinery and equipment in the private sector, it increased from Rs 4.6 billion in 2006 to Rs 11.2 billion in 2011. Credit expansion also played a major role in creating the rupee crisis. While nominal GDP growth has been on an average 13.6 per cent from FY 2002-03 to 2010-11, the average credit growth was 27.4 per cent for the same period. The government report found that as of December 2011, the total credit of the financial institutions increased from a total of Nu 36 billion in 2010 to Nu 47.5 billion, which is a 32 per cent increase. Similarly, in 2009 -10, the credit had grown from Nu 26 billion to Nu 36 billion. Thus, in two years, there was an increase of Nu 21.5 billion in the overall credit of the financial institutions.

The government report says that high domestic growth has been influenced by factors such as speculation in land prices, emergence of new banks, limited alternative investment opportunities, secure and good returns, on housing finance, rising cost of construction, favourable and comfortable loan repayment periods, etc. The report points out that the share of bank credit to the private sector grew from 72 per cent in 2002 to 96 per cent in 2011. The balance credit came from the non-bank financial institutions such as pension funds, and insurance companies which are also actively engaged in lending.

Bhutan's rupee crisis is an ongoing one. The previous government had taken some steps such as: trying to reduce imports, and boost exports, but with limited

effect. It also drastically reduced government expenditure, came up with new monetary policies, and increased taxes. However, despite some temporary relief, the rupee situation is expected to get worse, with more imports and mega projects in the pipeline, until 2017—when the first few mega projects will come on line and start generating rupees. The rupee problem in many ways, demonstrates the structural weakness of the Bhutanese economy, that does not have enough export capacity, and depends overly on one or two commodities like hydropower and tourism, which by themselves are not enough to meet our currency requirements, at least in the short term. India has provided assistance by increasing the credit line from the existing Rs 11 billion to Rs 14 billion. Bhutan is also using the SAARC currency swap arrangement.

Managing the rupee crisis is one of the foremost priorities for the newly elected PDP government, which has promised to look into the issue. In the short and medium term, help from India in the form of soft loans and grants will be vital. The new government is also exploring other avenues like reviving the profitable Bhutan lottery business to earn rupees. During the election campaign itself, it had come up with an Economic Stimulus Plan, which among other things, involved injecting Rs 5 billion into the economy. The financing for the ESP will have to come from the Indian government, and so far the indications from the Indian government have been positive as evidenced by Prime Minister Manmohan Singh's congratulatory message to the new prime minister of Bhutan wherein he assured Bhutan of all support.

Credit Crunch

In the midst of the credit crisis, the loan portfolios of Bhutan's financial institutions came under close scrutiny by the Central Bank, which revealed two main problems. One was that there was an unhealthy amount of exposure of the bank loans to sectors like housing, real estate, vehicles etc. The second was that there were some early signs of a liquidity problem, with bank deposits unable to keep up with the amount of credit the banks had given. In fact the RMA realised that Bhutanese banks since the early 2000s, had over leveraged and over exposed their loans.

In April 2012, the RMA introduced some measures and put caps on the banks to improve their liquidity problem, which led to an immediate cessation of credit, not only for housing and cars, but also for overdrafts, consortium financing etc. The growth of credit from April to June 2012 was only 1.98 percent, compared to 6.73 per cent in the same period in 2011. The 1.98 per cent was also possible because of the disbursement of loans that had been sanctioned much earlier. Initially RMA came under criticism for these measures, but eventually it became known, that even without any of RMA's restrictions, most, if not all Bhutanese banks were in no position to give loans due to liquidity problems. In fact there was a significant drop in deposits within the banking system. In June

2012, bank deposits fell by Rs 2.8 billion, when in June 2011, the fall had only been Rs. 866 million. In one troubling case that was brought to light by the media, a person wanting to withdraw Rs. 4.5 million from a current account in a major private bank, could not do so, as the bank did not have the liquidity at the time. Instead, a significant amount had to be transferred electronically, into the account of the person he intended to pay. For a few months in 2013, some credit started to be given again, but around June 2013 new restrictions from the RMA, primarily aimed at curbing rupee outflows and also overexposure of banks, led to a virtual credit freeze. Currently, only two banks out of five are giving very limited and conditional credit.

The credit crunch is having a devastating effect on the Bhutanese economy, with some sectors of the Bhutanese economy on the brink of collapse. Many construction companies that require huge Overdraft Loan Accounts to operate, are facing closure, some manufacturing industries have cut back production, major car importers are selling furniture and food products in their showrooms instead of cars, people are being laid off in the private sector etc. Many big and small businesses are defaulting on the loan payments to banks, and some are doing it intentionally, as they know they will not have access to more cash for a while. Ordinary people are also suffering with no access to loans to build houses, start businesses or buy cars. In many cases, people have taken loans and constructed half a building, but cannot get loans for completing the project. They however, have to continue paying interest on the loan for a building, that will not be giving them any income to pay off the loan interest.

While the rupee crisis brought the private sector to a grinding halt, the credit crunch which is much more serious, threatens to not only destroy the private sector, but also bring on a level of recession that the Bhutanese economy has never seen before. The private sector in a desperate bid in October 2012, petitioned the former government, through the Bhutan Chambers of Commerce and Industry for acceptance of ten main demands to deal with the credit crunch. These are: allowing External Commercial Borrowings, incentivising long term savings, allowing more banks, indentifying priority sectors for credit, easing restrictions on import of heavy vehicles, reviewing ad-hoc policies adopted after the rupee crisis, reinstating export promotion credit for exporters, continuing to fully financing ongoing projects, strengthening the tourism sector and fast tracking a policy on enhancing productive capacity to increase exports and reduce imports. There was considerable frustration within the private sector which felt that the former DPT government, far from helping them, had not even acknowledged the enormity of the problem. This became one of the major election issues.

Of the Rs 5 billion proposed in the ESP, around Rs.4 billion will be injected into banks to allow them to loan money, in order to kick start the economy. The remaining Nu 1 billion is to be given as subsidies. Both the rupee shortage and credit crunch indicate that the Bhutanese economy is overheating and still lacks

the capacity to handle the stress of fast economic growth. There is a lot of foment in Bhutan on the issue, as this financial crisis has come as a sharp learning experience, in Bhutan's economic modernisation. It has also shown that the Bhutanese leadership and business community has to diversify into other business areas, instead of relying on a few areas only. The Bhutanese economy is characterised either by huge mega projects like hydropower, or small shops, all selling the same thing and not leading to any substantial benefits. There is a crucial need to fill the gap with manufacturing, and service industries to create more jobs. The financial crisis has come as a wakeup call for Bhutan to focus more on the economy, and to encourage conditions that create healthy growth and remove several basic barriers to business. The new PDP government has promised to give top priority to the economy and has already formed a committee to look into various issues.

Annex 1: GDP By Kind of Activity at Current Prices 2011 (Million Nu)

Agriculture Livestock & Forestry	13,459.39
Crops	7,488.40
Livestock	3,241.19
Forestry & Logging	2,729.80
Mining and Quarrying	1,941.73
Manufacturing	7,044.82
Electricity and Water	11,911.61
Construction	13,916.57
Wholesale & Retail Trade	4,641.79
Hotels & Restaurants	948.65
Transport, & Communication	9,489.10
Financing, Insurance & Real Estate	7,007.73
Finance and Insurance	5,136.84
Real Estate & Dwellings	1,815.30
Business Services	55.59
Community, Social Services	10,942.11
Public Administration	6,063.56
Education and Health	4,878.55
Recreational Services	354.70
Plus: Taxes Net of Subsidies	3,922.37
Gross Domestic Product	85,580.58

Source: National Accounts Division, National Statistics Bureau.

NOTES

1. The main drivers of economic growth in Bhutan in 2011 were hydropower development and donor assistance. According to the National Accounts Division, GDP (at current prices) stood at \$1.833 bn; Real GDP growth was 8.51 per cent; Per Capita Income was \$2,590; Inflation rate of the Consumer Price Index was 8.86 per cent; Foreign exchange reserve stood at \$702.1 million and external debt was 89 per cent of GDP. See, "Annual Report 2012", National Statistics Bureau, Royal Government of Bhutan,

2. Information on the 5 Year Plans is sourced from the Gross National Happiness Commission at <http://www.gnhc.gov.bt/> and the Center of Bhutan Studies at <http://www.bhutanstudies.org.bt>
3. The Ngultrum and Rupee are pegged at the same value.
4. Information on various hydropower projects is sourced from *The Bhutanese, Business Bhutan* and the *Kuensel*.
5. "Balance of Payments with India and the Rupee Shortage", Finance Ministry, Royal Government of Bhutan, 2012.
6. "Indian Rupee Task Force Report", Bhutan Chambers of Commerce and Industry and QED, 2012.
7. Ibid.
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18

Maldives: Economic Growth and Political Developments

Bandhu Ibrahim Saleem

Introduction

Maldives is located in the Indian Ocean. It comprises about 1,190 coral islands formed by a double chain of coral atolls. Out of these, only 194 islands are inhabited, and the others remain in their natural state with the native vegetation and coral sand beaches. There is no wildlife in these islands. The length of the Maldives archipelago is 700 km from north to south, and the broadest point of the country is 100 km wide. The closest land mass is Southern India, which is 600 km, followed by Sri Lanka, which is to the south west of Maldives by 750 km. The atolls are spread on about 90,000 square km of sea. The islands are low-lying, and experience two monsoons similar to Southern India. The average rainfall is about 1,925 mm per annum. Average sunshine hours are 8 hours a day, and the average temperature varies between 25–30° Celsius.

Total land area of the islands is 115 square km. The population of Maldives is 330,625 (2012 estimates), and they live on islands of varying size. In addition to inhabited islands, there are 100 islands classified by the government as industrial islands, which are developed exclusively for the tourism industry. The population density is 1,102 per square km.

The population growth, which was 3 per cent in 1990, has been declining, and appears to have now declined to 2 per cent per annum. This is due to the awareness of the benefits of a small family and good upbringing of the children. The family planning education programs have worked well together with the availability of family planning devices. However, the population of Maldives remains young, that is, 60 per cent (192,310) of the total population is below the age of 30 years. The student population (below 19) is estimated to be 132,941, which is 40 per cent of the population.

Table 1: Population of Maldives 1990-2006

	1990	1995	2000	2006
Total Population	213,215	244,814	270,101	298,968
Male	109,336	124,622	137,200	151,459
Female	103,879	120,192	132,901	147,509
Inter-censal annual growth rate (%)	3	3	2	2
Male' island population as per cent of total (%)	26	26	27	35
Sex ratio (males per 100 females)	105	104	103	103
Dependency ratio (dependants per 100 working age pop)	99	98	81	57
Economically active population	56,435	67,476	87,987	128,836
Mid-year population (estimated)	212,269	244,827	271,410	300,466
(Vital statistics)				
Infant mortality rate (under 1) / '000 live births	34	32	21	16
Mortality rate (under 5) / '000 live births	48	47	30	18
Crude birth rate / '000 population **	41	28	20	19
Crude death rate / '000 population **	6	5	4	4
Maternal mortality rate / '000 live births	2	2	1	1
Still birth rate / '000 live births	19	22	15	10
Total fertility rate				2.1
Male life expectancy rate	63.9	69.9	70.0	72.0
Female life expectancy rate	63.1	71.6	70.1	73.2
Memorandum				
No Inhabitant Islands	202	201	200	194
No of expatriates working	8,689	18,510	27,716	44,845

Source: Department of National Planning Male', Statistical Yearbooks.

Maldivians live on islands of different sizes with varied natural vegetation. There are five islands with a population of less than 100 (less than one per cent of total), and one island with the highest population of 100,000. The majority of islands, that is, 47 islands (24 per cent of the total islands) have a population of 1,000-1,999 and 20 islands (10 per cent of total) have a population of 400-499. The population is centred on distantly placed islands, which makes it sometimes very un-economical to administer and provide basic services. Weather conditions and distances make transportation very expensive. There are very few scheduled transport links intra- and inter- atoll. The availability of fresh water, specifically potable water, is going to be an issue in the near future, especially during the dry season period (Jan-April). The fresh water lens is already depleted

or nearly depleted in densely populated islands. The alternative to ground fresh water is desalination water plants driven by electric power. On many islands there are rain water storage tanks for cooking and bathing purposes. Maldives is the only island country in the SAARC (South Asian Association for Regional Cooperation) region with a unique geographical position of coral atolls and sea all around it. The Human Development Index (HDI) rank of Maldives in 2011 was 109.

The Economy

The economy has grown on an average 6 to 8 per cent during the period from 1995 to 2011. However, there are many peaks and low peaks during the period under review. These abrupt changes indicate the vulnerability of the economy which depends on tuna fisheries, tourism, agriculture and other related sectors and on the import price in the international trade of petroleum, food and construction materials.

Table 2: Gross Domestic Product (in millions of Rufiyaa)

	1995	2000	2008	2009	2010 estimated	2011 Provisional
ISIC ¹ Industry/Economic Activity						
Primary	481.0	546.4	698.3	647.0	602.3	595.9
Secondary	764.5	1245.1	3,597.4	2,656.2	2,793.2	2,957.0
Tertiary	5983.0	8684.4	14,446.1	14,518.8	15,429.9	16,660.5
Fisim ²	-148.77	-212.08	-215.35	-173.63	-166.87	-162.09
GDP at basic price	7,079.7	10,263.8	18,985.70	17,648.4	18,658.5	20,051.3
Memorandum items:						
Mid-Year Population (inclusive of expatriates)	263,324	299,126	390,414	384,801	393,578	406,359
GDP at 2003 constant prices (Million US\$)	553.1	801.9	1,447.4	1,378.8	1,457.7	1,566.5
GDP per capita at 2003 constant prices (MVR)	26,885.7	34,312.7	47,453.3	45,863.6	47,407.4	49,343.7
GDP per capita at 1995 constant prices (US\$)	2,100.4	2,680.7	3,707.3	3,583.1	3,703.7	3,855.0
GDP per capita at 1995 constant prices (PPP\$)	-	-	6,003.70	5,697.00	6,119.20	6,417.60

Source: Maldives Monetary Authority (Monthly Statistics August 2012).

It is evident that the structure of the economy has not changed from 1995 to 2010. The tertiary sector has been increasing in the economy, the primary sector has been slowly declining and the secondary sector is increasing gradually. (Table 2) Tourism accounts for nearly 40 per cent of the economy, while the government and other sectors, which include government administration,

education, health and social services, account for nearly 20 per cent, followed by transport and communication which are growing rapidly.

Gross Domestic Product (GDP)

The Maldivian economy is an open and liberal economy. The main sectors of the economy consist of tuna fisheries, tuna processing and tuna export. Tourism is the most important sector now, accounting for 80 per cent of the foreign exchange income. The sector has secondary effects on the economy in trade, food supplies, air and sea transport. The tuna fishery is the second largest sector. The fishing industry and processing for export is contributing about 20 per cent of the foreign exchange. The agricultural sector, though small, is expanding fast. The main produces are fruits like bananas, watermelon and passion fruit and vegetables like salad leaves, cucumber and chillies.

In 1999, the GDP expanded by 16 per cent compared to the previous, year mainly due to the growth in tourism, fisheries, transport and communication. For the first time, tourist arrivals crossed 200,000 in 1990, which was reflected in all other sectors. The fisheries sector output also increased from 9.3 per cent in 1989 to 16.9 per cent in 1990. This was the highest GDP growth overall, doubling compared to the previous year. The GDP for the rest of the years between 1991 and 1995, grew on an average of 6 per cent again driven by tourism, whereas fisheries sector was on a downward trend. The per capita income reached from US\$ 1,482 to US\$ 3,800, almost doubling at constant prices. However, all this does not indicate that the wealth can be maintained, as the economy is dependent on fisheries and tourism sectors, which are very susceptible to external shocks.

According to the GDP estimates of November 2011, growth in real GDP is projected at 5.5 per cent during 2012, supported by the strong growth of the tourism sector. Meanwhile, real GDP has grown by 7.5 per cent in 2011, underpinned by the strong growth of the tourism sector and related sectors such as transportation, construction and communication.

Fiscal Developments

The government expenditure data of 2011 shows that fiscal deficit has narrowed. However, the estimates are subject to scrutiny. According to provisional estimates of Ministry of Finance and Treasury, the fiscal deficit, after grants, was expected to fall to 10.2 per cent of GDP in 2011, which was at 16.1 per cent in 2010. Table 3 summarises the fiscal position for the period 2007-2011.

Public expenditure has been growing at a faster rate than revenue. The current expenditure has been increasing its share, and there is a declining trend of capital expenditure. In 1995, current expenditure and capital expenditure, both constituted half of the total expenditure. However, from 1996 onwards, this trend reversed, and by 2000, the current expenditure was 60 per cent of the total

Table 3: Summary of Central Government Finance 2007-2011

(In millions of Rufiyaa)

Particulars	2007	2008	2009	2010	2011
Total Revenue & Grants	7,571.2	7,456.5	5,734.8	6,546.9	9,095.7
Total Revenue	6,527	6,939.5	5,313.3	6,392.4	8,323.3
Current revenue	6,490.7	6,897.2	5,299.4	6,343.0	8,292.9
Capital revenue	36.5	42.3	13.9	49.4	30.4
Grants	1,44.0	517.0	421.5	154.5	772.5
Expenditure & net lending	8,283.2	10,176.0	10,953.4	10,815.1	12,159.9
Total Expenditure	8,325.4	10,342.4	11,104.3	10,996.4	12,503.9
Current expenditure	6,560.1	7,463.2	8,764.9	8,428.1	9,463.2
Net lending	-42.2	-166.4	-150.8	-181.3	-344.0
Overall Balance	-712.0	-2,719.5	-5,218.6	-4,268.1	-3,064.1
Overall balance excluding grants	-1,756.0	-3,236.5	-5,640.1	-4,422.7	-3,836.6
Current balance	-69.4	-566.0	-3,465.5	-2,085.0	-1,170.2
Financing	712.0	2,719.5	5,218.6	4,268.1	3,064.1
Foreign financing	697.4	747.7	1,006.2	1,228.3	1,647.3
Domestic financing	14.6	1,971.8	4,212.4	3,039.8	1,647.3
Memorandum Items:					
Nominal GDP	19,737.3	24,212.9	24,858.0	26,566.4	29,936.1
Deficit as percentage of GDP	-3.6	-11.2	-21.0	-16.1	-10.2

Source: Maldives Monetary Authority (Monthly Statistics August 2012).

expenditure, excluding net lending. The current expenditure has reached 70 per cent of the total expenditure in 2010. The external debt in 1995 was MVR 1160.7 million. This reached MVR 19,736 million in 2010. The medical benefit program for all citizens (Universal Health Program) had a high negative impact on public expenditure. Subsidies for electricity generation (cost of fuel) too need to be examined, which will help ameliorate the pressure on the budget deficit. The Civil Service Commission was formed under Law No: 5/2007. The salary of the Civil Servants has led to an unaffordable higher wage bill. Institutional reform for an efficient and effective public service needs to be implemented to overcome this issue.

It is important to note that for the first time in Maldives, tax laws were introduced, and laws became effective in 2011. This has indeed helped the fiscal position to improve. Nevertheless, the expenditure level shown in the provisional level estimates is likely to be understated. The fiscal position has not improved compared to 2010 due to this reason.

Revenue

In 2011, total revenue (including grants) rose to MVR 9.1 billion during the year or 30 per cent higher than in 2010. Tax revenues increased by 66 per cent to MVR 4.9 billion. This is due to the new taxes introduced in 2011. Amongst

these is the new ad valorem tax on tourism, Tourism-Goods and Services Tax (T-GST), a general tax of GST on domestic consumption. Due to higher volume of imports, import duties also increased by 19 per cent. However, lowering and waiving of import duties for certain imports, resulted in a decline of 1 billion Rufiyaa in revenue. The non-tax revenue (NTR) resort leased income increased by 45 per cent in the period amounting to MVR 1.6 billion. The transfer of profit from state own enterprises declined by 21 per cent due to lower profits.

Financing the fiscal deficit is being done through bilateral assistance, yet 60 per cent of the deficit was financed from the domestic sector, mainly by selling government securities to the commercial banks and state-owned enterprises. The government tabled the bill for personal income tax in the *Majlis*, which is still pending, whereas the laws for corporate profit tax and business profit tax have been ratified and implemented in 2010. This will enhance the tax revenue of the government, which is a welcome move. The depreciation of currency (a move to remain afloat) from the previously applied fixed exchange rate in 2011 by about 20 per cent has increased pressure on all imports of food and petroleum products. By February 2012, Malé consumer price inflation had increased by 20 per cent in one year. The inflation rate during March 2011 was 5 per cent, and by November it had reached 17 per cent.

Financial Sector

The financial sector in Maldives is very narrow and is dominated by the banking sector, which comprises seven commercial banks. The Non-Bank Financial Institutions (NBFIs) in Maldives include a finance leasing company, a specialised housing finance institution, a pension administration office, insurance companies, insurance brokers and agents, money service businesses and securities market intermediaries. The banking sector includes two locally incorporated banks, four branches of foreign banks and a subsidiary of a foreign bank. The locally incorporated banks comprise the Bank of Maldives Ltd (BML), established in 1982, which is the national bank with the majority shareholding owned by the Government of Maldives and the Maldives Islamic Bank Pvt Ltd (MIB), the first Islamic bank in the country, which opened in March 2011. The four branches of foreign banks are the State Bank of India (SBI) (1974), Habib Bank Limited (HBL) (1976), Bank of Ceylon (BOC) (1981) and Hong Kong Shanghai Banking Corporation Ltd (HSBC) (2002), while the subsidiary of a foreign bank is the Mauritius Commercial Bank, Maldives Pvt Ltd (MCB) (2008).

By the end of 2011, the commercial banks had a total of 33 branches and 47 Automated Teller Machines (ATMs) across Maldives with 12 branches and 27 ATMs located in urban areas (Malé, Hulhumalé and Villimalé), and the rest located on different atolls across the country. The net foreign assets of the banking sector have become negative by 7.5 per cent in 2010, which reflects the pressure

on Rufiyaa due to lower tourist receipts, fish exports and high repayment of external debt. There has been variable movement indicating the sale of some state assets in 2010. The monetary base has been growing at a slower rate of 4.4 per cent in 2012, compared to 24.5 per cent in 2011. (Table 4)

Table 4: Central Bank Survey (2008-2012)

	<i>(In millions of rufiyaa)</i>				
	2007	2008	2009	2010	2011
Net foreign assets	3,857.1	3022.0	3071.7	4067.6	4725.5
Claims on other depository corporations	0.0	0.0	0.0	0.0	0.0
Net claims on central government	906.1	2640.6	3419.2	2725.0	3527.4
Claims on other sectors	12.3	9.7	4.8	5.9	4.7
Monetary base	4,374.1	5382.4	6143.9	6064.3	7551.3
Other liabilities to other depository corporations	7.8	6.3	15.7	496.7	85.3
Deposits and securities other than shares excluded from monetary base	0.1	0.1	0.1	10.1	10.1
Loans	0.0	0.0	0.0	0.0	0.0
Shares and other equity	197.4	205.7	432.7	349.8	752.1
Other items (net)	196.0	77.8	-96.6	-122.2	-141.3
<i>(Twelve month percentage change)</i>					
Net foreign assets	37.1	-21.6	1.6	32.4	16.2
Claims on non-residents	33.0	-21.9	8.4	34.1	15.1
Liabilities to non-residents	-37.4	-33.2	313.1	52.5	4.8
Net claims on central government	-6.3	191.4	29.5	-20.3	29.4
Claims on central government	6.3	83.8	25.2	-6.9	-0.0
Monetary base	27.8	23.0	14.1	-1.3	24.5
Currency in circulation	13.9	33.3	2.1	4.0	17.4
Liabilities to other depository corporations	35.3	20.7	19.4	-2.9	26.6

Source: Maldives Monetary Authority (Monthly Statistics August 2012).

Among the Non-Bank Financial Institutions (NBFIs), the leasing business is operated by the Maldives Finance Leasing Company Pvt Ltd (MFLC) (2002), while the Housing Development Finance Corporation Plc (HDFC) (2004) is the only specialised housing finance company providing housing finance for longer pay back periods. The insurance sector includes the Allied Insurance Company of the Maldives Pvt Ltd (1984), Sri Lanka Insurance Corporation Ltd (1976), Amana Takaful (Maldives) Pvt Ltd (2010) and Ceylinco Insurance Company Pvt Ltd (2010). In addition, NBFIs also include specialised insurance brokers and agents in the insurance industry and money transfer operators. All the

commercial banks and NBFIs are regulated by the central bank—the Maldives Monetary Authority (MMA). However, the securities market intermediaries, including brokers, dealers, investment advisers, stock exchange, central depositories and the pension industry, are regulated by the Capital Market Development Authority (CMDA), which is a separate entity with the statutory power to license and regulate these intermediaries.

External Sector

Despite improvements in the services receipts from the tourism industry, the current account deficit more than doubled to record US\$490.1 million in 2011 (24 per cent of GDP), compared to US\$207.2 million in 2010 (see Table 5). This was largely due to an increase in the merchandise trade deficit of the Balance of Payments during the year.

Table 5: Balance of Payments 2007-2011

	<i>(in millions of US Dollars)</i>				
	2007	2008	2009	2010	2011
A. Current Account	-460.3	-777.3	-333.9	-207.2	-490.1
Balance on goods	-1077.8	-1,317.6	-912.7	-1044.3	-1378.9
Balance on services	1,057.0	1,043.8	1,036.0	1,358.8	1,441.0
Balance on income	-248.8	-290.4	-277.8	-322.6	-333.3
B. Capital Account	46.1	51.2	29.3	9.3	30.2
C. Financial Account					
D. Net Errors and Omissions					
(sum A+B+C+D+E)	95.4	415.6	128.7	267.6	383.5
E. Reserves and Related Items	-76.9	67.8	20.4	89.2	-15.3
Reserve assets	-76.9	67.8	20.4	89.2	-15.3
Borrowing from IMF	0.0	0.0	0.0	0.0	0.0
Memorandum Items					
Exports of Goods & Services (XGS)	1,620.7	1,803.5	1,605.3	2,007.4	2,327.4
Current account as per cent of GDP	-29.9	-41.1	-17.2	-10.0	-24.1
Reserves (millions of US dollars)	308.5	240.6	261.0	350.2	334.9

Source: Ministry of Finance and Treasury.

In 2011, the merchandise trade deficit increased by 32 per cent to record US\$1,378.9 million compared to US\$1,004.3 million in 2010. Although there was a notable increase in merchandise exports, this was offset by the 39 per cent increase in merchandise imports³ during the review year. Proceeds from merchandise exports are divided into domestic exports, which contributed 37 per cent of merchandise exports, and re-exports contributed the remaining bulk portion. Re-exports, which mainly comprise jet-fuel sold to air carriers (83 per cent), increased by 77 per cent, largely on account of higher fuel prices charged during the review year. Domestic exports, dominated by fish exports, performed

well during 2011 recording an impressive growth of 72 per cent and reached US\$127.4 million in 2011. At the end of 2011, earnings from fish exports increased by 77 per cent to record US\$120.6 million.

Conversely, the volume growth of fish exports was at 14 per cent in 2011. During the review year, the fresh chilled or frozen tuna category dominated the fish exports composition, constituting 80 per cent to total fish exports. Dried and salted dried tuna contributed 9 per cent, while canned or pouched tuna contributed 8 per cent. In 2011, earnings from fresh chilled or frozen tuna more than doubled, while canned or pouched tuna export earnings increased by 58 per cent. However, a decline of 18 per cent was recorded in the export earnings from dried and salted dried tuna during the year.

With respect to merchandise imports, there was a substantial increase in the total value of merchandise imports⁴ in 2011, totalling US\$1,465.3 million. This was a 34 per cent (US\$ 374.5 million) increase in value as compared to 2010. The sharp rise in the value of imports reflected the depreciation of the rufiyaa, together with the spike in global oil prices during the year. Imports are divided into imports by the private sector and imports by the public sector, which added up to 69 per cent and 31 per cent of total imports, respectively.

Private sector imports are further divided into private sector imports eluding tourism sector imports (73 per cent) and imports made directly by the tourism sector (27 per cent). Likewise, public sector imports are classified into imports by public sector non-financial enterprises (76 per cent) and imports by the government (24 per cent). When considering the composition of imports, food items accounted for 20 per cent of the total imports, while petroleum products and wood, metal, cement and aggregates accounted for 25 per cent and 10 per cent of the total imports, respectively.

Expenditure on food items in 2011 rose by 26 per cent in annual terms and totalled US\$296.9 million. Meanwhile, imports of petroleum products increased by 46 per cent during the year, with a value adding up to US\$366.4 million due to higher global fuel prices. Further, the expenditure on wood, metal, cement and aggregates rose by 27 per cent compared to the previous year, which reflected the recovery of the construction industry.

Services

The balance on services in the Balance of Payments improved by 6 per cent in 2011, due to an improvement in travel receipts. Travel receipts (based on GST on tourism revenue received by the Maldives Inland Revenue Authority) represented around 94 per cent of all service receipts, reached US\$1,868.2 million in 2011. This was an increase of US\$155.3 million from 2010. Over the same period, Maldivians' expenditure on travel abroad increased by US\$4.5 million

compared to 2010. Transportation payments increased by 15 per cent during 2011, owing to the growth in import payments.

Income

The income account of the Balance of Payments is estimated to deteriorate by 3 per cent, owing to an increase in net outflow of income from the country. In this regard, outflow of income in 2011 is estimated at US\$340.0 million, compared to US\$326.7 million in 2010. This is principally owing to an increase in outflow of income on direct investment and the increase in interest payments on foreign borrowings.

Current Transfers

The deficit on current transfers widened to US\$218.8 million in 2011, from US\$199.1 million in 2010, owing to an increase in current transfer outflows from the country. The growth in current transfer outflows was due to the increase in workers' remittances during the year. However, in 2011, transfer inflows also increased from US\$15.4 million to US\$25.9 million, reflecting an increase in official grants.

Financial Account

In 2011, the surplus on the financial account increased by US\$41.5 million to US\$61.0 million. This was due to an increase in inflow from Foreign Direct Investment (FDI) in 2011, compared to 2010. FDI inflows for 2011 stood at US\$281.6 million as compared to US\$216.5 million in 2010. The net 'other investment'⁵ flow to the country deteriorated significantly in 2011. The main reason for this was the increase in foreign assets of the commercial banks and the private sector. The foreign liabilities of commercial banks registered a decline of US\$110.9 million over 2010. The foreign assets of commercial banks increased by US\$33.2 million, as compared to the US\$11.4 million increase at the end of 2010. Conversely, private sector debt registered a US\$28.6 million increase in the review year.

Overall Balance and International Reserves

The overall balance showed a deficit of US\$15.3 million, leading to a drawdown of reserves by the same amount. At the end of 2011, gross international reserves stood at US\$334.9 million, compared with US\$350.2 million at the end of 2010. In terms of import cover, gross reserves were equivalent to 2.7 months of imports at the end of 2011. This value stood at 3.9 months at the end of 2010.

Exchange Rate

The fixed exchange rate regime of Maldives, whereby the rufiyaa was pegged to the US dollar, was changed with the introduction of a horizontal exchange rate

band during the year. With effect from 11 April 2011, the Maldivian rufiyaa was allowed to float within a band of 20 per cent in either direction around a central parity of MVR12.85 per US dollar. That is, the rufiyaa was allowed to fluctuate between MVR10.28 and MVR15.42. Following the introduction of the exchange rate band, the rufiyaa depreciated sharply, reaching the upper limit of the band by the end of April 2011. Reflecting this, as at the end of December 2011, the Maldivian rufiyaa had depreciated, in annual terms, against all currencies of the major trading partners. The rufiyaa depreciated by 20 per cent against the US dollar, by 29 per cent against the Japanese yen, by 23 per cent against the Sterling pound, by 24 per cent against the Singapore dollar, by 21 per cent against the euro and by 10 per cent against both the Indian rupee and the Sri Lankan rupee.

External Debt

The information on external debt statistics is limited to foreign borrowings of the government, government guaranteed borrowings and external liabilities of commercial banks. According to information obtained from the Ministry of Finance and Treasury and the MMA, the official external debt stood at US\$1,015.1 million (50 per cent of GDP), compared to US\$962.6 million at the end of 2010 (46 per cent of GDP).

Public and publicly guaranteed (medium- and long-term) debt rose to US\$745.3 million at the end of 2011. Such debt increased to 37 per cent of GDP in 2011, while it stood at 30 per cent during the previous year. Foreign liabilities of commercial banks recorded a decline of 20 per cent and stood at US\$269.8 million at the end of 2011. As observed in the past, loans from multilateral and bilateral sources constituted the bulk of public sector debt, with 73 per cent of all public debt obtained from these sources. Loans from multilateral sources increased by 11 per cent and reached US\$350.2 million at the end of 2011. Meanwhile, loans from bilateral sources increased by 6 per cent and stood at US\$190.5 million at the end of the review year. The debt service ratio of public and publicly guaranteed debt also increased during the year to 6.9 per cent as compared to 5.1 per cent at the end of 2010.

Political Developments and Democracy

In June 2004, the government announced its plan to reform the political process that includes, amongst others, changing the constitution which had been in place from 1998. The rationale behind this change was the changing situation in Maldives and the need to strengthen governance and bring about separation of powers between the executive, the legislature and the judiciary. In order to kick off the political reform process, *Special Majlis* elections were held in May 2004,

and the elected took oath of office in June 2005. Rules of procedure of the *Special Majlis* were adapted in October 2004.

The establishment and management of political parties were decreed by the President of Maldives in June 2005. The debate for constitutional reform began in February 2006. The new constitution was ratified on August 2008. The new constitution has the fundamental rights of the citizens well described, and the powers devolved on the executive, the legislature and the judiciary. In addition, the constitution called on the *People's Majlis* to establish a Civil Service Commission, a Judicial Service Commission, a Human Rights Commission and an Anti-Corruption Commission. These commissions constitute the executive branch. The former Ministry of Atolls Administration was disbanded and power distributed to island councils and atoll councils. All these independent commissions brought additional public expenditure, which was very high.

The first multiparty presidential elections were held in October 2008, and as per the result of the first round of elections, out of six candidates no candidate got 51 per cent of the simple majority, as required by the constitution. The second round of the presidential election held on October 28, 2008 was won by Mohamed Nasheed of the Maldivian Democratic Party (MDP) by 54.1 per cent of the votes.

The first multiparty parliamentary election was held on May 9, 2009. The results of the election concluded that the simple majority was won by Dhivehi Rayyithunge Party (DRP) with 28 seats, the independent candidates won 13 seats and MDP got 26 seats.

The political differences within the party and within the opposition started to escalate. In June 2010, President Nasheed's cabinet resigned *en masse*, as the opposition was preparing for a vote of no confidence in the *Majlis* against the ministers. In July 2010, Mulak constituency Parliamentarian and People's Alliance Leader Abdulla Yamin and Qasim Ibrahim, leader of the Republican Party and Parliamentarian for Maamigili constituency, were arrested by police without citing any charges against them. They were released under court order, as it was illegal to keep them under arrest.

During February 2011, Elections Commission conducted the first local council elections throughout the country. All the opposition political parties organised a very large rally in December 2011. Its objective was to protest against the alleged Anti-Islamic practices of President Nasheed's government. On January 15, Judge Abdulla Mohamed ordered the release of Mohamed Jameel Ahmed after the Maldives Police Service failed to show any legitimate reason for his arrest. On January 16, Maldives Police Service summoned Judge Abdulla Mohamed for questioning; on the same day, Judge Abdulla Mohamed lodged an application to quash the Maldivian Police Service summons and obtained an interim injunction against the Maldivian Police Service. Armed with this interim

injunction, Judge Abdulla Mohamed refused to attend to the Maldivian Police Service. The government then decided to use the military to detain and incarcerate Judge Abdulla Mohamed.

On the same night, the military entered Judge Abdulla's home. He was detained, and taken under protection and transported to the military training centre in Girifushi, where he spent 22 days. He was not allowed to consult or instruct his legal counsel under the constitution. Political parties began to protest against the unconstitutional act of the government. The Human Rights Commission of Maldives condemned the arrest of Judge Abdulla and asked for his release, as his arrest as well as detention was a violation against the basic rights and freedom guaranteed by the constitution of Maldives. Similar calls were made by prominent Maldivian lawyers, the Judicial Service Commission of Maldives, the Chief Justice of the Supreme Court and High Court of Maldives, Prosecutor General of Maldives and International Commission of Jurists. All these appeals were ignored by President Nasheed.

From January 17 onward, opposition political parties started protests calling for his release. The protests were made during the night and commercial television stations continued to air the protests live. The protests continued, and on February 6, the pro- and anti-government protesters were facing each other. The police tried to calm them, but Military assistance was sought by the government. It led to increased confusion and tension, and the protests continued till early morning. Finally, President Nasheed gave orders for the withdrawal of the police special operations from the protest zone. But the personnel refused to depart, claiming it was an unlawful order. They further claimed that it was their sworn duty to prevent breach of peace and violence. The protesters marched in front of the Republican Square and demanded the release of Judge Abdulla. The protesters continued to call for the resignation of President Nasheed, later even the police protested. The anti-government protests continued until the morning of February 7, 2012.

About 7 a.m. on February 7, President Nasheed walked from the Military Headquarters to deal within the situation personally. He was protected by his bodyguards and other Military personnel. President Nasheed failed to achieve his objective, and was heckled. The crowd abused him and made clear calls for his resignation. He then returned to the Ministry of Defence Headquarters. At the Defence Headquarters, he asked the senior military officials not to use any fire arms to solve this crisis. He also mentioned that he would like to resign. He then proceeded to the President's office to meet the cabinet. In the cabinet meeting, he wrote by hand, his letter of resignation to the speaker of *Majlis*. By then, a press conference was arranged. President Nasheed announced his resignation to the media. The resignation letter was delivered to the Speaker of Parliament.

On February 7, Vice President Mohamed Waheed was sworn in at the parliament, before the Chief Justice of the Supreme Court and the speaker of the parliament as President of Maldives. On February 8, 2012, the local and international media reported that President Nasheed claimed that he was forced to step down at gunpoint and urged his successor to resign so that he could continue in office. President Mohamed Waheed formed a Commission of National Enquiry on February 12, 2012. The commission concluded its work and published it on August 30, 2012. The commission concluded: "Consequently, subject only to the issue of the resignation not being voluntary as a result of illegal coercion, the assumption of office of the President by Dr. Waheed on the afternoon of 7 February 2012 [*sic*] was in accordance with constitution."

Conclusion

Maldives being a small island country, majority of the population lives in small islands with no industrial base. The economy has done remarkably well during 2000-2010, growing at 6 per cent annually. However, owing to the democratisation process and the political changes from 2005 onwards, the economic growth has slowed down somewhat, and this change has strained the business climate.

Public expenditure has been growing at a faster rate than the revenue. In 1995, current expenditure and capital expenditure both constituted half of the total expenditure. This trend has reversed from 1996, and by 2000, it reached 60 per cent of the expenditure, excluding net lending, and further deteriorated to 70 per cent of the total expenditure by 2010. Although taxation was introduced for the first time, still personal income tax bill remains at the Majlis awaiting debate.

Overall budget deficit remained unsolved at 10.2 per cent of GDP in 2011. Inflation remained high at about 6 per cent in 2011 and the Rufiyaa depreciated against the US\$ by 20 per cent in 2012. The loose fiscal discipline, public expenditure on welfare and subsidies are still to be addressed.

Several independent institutions created after the democratic process, together with the local atoll councils, have put extra pressure on the fiscal deficit because of the high number of staff and their wage package. The institutions to manage the economy are home grown and need much improvement in creating and bringing expertise in management and administration. Maldives lacks experience in these areas of public administration. In addition, technical training is required, and strengthening the health and education sectors is important. The rest of the SAARC countries have the expertise and other resources to help Maldives in these areas of institution building.

Annex I: Gross Domestic Product 2007-2011

		2007	2008	2009	2010 estimated	2011 Provisional
ISIC ⁶	Industry / Economic Activity					
	Primary	16,512.2	698.3	647.0	602.3	595.9
A & C	Agriculture and mining	722.9	344.8	336.9	351.8	365.3
B	Fisheries	341.4	353.5	310.1	250.5	230.6
	Secondary	381.5	3,597.4	2,656.2	2,793.2	2,957.0
D	Manufacturing	894.1	1,016.5	813.7	757.7	771.5
	<i>fish preparation</i>		595.8	452.5	377.0	370.8
E	Electricity and water supply	439.9	502.8	593.8	611.5	688.4
F	Construction	1,950.8	2,078.10	1,302.8	1,423.9	1,497.1
	Tertiary	12,729.0	14,446.1	14,518.8	15,429.9	16,660.5
G	Wholesale and retail trade	762.5	862.5	765.4	764.1	789.7
H	Tourism (Resorts, etc.)	4,704.3	4,870.0	4,608.1	5,334.8	6,061.3
I	Transport and communications	2,550.2	2,968.0	3,208.1	3,389.2	3,671.6
J	Financial services	475.3	513.0	485.1	508.0	523.8
K	Real Estate	1,587	1,519.1	1,451.4	1,412.3	1,380.6
K	Business services	200.9	216.8	206.7	251.1	222.6
LMNO	Others	2,448.0	3,281.9	3,612.5	3,612.6	3,804.3
	Fisim⁷	-224.5	-215.35	-173.63	-166.87	-162.09
	GDP at basic price	16,512.2	18,985.70	17,648.4	18,658.5	20,051.3
(Annual Percentage Change)						
	Primary	-11.9	-3.4	-7.4	-6.9	-1.1
A & C	Agriculture and mining	3.0	1.0	-2.3	4.4	3.8
B	Fisheries	-22.0	-7.3	-12.3	-19.2	-8.0
	Secondary	22.5	9.5	-26.2	5.2	5.9
D	Manufacturing	5.3	13.7	-20.0	-6.9	1.8
E	Electricity and water supply	14.9	14.3	7.4	13.3	12.6
F	Construction	34.7	6.5	-37.3	9.3	5.1
	Tertiary	9.2	13.5	0.5	6.3	8.0
G	Wholesale and retail trade	8.5	13.1	-11.3	-0.2	3.4
H	Tourism (Resorts, etc.)	9.7	3.5	-5.4	15.8	13.6
I	Transport and communications	18.6	9.4	-5.3	28.9	30.8
J	Financial services	12.0	7.9	-5.4	4.7	3.1
K	Real Estate	-1.3	-4.3	-4.5	-2.7	-2.2
K	Business services	12.0	7.9	-4.6	4.1	3.5
LMNO ⁸	Others	54.4	189.8	16.2	-4.8	39.4
	Fisim⁹	-0.5	-4.1	-19.4	-3.9	-2.9
	GDP at basic price	10.6	12.2	-4.7	5.7	7.5
Memorandum items:						
Mid-Year Population (inclusive of expatriates)		390,414	384,801	393,578	406,359	
GDP at 2003 constant prices (Million US\$)		1,447.4	1,378.8	1,457.7	1,566.5	
GDP per capita at 2003 constant prices (MVR)		47,453.3	45,863.6	47,407.4	49,343.7	
GDP per capita at 1995 constant prices (US\$)		3,707.3	3,583.1	3,703.7	3,855.0	
GDP per capita at 1995 constant prices (PPP\$)		6,003.70	5,697.00	6,119.20	6,417.60	

Source: Maldives Monetary Authority (Monthly Statistics August 2012).

Annex II: Central Bank Survey 2008-2012¹⁰

	2007	2008	2009	2010	2011
Net foreign assets	3,857.1	3022.0	3071.7	4067.6	4725.5
Claims on non-residents	3,97.7	3089.3	3349.5	4491.3	5169.6
Liabilities to non-residents	-100.6	-67.3	-277.8	-423.6	-444.1
Claims on other depository corporations	0.0	0.0	0.0	0.0	0.0
Net claims on central government	906.1	2640.6	3419.2	2725.0	3527.4
Claims on central government	1,830.7	3365.0	4213.0	3921.5	3920.2
Liabilities to central government	-924.6	-724.4	-793.8	-1196.5	-392.8
Claims on other sectors	12.3	9.7	4.8	5.9	4.7
Claims on other financial corporations	0.0	0.0	0.0	0.0	0.0
Claims on public non-financial corporations	0.0	0.1	0.0	0.0	0.0
Claims on private sector	12.3	9.6	4.8	5.9	4.7
Monetary base	4,374.1	5382.4	6143.9	6064.3	7551.3
Currency in circulation	1,322.3	1762.2	1799.7	1871.1	2196.7
Liabilities to other depository corporations	61.2	3609.6	4308.5	4182.6	5294.2
Liabilities to other sectors	7.8	10.5	35.7	10.5	60.4
Other liabilities to other depository corporations	0.1	6.3	15.7	496.7	85.3
Deposits and securities other than shares excluded from monetary base	0.0	0.1	0.1	10.1	10.1
Deposits included in broad money	0.0	0.0	0.0	0.0	0.0
Securities other than shares included in broad money	0.0	0.0	0.0	0.0	0.0
Deposits excluded from broad money	0.1	0.1	0.1	10.1	10.1
Securities other than shares excluded from broad money	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0
Shares and other equity	197.4	205.7	432.7	349.8	752.1
Other items (net)	196.0	77.8	-96.6	-122.2	-141.3
<i>(Twelve month percentage change)</i>					
Net foreign assets	37.1	-21.6	1.6	32.4	16.2
Claims on non-residents	33.0	-21.9	8.4	34.1	15.1
Liabilities to non-residents	-37.4	-33.2	313.1	52.5	4.8
Net claims on central government	-6.3	191.4	29.5	-20.3	29.4
Claims on central government	6.3	83.8	25.2	-6.9	-0.0
Monetary base	27.8	23.0	14.1	-1.3	24.5
Currency in circulation	12.9	33.3	2.1	4.0	17.4
Liabilities to other depository corporations	35.3	20.7	19.4	-2.9	26.6

Source: Maldives Monetary Authority.

Annex III: Balance of Payments 2007-2010¹¹

	2007	2008	2009	2010	2011 Rev Est
A. Current Account	-460.3	-777.3	-333.9	-207.2	-490.1
Balance on goods	-1077.8	-1,317.6	-912.7	-1044.3	-1378.9
Goods: credit	227.0	331.4	169.0	197.5	346.4
Domestic exports f.o.b.	107.8	125.9	76.4	73.9	127.4
Other	119.2	205.5	92.7	123.6	219.0
Goods: debit	-1,304.8	-1,649.0	-1,081.7	-1,241.8	-1,725.3
Imports f.o.b.	-1,304.8	-1,649.0	-1,081.7	-1,241.8	-1,725.3
Balance on services	1,057.0	1,043.8	1,036.0	1,358.8	1,441.0
Services: credit	1,393.7	1,472.1	1,436.3	1,809.9	1,981.0
Travel	1,331.4	1,392.3	1,365.8	1,712.9	1,868.2
Services: debit	-336.7	-428.4	-400.2	-451.1	-540.0
Balance on income	-248.8	-290.4	-277.8	-322.6	-333.3
Income: credit	26.7	14.0	5.8	4.0	6.6
Income: debit	-311.5	-304.4	-283.5	-326.7	-340.0
Balance on current transfers	-154.7	-213.1	-179.5	-199.1	-218.8
Current transfers: credit	47.9	19.8	24.5	15.4	25.9
Current transfers: debit	-202.6	-232.9	-204.0	-214.5	-244.7
B. Capital Account	46.1	51.2	29.3	9.3	30.2
C. Financial Account	395.7	242.7	196.3	19.5	61.0
Direct Investment (net)	125.6	175.0	154.0	216.5	281.6
Direct investment in Maldives	125.6	175.0	154.0	216.5	281.6
Portfolio Investment (net)	3.3	11.4	-12.0	-12.2	0.1
Other Investment (net)	266.9	56.3	54.4	-184.8	-220.7
Other investment assets	-135.5	-102.3	-134.1	-165.6	-201.3
Banks ¹²	-15.7	23.0	-11.2	-11.4	-33.2
Other sectors	-119.8	-125.3	-122.9	-154.2	-168.1
Other investment liabilities	402.4	158.6	188.5	-19.2	-19.4
Monetary authorities	-4.7	-2.6	16.5	11.4	-4.3
General government	36.4	60.5	71.0	74.6	67.2
o.w. Loans	36.4	60.5	71.0	74.6	67.2
Disbursements	65.4	97.7	110.7	124.1	132.9
Amortisations	-29.0	-37.2	-39.7	-49.5	-65.7
Banks	210.9	7.2	-15.6	-69.4	-110.9
Other sectors	159.8	93.4	116.6	-35.9	28.6
D. Net Errors and Omissions (sum A+B+C+D+E)	95.4	415.6	128.7	267.6	383.5
E. Reserves and Related Items	-76.9	67.8	20.4	89.2	-15.3
Reserve assets	-76.9	67.8	20.4	89.2	-15.3
Borrowing from IMF	0.0	0.0	0.0	0.0	0.0
Memorandum Items					
Exports of Goods & Services (XGS)	1,620.7	1,803.5	1,605.3	2,007.4	2,327.4
Current account as per cent of GDP	-29.9	-41.1	-17.2	-10.0	-24.1
Reserves (millions of US dollars) ¹³	308.5	240.6	261.0	350.2	334.9

Source: Maldives Monetary Authority.

Annex IV: External Debt 2007-2011

	2007	2008	2009	2010	2011 Rev Est
Total external debt outstanding and disbursed	828.3	878.7	933.7	962.6	1,015.1
Public and publicly guaranteed (medium and long term)	420.0	455.9	533.3	626.6	745.3
Multilateral	272.4	282.5	290.5	316.4	350.2
Bilateral	45.6	58.5	146.2	179.2	190.5
Financial Markets	27.5	45.5	38.8	-	-
Commercial	-	-	-	52.5	62.2
Suppliers Credit	74.5	69.4	57.8	71.2	87.2
Pipeline	-	-	-	-	50.0
Guaranteed Debt	-	-	-	7.4	5.1
Commercial banks	408.3	422.8	400.4	336.0	269.8
Head offices or branches	302.4	375.1	353.6	316.1	263.7
Other depository institutions	105.9	47.7	46.8	19.8	6.1
Public and publicly guaranteed (medium and long term)					
Disbursements ¹⁴	65.4	97.7	110.7	141.8	152.9
Debt service	39.3	52.2	50.2	48.5	70.0
Amortisation	29.0	37.2	39.7	40.5	60.7
Interest payments	10.3	15.0	10.5	8.0	9.3
<i>(In percent of GDP)</i>					
Total external debt outstanding and disbursed	53.7	46.4	48.1	46.4	50.0
Public and publicly guaranteed debt	27.2	24.1	27.5	30.2	36.7
Commercial banks debt	26.5	22.3	20.6	16.2	13.3
Debt service ratio (public and publicly guaranteed)	4.5	5.0	6.1	5.1	6.9
Memorandum Items					
Nominal GDP ¹⁵	1,5420	1,891.6	1,942.0	2,075.5	2,029.6
Exchange Rate (avg mid)	12.8	12.8	12.8	12.8	15.4
Exports of goods and services (XGS)	1,620	1,803.5	1,605.3	2,007.4	2,327.4

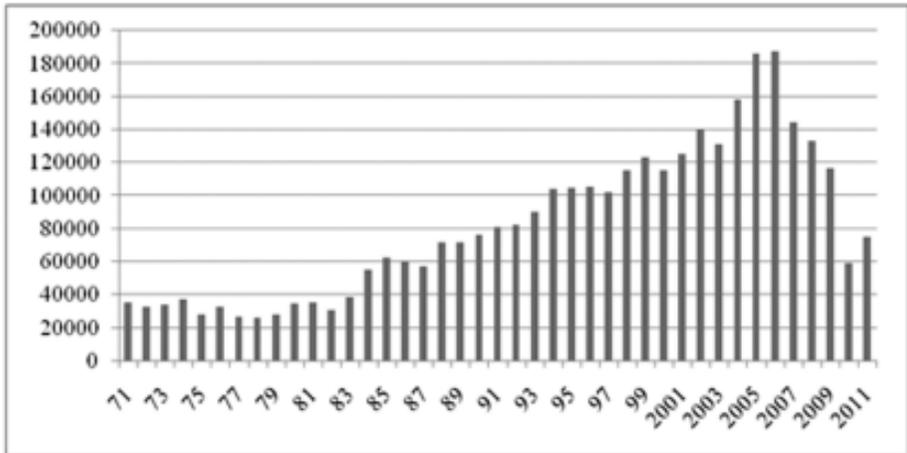
Annex V: Notes On Pole and Line Fishing

- 1.1. In Maldives, tuna fisheries is an important part of the GDP, which creates employment and generates income for the island community. Tuna fisheries traditionally were carried out in sailing boats called *Dhoni* which were mechanised in 1974. (The size of these *Dhonis* is 11 to 12 m.) This change has brought about a revolution in the life of fishermen and their families by curtailing the travel time between the islands and atolls. The *Dhonis* are used as a means of transport between the islands and intra-atoll. Passengers and basic necessities such as provisions, fuel and oil are brought to the island by means of these vessels from main supply centres of Malé.
- 1.2. The *Dhoni* and its crew sails early morning to catch live bait (small fish like sprats which are about 9-12 mm) near the coral reefs. By using nets, it is hauled into already flooded bait compartment of the *Dhoni*.
- 1.3. Once the bait is in the compartment, fresh sea water is circulated continuously by bailing out the *Dhoni*. The fresh sea water flows into the compartment through a valve. The mechanical pump has replaced traditional bailing of water by hand. When enough bait is collected, the *Dhonis* sail into the ocean and look out for schools of Skipjack (*Katsuwonus pelamis*) and Yellow fin tuna (*Thunnus albacares*). Skipjack is about 1.5 to 12 kg each and Yellow fin ranges from 2-25kg each.
- 1.4. When the *Dhoni* reaches the schools of tuna, the speed is reduced, and live bait is thrown into the sea to attract the fish and bring them to the surface. The captain and others then start fishing by using a pole and line with a barbless hook, which separates the fish from the hook automatically. For about eight crew members, it can take around 1 to 3 hours to catch 5 tons of fish on an average.
- 1.5. There are no fixed wages for the fishermen, except for the captain of the boat, to whom the boat owner pays a monthly cash bonus as an incentive. The catch is divided amongst the boat owner and the crew. In this share system, the hierarchies of the fishermen are pre-determined and accepted by all. This established sharing system exists traditionally and is implemented nationwide. The harvested catch is brought to the respective homes of the crew. The next process is butchering, removing the intestine, the head and gills and the gutting of the fish. This is followed by boiling, smoking and further drying the fish in the sun; this is carried out by the women of the family. The product when processed is hard and can last for months without deterioration. This product is called "*Maldivian fish*". which is exported to Sri Lanka.
- 1.6. The mechanisation of the fishing fleet began in 1972, and the traditional sailing *Dhoni* was strengthened to install an inboard diesel engine with a reduction gear and a propeller shaft. The government extended credit to fishermen by supplying and installation of engines on *Dhonis*. The *Dhoni* was valued as the equity of the owner and the credit agreement was signed between the boat owner and government. This project developed very well and extended over a period of 10 years. Along with the introduction of mechanised *Dhonis*, freezing

of tuna was introduced. Freezer ships (900 GRT) were accompanied with five smaller ships of (15 GRT); tuna was delivered to these ships, where it was weighed and cash was paid to fishermen at a fixed price.

- 1.7. The catch is sold directly to the mother vessels where fishermen are paid cash on the spot. The fish is sold to the freezer and collector vessels without removing gills and guts. This brought more income to the fishing community than dried *Maldivé fish*. These ships are located close to the main fishing islands of the atolls. Selling fish direct to the mother vessels had reduced the workload of fishermen and their families, who otherwise would be engaged in cooking, smoking and sun drying the fish. In this way, women at home have sufficient free time to attend their children and take care of their educational needs.
- 1.8. The following graph shows the Skipjack catch from 1971 to 2011.

Graph F1: Skipjack Catch: 1971-2011 (in metric tons) *



Note: *The above graph does not include yellow fin tuna catch.

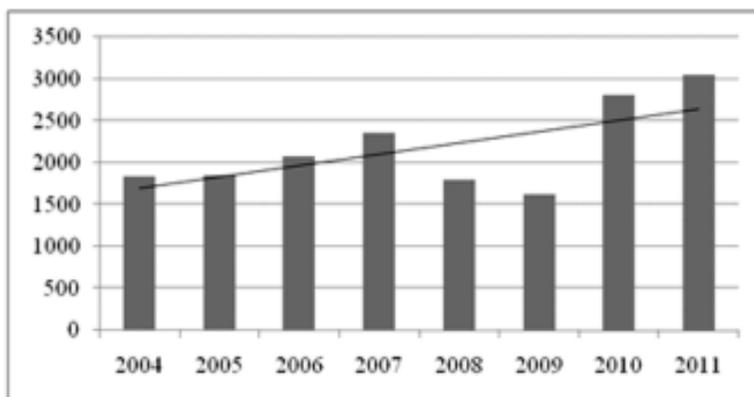
Source: Ministry of Fisheries Maldives Year Books.

- 1.9. The fish is then frozen to -18°C and stored on board freezer vessels at -25°C until the fish is exported by a refrigerated cargo ship. The mother ship remains at anchorage until the vessel is full, and then frozen fish is transferred to the carrier ship for export.
- 1.10. Having gained sufficient experience in the freezer ships operations, the authorities embarked on development of bigger fishing *Dhonis*. Land-based cold storage facilities and additional value added products were introduced in constructing canning factories.
- 1.11. Government constructed a boat building yard and started a new Generation of fishing vessels. These vessels were given to fishermen on lease purchase basis. The first batch of six *Dhonis* were given to fishermen in 1983, and thereafter additional six every three months. Introduction of these new vessels in the fishing fleet had started the increase of catch from 1981 as shown the graph F1. In total, 150 *dhonis* were built in a central boat yard and leased to

Dhoni captains, who became active fishermen and boat owners, whereas traditionally boat owners did not actively participate in fishing.

- 1.12. A new land-based cold storage of 700 m with a 50 m cannery was built, targeting the northern atolls, in 1987. Targeting the Central Atolls, a cold storage of 300 m was constructed in 1994, and additional 700 m cold storage was added to this facility in 1996. At the same time, targeting the southernmost four atolls, a cold storage of 2000 m was built in 1995. With these new facilities in action, the catch of fish was increased tremendously up to a record catch of 187,335 metric tonnes in 2006.
- 1.13. It can be observed in Graph F1 that after 2006, the catch of fish has started reducing. It is mainly because of the increase in fuel price and La-Nino effect in the Indian Ocean during the period 2006-2010. The plankton (food for fish) in the Indian Ocean was reduced by 30 per cent. Another reason for decreasing of skipjack landing is because of the better prices fishermen were getting from hand line yellowfin tuna. This fishery is different from Skipjack fisheries and almost 50 per cent of skipjack fishing *Dhonis* were diverted to yellow fin tuna. As a result, the effort was reduced although Catch per Unit effort remained the same.

Graph F2: Catch Per Unit Effort (CPU) 2004-2011



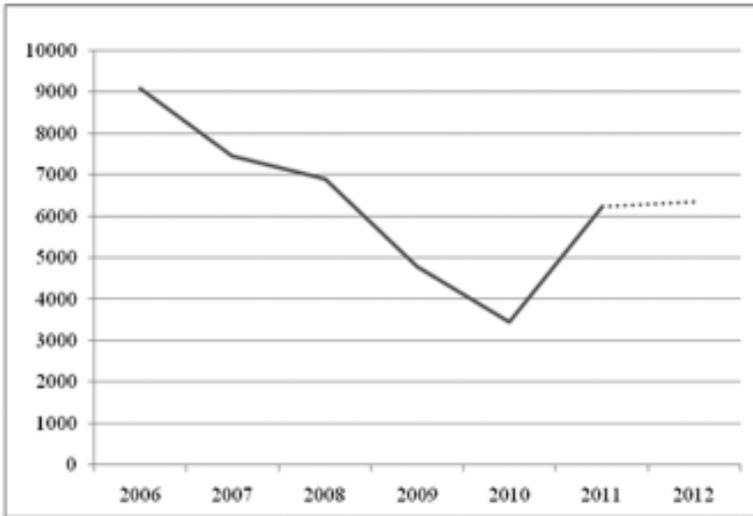
Source: Ministry of Fisheries Maldives (Fisheries Year Books).

- 1.14. Catch per unit effort is the average quantity of fish caught in kilograms for number of trips sailed. Graph F2 indicates that unit effort fell during 2007 and 2008, as a result 40 per cent of *Dhonis* diverted to hand line yellow fin fishery.
- 1.15. Yellow fin is processed and exported fresh, in ice to various countries by air. Yellow fin fishery has developed as a separate fishery from the pole and live skipjack fishery.
- 1.16. The established land-based facilities are supported by harbour and docks, where the fishing *Dhonis* discharge their catch directly on the jetty. On the jetty, the size and quality is sorted out, and the catch is transported into the freezing

facilities, where either brine freezing or blast freezing is done. Land-based facilities have created new employment opportunities in the area like wharf attendants, dock foremen, suppliers of oil and ice and jobs for mechanics in maintenance of refrigeration machinery. These facilities can handle more volume than freezer vessels, thereby reducing the fixed cost.

- 1.17. It is interesting to note that the yellow fin tuna is exported chilled in ice. Generally, this cargo is exported by air to the consumer markets to maintain the freshness.

Graph F3: Yellow Fin Tuna Exports (metric tons)



Source: Maldives Seafood processing and exports Association.

- 1.18. The above export quantity (Graph F3) is solely for processed yellow fin tuna. This includes gill and gutted headless tuna and tuna loins.

NOTES

1. ISIC refers to International Standard Industrial Classification of all economic activities.
2. Fisim refers to financial services indirectly measured.
3. Merchandise imports value in the Balance of Payments reflects imports (free on board) and includes adjustments for coverage and valuation.
4. Valued on cost, insurance and freight (c.i.f.) basis.
5. Net 'other investment' flow to the country consists of changes in foreign assets and liabilities of commercial banks, financial flows of the government and the central bank, and foreign borrowings of the private sector.
6. No. 1.
7. No. 2.
8. LMNO—Government administration, education, health and social services.
9. No. 2.
10. New Format is based on *IMF Monetary and Financial Statistics Manual 2000 (MFSM 2000)*.

“Claims on” represents all claims including loans and advances to and holdings of securities, shares and other equity issued by the respective sector.

“Claims to” represents all liabilities issued by the central bank to the respective sector.

11. *This BoP format conforms to the Balance of Payment Manual (BPM5)*, 5th Edition, 1993. The Balance of Payments statistics of Maldives have been extensively revised due to coverage issues. Data represents information available as on 4 September, 2012.
12. Series have been revised on May 20, 2007 to include deposits of non-residents with commercial banks.
13. From 2001 onwards, gross reserves are compiled in accordance with the new reporting format of monetary statistics (MFSM-2000).
14. Disbursements for 2009 exclude the US\$17 million unutilised by the end of 2009 from the US\$50 million trade credit facility from the Indian Government.
15. Revised in November 2011.

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PART III

Stability and Growth in
South Asia

19

India's Role in the Economic Re-integration of the Indian Sub-continent¹

Sanjaya Baru

The recent decision of the governments of India and Pakistan to restore normal trade relations has been hailed in both countries, and the region, as an important step towards economic integration and sustained economic growth in the region.² Taken together with the rapid growth of bilateral trade between India and its other South Asian neighbours, due to the signing of bilateral free trade and comprehensive economic cooperation agreements over the past decade, these recent measures will enable South Asia to realise the potential of a regional Free Trade Agreement (SAFTA) and move towards a South Asian Economic Union (SAEU).

In pursuing this shared regional agenda the member countries of the South Asian Association for Regional Cooperation (SAARC) will only be re-integrating a geographically and historically constituted regional economy that has benefitted from centuries of free flow of goods, capital flows, people and ideas. South Asia, as it is known today, is nothing more than the 'Indian sub-continent' that the world has been familiar with for centuries. The Indian sub-continent was both an integrated economic entity as well as the 'cross-roads' of inter-regional trade flows across the Eurasian land mass and the Indian Ocean littoral.

The Indian Sub-continent as an Integrated Economic System

An 'Economic Union' implies the integration of markets, the ease of travel and trade, efficient connectivity and cultural interaction. All these attributes have increasingly come to characterise interaction within the region called South Asia. South Asia is the modern term for what geographers have for long called the 'Indian sub-continent'. With the end of the British rule in India in 1947, the political landscape of the sub-continent changed once again with the creation of new nations, as it had through the centuries. The Republics of India and Pakistan

came into being. The two, along with the Kingdoms of Nepal and Bhutan, and the Republic of Sri Lanka defined the broad contours of the new 'South Asia'.

South Asia's integrated economic and ecological system got broken up into compartmentalised political entities due to the emergence of independent states in the region. In seeking to re-establish an SAEU, it is important to remember that the 'political' division of the region created artificial discontinuities that are now being sought to be removed through institutions of regional cooperation and integration.

South Asia—Island or Crossroads?

There are some economic historians and geo-economists who have viewed South Asia as a 'self-contained' unit, bounded by natural boundaries and barriers that have limited the region's interaction with the Eurasian land mass, and the Indian Ocean littoral. Thus, for example, geopolitical analyst George Friedman put forward the view that the sub-continent was an 'island':

The geopolitics of India must be considered in the geographical context of the Indian subcontinent—a self-contained region that includes India, Pakistan, Bangladesh and, depending how one defines it, Nepal and Bhutan. We call the subcontinent "self-contained" because it is a region that is isolated on all sides by difficult terrain or by ocean. In geopolitical terms it is, in effect, an island. This "island" is surrounded on the southeast, south and southwest by the Bay of Bengal, the Indian Ocean and the Arabian Sea. To the west, it is isolated by mountains that rise from the Arabian Sea and run through Pakistan's Baluchistan province, stretching northward and rising higher and higher to the northwestern corner of Pakistan. There, at the Hindu Kush, the mountain chain swings east, connecting with the Pamir and Karakoram ranges. These finally become the Himalayas, which sweep southeast some 2,000 miles to the border of Myanmar, where the Rakhine Mountains emerge, and from there south to India's border with Bangladesh, and to the Bay of Bengal.³

As opposed to this 'isolationist' view of the region stands its exact opposite, the view that South Asia was indeed the 'crossroads' of Asia, integrated with the land-based and sea-based trade and flow of people across Asia. Historian K.M. Pannikar's classic treatise, *India and the Indian Ocean*, offers a comprehensive account of the ancient and more recent maritime links between South Asia and the Persian Gulf and Arab peoples, on the western side, and South-east Asia and the peoples of Indo-China, on the eastern side.⁴

As historian Fernand Braudel observed in his three volume account of the rise of the global economy,

The Far East taken as a whole, consisted of three gigantic world economies—Islam, overlooking the Indian Ocean from the Red Sea and the Persian Gulf, and controlling the endless chain of deserts stretching across Asia from

Arabia to China; India, whose influence extended throughout the Indian Ocean, both East and West of Cape Comorin; and China, at once a great territorial power—striking deep into the heart of Asia—and a maritime force, controlling the seas and countries bordering the Pacific. And so it had been for many hundreds of years.⁵

It is important to appreciate this historical context. The South Asian region was not only 'internally' integrated through history, but it was an integral part of the larger Asian and Indian Ocean economies that linked the Arabs of West Asia, the varied ethnic groups of Central Asia and the peoples of the Indo-China region (now South-east Asia). More recently, during the colonial era, the industrial economies of the region were also integrated across current political boundaries.⁶

The SAEU in the 21st Century will therefore, enable the region to reconnect 'internally', thereby re-establishing economic links that existed even till the middle of the 20th Century, as well as 'externally' with Asia to its West, North-west, East and South-east, re-integrating much older economic and cultural links that had once created the world's most prosperous continental economy.⁷

South Asia is not merely a geographical or a geopolitical entity, it is also a civilisational entity. This latter notion would be rejected by many in each of the countries of the region since each one of them is seeking to establish not just their individual national identity, but also a distinct cultural identity. Unlike in Europe, where the effort has been to emphasise the civilisational oneness of the region, in South Asia nascent state formation has meant that each country has sought to focus on what differentiates one nation from another rather than the common roots of their contemporary identity. However, the fact is that racial and cultural similarities are threads that run through the fabric of the region.

What geography proposes, history disposes. Despite the ties that bind South Asia, post-colonial nation building, the geopolitics of the Cold War and unsettled political and territorial disputes have impeded regional cooperation. As part of its own nation-building project, Pakistan sought to 'look west' to the Islamic nations of West and Central Asia. In due course India, Nepal, Bhutan and Sri Lanka began looking East. It is in the face of such hurdles, that a regional association for cooperation was sought to be formed. The creation of the SAARC was therefore, an act of faith. It is the most important framework for regional cooperation in South Asia though other sub-regional groups have come into being aimed at speeding up the process of regional integration.⁸

Regional Cooperation and Institution Building in South Asia: P2P, B2B and G2G

There are three distinct dimensions to bilateral and regional integration: government-to-government (G2G) relations, business-to-business (B2B) relations and people-to-people (P2P) relations. All regional groups, be it the European

Union (EU), or the Association of South-East Asian Nations (ASEAN), or any other such regional entity, have entailed cooperation/integration across all three dimensions.

*Measured against this criterion, South Asia has seen considerable economic integration. Contrary to a widespread feeling that South Asia has been a laggard in regional cooperation/integration (RCI), the facts on the ground suggest a high level of G2G, B2B and P2P interaction within the region.*⁹ It has been observed, ‘...there are good reasons to believe that a variety of local and global factors will increasingly push the countries of the region in the direction of increased regional cooperation’.¹⁰ Among these factors are:

- (i) shared concerns about low level of human development, mass poverty and the consequent problems of social and political instability and violence, migration, disease, etc.;
- (ii) recognition of new synergies in industrialisation and growth of services economy;
- (iii) shared platforms in dealing with multilateral trade negotiations;
- (iv) shared concerns regarding climate change and multilateral regimes pertaining to environmental standards.¹¹

There is growing recognition in the sub-continent that their shared historical and socio-economic legacies have imposed a shared burden in terms of inadequate human development and poverty alleviation. The late Dr. Mahbubul ul Haq, an eminent Pakistani economist and initiator of the United Nations Development Program - Human Development Reports (HDR), took the initiative to publish an annual South Asian HDR focusing on such issues. The SAARC’s Social Charter and agendas for poverty eradication and eradication of illiteracy and disease takes some of these ideas forward. The region can benefit collectively from shared programmes of population control and women’s education and empowerment given the complex religio-cultural barriers to change.

In the field of industrial development, the earlier fears of a regional free trade agreement being a zero-sum game in favour of India are being replaced by growing recognition that this could be a win-win process.¹²

Finally, the region has collectively benefited from working together at the World Trade Organisation and other such multilateral economic forums and organisations. Even at the IMF and World Bank, and at the Asian Development Bank, South Asian governments resist ‘beggar-thy-neighbour’ approaches, and try to work together on regional and national issues.

Apart from such shared concerns, regional cooperation would be pushed forward by the need of the sub-continental neighbours—India, Pakistan, Bangladesh, Nepal and Bhutan, to arrive at consensual frameworks for river water utilisation. All these countries are critically dependent on snow-fed rivers originating in the upper Himalayas and flowing through the Tibetan peninsula.

The sub-continental countries will have to work together to ensure that China does not curtail their access to these waters and at the same time ensure that they arrive at equitable and practical agreements for river water sharing. Until now, India has had bilateral water-sharing agreements with its neighbours. It is possible that in future, countries will seek regional solutions involving all riparian states.

These issues have come to the fore in the on-going discussions on climate change. There is a recognition especially after recent earthquakes and the tsunami that the region has a shared geography that necessitates not just working together on natural disaster management, but also on larger issues of environmental change. South Asia could well adopt a consensual position in the negotiations on climate change and carbon emission norms.

Finally, shared security concerns, especially the threat of terrorism, is forcing the governments of the region to work more closely together, especially in the field of intelligence sharing.

Despite the slow progress of regional institution building in South Asia, a growing realisation that the region faces common natural, economic and political challenges is forcing the pace of regional cooperation in South Asia. In turn, this could contribute to better institution building.

South Asian Regionalism

Three factors have shaped the formation of 'regional cooperative institutions' in the post-War period. First, what may be termed as 'state' driven factors, namely, the dynamics of the Cold War and its resultant alliance formations; second, 'market' based factors, namely, the globalisation of business and the dynamics of cross-border investment and trade flows; third, 'civil society' and 'political' factors, namely national security and economic interests of member-nations.

Unlike in other regions, most importantly western Europe and south-east Asia, none of these factors played an important role in driving the process of regional cooperation in South Asia. There are few 'shared security concerns', and hardly any shared security threat to bring the nations of South Asia together, at least till recently. In fact, the Cold War divided the region rather than unite it, unlike in western Europe and south-East Asia. The roots of both, the EU and the ASEAN lie in the Cold War era when shared security concerns brought the nations of these regions together. Even cross-border mergers and the 'Flying Geese' factor did not play any role in South Asia given the relatively low levels of foreign direct investment in the region compared to Europe and South-east Asia.

As Gowher Rizvi, a perceptive analyst of Bangladeshi origin has observed:

Even though the compulsion towards regional cooperation in South Asia is enormous, the process of the establishment of an organisation has been slow, hesitant and uncertain. Not only have the economic linkages with the

metropolis, Indo-Pakistan rivalry and the fear of India acted as brakes on cooperation, but South Asia also lacks some of the preconditions which have facilitated cooperation in other regions. There is no perception of external or internal threat common to all the States of South Asia. The threat to security is perceived to come from each other, not from an external enemy.¹³

Against the background of internal political differences, SAARC chose to stay away from bilateral political issues, and instead focused on opportunities for regional economic and civil society cooperation. The launch of a SAFTA and other South Asian projects and programmes, both inter-governmental and non-governmental have imparted further momentum to the association. Thus, institution building in SAARC has largely been around opportunities for economic cooperation with the initiative remaining largely with governments.¹⁴ While there is considerable P2P movement across borders, especially between India, Sri Lanka, Nepal and Bangladesh, the virtual absence of cross-border supply chains and logistics networks has meant limited B2B interaction. However, G2G interface has remained high and often robust.

SAARC as G2G – Institutions and Iconic Projects/Programmes

Regional associations have two characteristics—first is geographical proximity, if not necessarily contiguity, and the second is shared economic, cultural and other characteristics of a community. Thus, ‘neighbourhood’ and ‘community’ are two dimensions of a regional association. There is however, a difference between ‘neighbourhood’ and ‘community’. The former is a purely geographical concept. The latter entails social, cultural and economic commonalities. The SAARC has both characteristics. It is a geographically well-defined ‘neighbourhood’ and a ‘community’ with several shared characteristics. Hence, it is only natural that SAARC has been able to emerge as an active association of nations, despite its slow start and persistent bilateral problems between some members.

There are two ways of assessing SAARC. First, its ‘institutional capacity’ and second its ‘regional activities’. While SAARC’s institutional capacity is limited by the absence of a strong, well staffed and well funded Secretariat, it has been able to create a large number of regional institutions and activities that have created a ‘sense of community’ within the region.¹⁵ While the SAARC Charter does not define the role of the Secretariat, a Memorandum of Understanding on the Establishment of the Secretariat, November 1986, states that the ‘role of the Secretariat shall be to co-ordinate and monitor the implementation of SAARC activities and to service the meetings of the Association’.¹⁶

Apart from being the administrative head of a Secretariat, whose main function is to implement the resolutions of the SAARC Summit, and the decisions taken by the Council of Ministers and the Standing Committee (Foreign

Secretaries of member countries), and to assist in organising various ministerial and official meetings, the SAARC Secretary-General is expected to 'act as the channel of communication and linkage, when so empowered by the Standing Committee, between SAARC and other international organisations, on matters of mutual interest. In doing so, the Secretary-General shall be guided by the decision of the Council of Ministers, that initiatives for collaboration with external agencies should stem from SAARC itself, based on its own determination of priorities, and keeping in mind the relevant provisions of the SAARC Charter'.

We have argued elsewhere that as the first step towards the creation of an SAEU, the SAARC Secretariat would have to be strengthened with funds and professional staff. Apart from diplomats representing member country governments, the Secretariat will have to employ subject and technical experts who can guide SAARC in the implementation of programmes and projects.

Regional groupings of nations have always thrived on iconic projects and programmes. The creation of the EU 'Single Market' had huge symbolism for the European Union, apart from practical relevance for the unification project. SAARC took a long time to define such an iconic regional project or even programme. It launched a series of 'regional' institutions' but few have had any significant regional impact. At last count, SAARC had established as many as 13 regional institutions covering a wide range of activities. These include: the SAARC Agricultural Information Centre (Bangladesh), the SAARC Tuberculosis and HIV/AIDS Centre (Nepal), the SAARC Human Resources Development Centre (Pakistan), the SAARC Documentation Centre (India), the SAARC Energy Centre (Pakistan), the SAARC Coastal Zone Management Centre (Maldives), the SAARC Meteorological Research Centre (Bangladesh), the SAARC Forestry Centre (Bhutan), the SAARC Audio Visual Exchange Committee (Nepal) and more recently the South Asian University (India) and the SAARC Disaster Management Centre (India). The SAARC Secretariat is responsible for reporting to the summit on the activities of these institutions. The activities of these centres are approved by the Programme Committee and the SAARC summits, while the responsibility of its implementation is vested with the host country's government.

SAARC has created a number of Technical Committees (TC) and Working Groups (WG), that bring together a range of subject experts from member countries. These institutions enable closer interaction between professionals and institutions in member countries. The TC and WG span a wide range of subjects including infrastructure, science and technology, biotechnology, tourism, energy, human development and agriculture and rural development. The establishment of a South Asian University is an important step forward, both in SAARC's institutional development and in the promotion of greater civil society interaction. This institution could emerge as an 'iconic' SAARC project, like the Food Bank. SAARC desperately needs such iconic projects that make wider civil society impact

for regional cooperation to acquire popular appeal. Though its initial development leaves much to be desired!

The Regional Centres have not been able to make that impact, despite there being numerous such centres. Poor funding and inability to attract good talent could be one reason for these regional centres not making a regional impact. If the South Asian University has to make an impact and emerge as an iconic project, it would need adequate funding and high profile and high quality leadership.

SAARC has created a large number of governmental 'umbrella organisations' and is supporting even larger numbers of 'non-government' initiatives and institutions that have already helped create a sense of 'community' within the region.¹⁷

Building Blocks of B2B and P2P Cooperation

The next important step paving the way for the creation of an SAEU would be the strengthening of existing regional institutions and initiatives. In his comprehensive account of the status of regional cooperation in South Asia, Cuong Minh Nguyen, draws attention to the already existing high degree of regional cooperation and integration in South Asia and concludes:

Regional economic integration in South Asia and Southeast Asia is driven by strong production networks and development of vertical specialisation. Southeast Asia is the most active region in Asia in facilitating vertical specialisation. South Asia is indeed ranked second after Southeast Asia in vertical specialisation, especially in the sectors of textiles, food processing and services. But the two regions still have to continue to remove obstacles to encourage greater fragmentation of production networks and higher degree of specialisation among countries.¹⁸

These existing institutions and programmes constitute the building blocks of G2G, P2P and B2B cooperation in South Asia. This paper on a 'road map for SAEU', assumes that these existing institutions and programmes will be progressively strengthened to facilitate the maturation of a South Asia 'community'. Having taken the 'first step' of strengthening the SAARC Secretariat and the 'second' step of sustaining these initiatives, SAARC will have to take the 'third' step of facilitating greater economic and financial integration in the region.

This will require: first, a shared regional economic policy framework, beginning with the early implementation of the SAARC free trade agreement (SAFTA), creation of regional financial and regulatory institutions to enable smoother functioning of all factor markets, including capital markets; second, modern and efficient regional connectivity—including road, rail, air, telecom and maritime infrastructure; third, integration of energy, water and food security systems, to enable region wise response to energy security, water security and food security and finally, disaster management response; fourth, greater cultural

connectivity in terms of access to media and entertainment, books and other publications, and educational opportunities. This requires a liberal visa regime and development of tourism and tourism infrastructure, and regional educational and employment opportunities.

SAFTA

Early and full implementation of SAFTA must take precedence. As Shahid Kardar observes:

Presently, the distinguishing features of the South Asian Free Trade Agreement (SAFTA), which make the pact ineffectual in many respects, continue to be substantial negative lists, tariff concessions restricted to a relatively narrow range of products, high non-tariff barriers, complicated and stringent product specific rules of origin and the exclusion of services, capital mobility and movement of at least skilled labour to levels prevailing in other regional groupings, from the ambit of this accord. These factors and fears about asymmetry in gains have influenced the existing configuration of trade and prevented the region from realizing its potential for inclusive growth over an extended period offered by the vertical integration of production structures. The pattern of industrialisation can be changed with countries specializing through the sub-division of production processes, using modern technology and the opportunities for trade provided by lower transportation costs and improved communication physical infrastructure and systems.¹⁹

Trade integration is a step in the direction of greater economic integration. This involves integration of capital and financial markets, liberalisation of cross border investment and the creation of regional supply chain networks facilitated by multi-national investment.

There is now adequate literature substantiating the claim that regional economic integration will accelerate the pace of economic growth and development in South Asia. The literature is emphatic in underscoring the economic benefits to both- large economies like India, and the smaller economies in the region. The ADB has lent its imprimatur to this body of intellectual opinion with its wide-ranging analysis of regional cooperation and integration.²⁰

Regional trade is an important instrument of regional cooperation but it is not an end in itself. Trade facilitates cross-border investment and is in turn facilitated by it. Intra-regional cross-border investment is still insignificant in South Asia. The literature on Southeast Asian economic integration demonstrated the central role of cross-border investment and the establishment of regional supply chains.²¹

An important step taking South Asia closer to the creation of an economic union, would be to adopt policies that facilitate the establishment of such regional supply chain networks, involving both regional and global corporations. Improved

physical connectivity, supportive financial systems that facilitate cross-border business activity and regional integration of markets would facilitate this process.

Connectivity

Regional connectivity is a key challenge for South Asia. Physical connectivity must accompany economic policies that facilitate greater interaction between the peoples and businesses in the region. There are four dimensions to connectivity, (i) transport and the facilitation of movement of goods and people; (ii) financial integration and the movement of capital; (iii) infrastructure and policies for the movement of energy, water and food; and (iv) telecommunication, information flow and the movement of entertainment, publications and cultural products.

Transport

An ADB report on building a regional multi-modal transport system in South Asia observed:

The globalisation of economies is now a universal phenomena that resulted in the integration of national economies at both regional and sub regional levels. The international production system is being increasingly characterized by a new division of labour, that often involves break down of the production process into sub activities that are spread across national boundaries. This is making production increasingly multi-national in character and isolated economies are becoming increasingly dependant on and linked with each other. A more liberalized regime of trade and transport coupled with advances in international logistics, information technology, electronic documentation, cross border facilitation measures, streamlined customs procedures and other such developments have greatly expanded the scope for international trade in goods and services with consequent increased demand for movement both within and across national boundaries.²²

In a highly competitive world economy, transport cost is a significant determinant of competitiveness and an integrated and efficient transport network is an essential element of regional development. This has been recognised at the Heads of Government (HoG) level at the SAARC summits (Islamabad, 2004 and Thimpu, 2010). The SAARC Regional Multimodal Transport Study (SRMTS) identifies a variety of steps that governments in the region must take, to reduce the cost of poor connectivity in improving the competitiveness of SAARC economies.

Surface transport remains the dominant mode of transport in South Asia. Road transport accounts for 65-70 percent of the freight movement in the mainland countries of the SAARC. Restrictions on movement of goods, services and people as well as the absence of good infrastructure have come in the way of greater regional integration. The most comprehensive study of regional transport

connectivity was undertaken by the ADB for the SAARC secretariat. The SRMTS, published in June 2006, identifies existing road connectivity points for the region (see Table 1).

The SRMTS report identifies the hurdles to improved road connectivity that have to be removed as:

- (i) absence of a common regional road transport and motor vehicles act;
- (ii) poor infrastructure at border posts;
- (iii) complex documentation and checking systems.

In the case of rail transport the problems identified are:

- (i) Lack of through-transport agreement and infrastructure for rail wagons: The lack of standardisation of infrastructure and rolling stock makes through-transport impossible. In addition, there is a lack of through-transport agreements between the countries concerned to allow rail wagons from one country to traverse the other. The technical incompatibility between the tracks with narrow gauge and broad gauge tracks meeting at the border reinforces the problem.
- (ii) While passenger train links have been established between India and Pakistan, freight train infrastructure is not yet in place. The Munabao station (on the Indian side) had been commissioned as the main interchange point, equipped with facilities to handle passenger traffic including customs, security and immigration facilities. However, infrastructure for handling goods trains including yard lines, goods sheds and customs check points are non-existent. Rail connectivity will once again become a major form of transportation of both goods and people in the years to come. South Asia has to revive erstwhile links and create new ones.

Inland waterways remain even less developed as a mode of transport both within countries and between countries in South Asia. While the infrastructure for maritime connectivity is improving, with the modernisation of ports, it also remains under-developed as a mode of transport of both goods and people. Inland waterways traffic has been curtailed by poor maintenance of canals and rivers, silting, erosion and the drying up of rivers and canals. Water-based connectivity had been an important means of transport of people and goods in South Asia and is set to regain importance. Apart from infrastructure and environmental hurdles, water and sea transport within SAARC is constrained by the same problems that are encountered by land-based connectivity, in terms of cumbersome procedures for transportation, of both people and goods, and poor infrastructure and logistics support.

Table 1: Road Connectivity in South Asia—Existing and Potential Points of Contact

Corridor	Countries	Inter-change Points
EXISTING ROAD CORRIDORS		
1	Lahore-New Delhi-Kolkata-Petropole-Benapole-Dhaka (2,322 km)	Pakistan, India and Bangladesh Wagha (Pakistan)/Wagha (India), Petropole (India)/Benapole (Bangladesh)
2	Karachi-Lahore-New Delhi-Nepalgunj-Kathmandu (3,147 km)	Pakistan, India and Nepal Wagha (Pakistan)/Wagha (India), Nepalgunj (Nepal)
3	Kathmandu-Kakarvitta-Phulbari-Banglabandha: (i) Mongla (1,362 km) or (ii) Dhaka-Chittagong (1,442 km)	Nepal, India and Bangladesh Kakarvitta (Nepal)/Panitanki (India), Phulbari (India)/Banglabandha (Bangladesh)
4	Kathmandu-Kakarvitta-Phuentsholing-Thimpu (1,011 km)	Nepal, India and Bhutan Kakarvitta (Nepal)/Panitanki (India), Jaigaon (India)/Phuentsholing (Bhutan)
5	Kathmandu- Kolkata/Haldia (1,323 km)	Nepal and India Birgunj (Nepal)/Raxaul (India)
6	Shillong-Sylhet-Dhaka-Kolkata (721 km)	India and Bangladesh Dawki (India)/Tamabil (Bangladesh), Benapole (Bangladesh)/Petropole (India)
7	Shillong-Sylhet-Chittagong (513 km)	India and Bangladesh Dawki (India)/Tamabil (Bangladesh)
8	Agartala-Akhaura-Dhaka-Kolkata (478 km)	India and Bangladesh Agartala (India)/Akhaura (Bangladesh), Benapole (Bangladesh)/Petropole (India)
9	Thimpu-Phuentsholing-Jaigaon- Kolkata/Haldia	Bhutan and India Phuentsholing (Bhutan)/Jaigaon (India)
10	Thimpu-Phuentsholing-Jaigaon-Burimari: (i) Dhaka-Chittagong (966km) and (ii) Mongla (880 km)	Bhutan, India and Bangladesh Phuentsholing (Bhutan)/Jaigaon and Chengrabandha (India)/Burimari (Bangladesh)
11	Kathmandu-Bhairahawa-Sunauli-Lucknow (663 km)	Nepal and India Bhairahawa (Nepal)/Sunauli (India)
12	Biratnagar – Kolkata (689 km)	Nepal and India Biratnagar (Nepal)/Jogbani (India)

(Contd.)

Corridor	Countries	Inter-change Points
13 Malda-Shibganj-Dhaka (344 km)	India and Bangladesh	Mehdipur(India)/Sonamasjid (Bangladesh)
14 Srinagar-Muzaffarabad	India and Pakistan	Kaman Post (India)/Chakothei (Pakistan)
POTENTIAL ROAD CORRIDORS		
15 Samdrup Jongkhar (Bhutan)-Guwahati (India)	Bhutan and India	n/a
16 Munabao-Khokrapar	India and Pakistan	Munabao (India)
17 Amristar/NankanaSaheb	India and Pakistan	n/a
18 Jammu-Sialkot	India and Pakistan	n/a

Source: SAARC Regional Multimodal Transport Study, SAARC Secretariat, 2009.

Table 2: Existing and Potential Rail Corridors in SAARC

	Countries	Inter-change Point
EXISTING RAIL CORRIDOR		
1	Ranaghat (India)-Dhaka (Bangladesh)	Gede (India)/Darshana (Bangladesh)
2	Bongaon (India)-Khulna (Bangladesh)	Petropole (India)/Benapole (Bangladesh)
3	Old Malda (India)-Ishurdi Jn. (Bangladesh)	Singhbad (India)/Rohanpur (Bangladesh)
4	Amritsar (India)-Lahore (Pakistan)	Wāgha (Pakistan)/Attari (India)
5	Jodhpur (India)-Karachi (Pakistan)	Munabao (India)/Khokhrapar (Pakistan)
6	Birgunj (Nepal)-Kolkata (India)	Birgunj(Nepal)/Raxaul (India)
7	Birgunj (Nepal)-Mumbai (India)	Birgunj(Nepal)/Raxaul (India)
POTENTIAL RAIL CORRIDORS		
8	Barsoi (India)-Parbatipur (Bangladesh)	Radhikapur (India)/Biroi (Bangladesh)
9	New Maynaguri (India)-Lalmonirhat (Bangladesh)	Changrabandha (India)/Burimari (Bangladesh)
10	Karimgunj (India)-Kulaura (Bangladesh)	Mahishasan (India)/Shahbazpur (Bangladesh)
11	Colombo (Sri Lanka)-Chennai (India)	Talaимannar (Sri Lanka)/Rameshwaram (India)
12	Badarpur (India)-Bhairab (Bangladesh)	Agartala (India)/Akhaura (Bangladesh)
13	Jammu (India)-Sialkot (Pakistan)	n/a
14	Jaynagar (India)-Janakpur (Nepal)	n/a
15	Hasimara (India)-Phuentsholing (Bhutan)	n/a

Source: SAARC Regional Multimodal Study, June 2006.

Table 3: Waterways Connectivity in South Asia

Corridors	Length (in km)	Countries served
1 Kolkata-Haldia-Raimongal-Mongla-Kaukhali-Barisal-Hizla-Chandpur-Narayanganj-Aricha-Sirajganj-Bahadurabad-Chilmari-Pandu	1,439	India and Bangladesh
2 Kolkata-Haldia-Raimongal-Mongla-Kaukhali-Barisal-Hizla-Chandpur-Narayanganj-Bhairabazar-Ajmiriganj-Markuli-Sherpur-Fenchuganj-Zakiganj-Karimganj	1,318	India and Bangladesh
3 Rajshahi-Godagari-Dhulia	<100	India and Bangladesh
4 Karimganj-Zakiganj-Fenchuganj-Sherpur-Markuli-Ajmiriganj-Bhairabazar-Narayanganj-Chandpur-Aricha-Sirajganj-Bahadurabad-Chilmari-Dhubri-Pandu	1,231	India and Bangladesh

Source: SAARC Regional Multimodal Study, June 2006.

Surprisingly, air connectivity too is weak and inadequate in South Asia. It is easier, and even cheaper, to fly from Colombo to Dhaka or Kathmandu via Bangkok rather than New Delhi or Kolkata. Inadequate direct flights between important cities in the regions also act as a constraint on air transport connectivity.

At present, in the SAARC region there are 21 airports from which flights to other regional destinations operate. The SAARC region's share of international passengers is only 1.9 percent while that of its regional passengers is even lower at 0.5 percent, and most of the latter is made up of tourists or those originally from the SAARC countries, who are now expatriates and residents in other parts of the world. Thus, travel undertaken by residents of SAARC would actually be lower than 0.5 percent. Given SAARC's low level of per capita income, one should expect South Asia to lag behind other regions in air transportation, but the numbers suggest that South Asia lags behind other regions by a wide margin in terms of intra-regional air traffic. (See Table 5)

In keeping with our view that South Asia must not be viewed as an 'island' but as the 'crossroads' of Asia, it is necessary for SAARC to view intra-regional surface transport connectivity as part of wider trans-continental connectivity. The proposed Trans-Asian Railways Network can revive land links between Eurasia and South Asia as well as with South-east Asia. The threat of climate change and the rising cost of crude oil could make land transport more economical in the 21st Century. Putting the infrastructure in place would therefore, be the priority for the creation of not just an SAEU, but also an Asian Economic Union/Community.

Table 4: Weekly (passenger) Flights Within the SAARC Region

From ↓/ To →	India	Nepal (Kathmandu)	Bangladesh (Dhaka)	Sri Lanka (Colombo)	Pakistan (Lahore, Karachi, Islamabad)	Afghanistan (Kabul)	Maldives (Male)	Bhutan (Paro)
India (Delhi, Kolkata, Mumbai, Chennai, Trivandrum, Kochi)		60	44	80	6	17	14	14
Nepal (Kathmandu)	38		7		2			3
Bangladesh (Dhaka)	27	7			4			
Sri Lanka (Colombo)	97				5		27	
Pakistan (Lahore, Karachi, Islamabad)	14	2	4			5		
Afghanistan (Kabul)					5			
Maldives (Male)	4							
Bhutan (Paro)	8	3		21				

Source: Latest available data from internet airlines websites.

Map 2: Existing and Proposed Trans-Asian Highway Networks

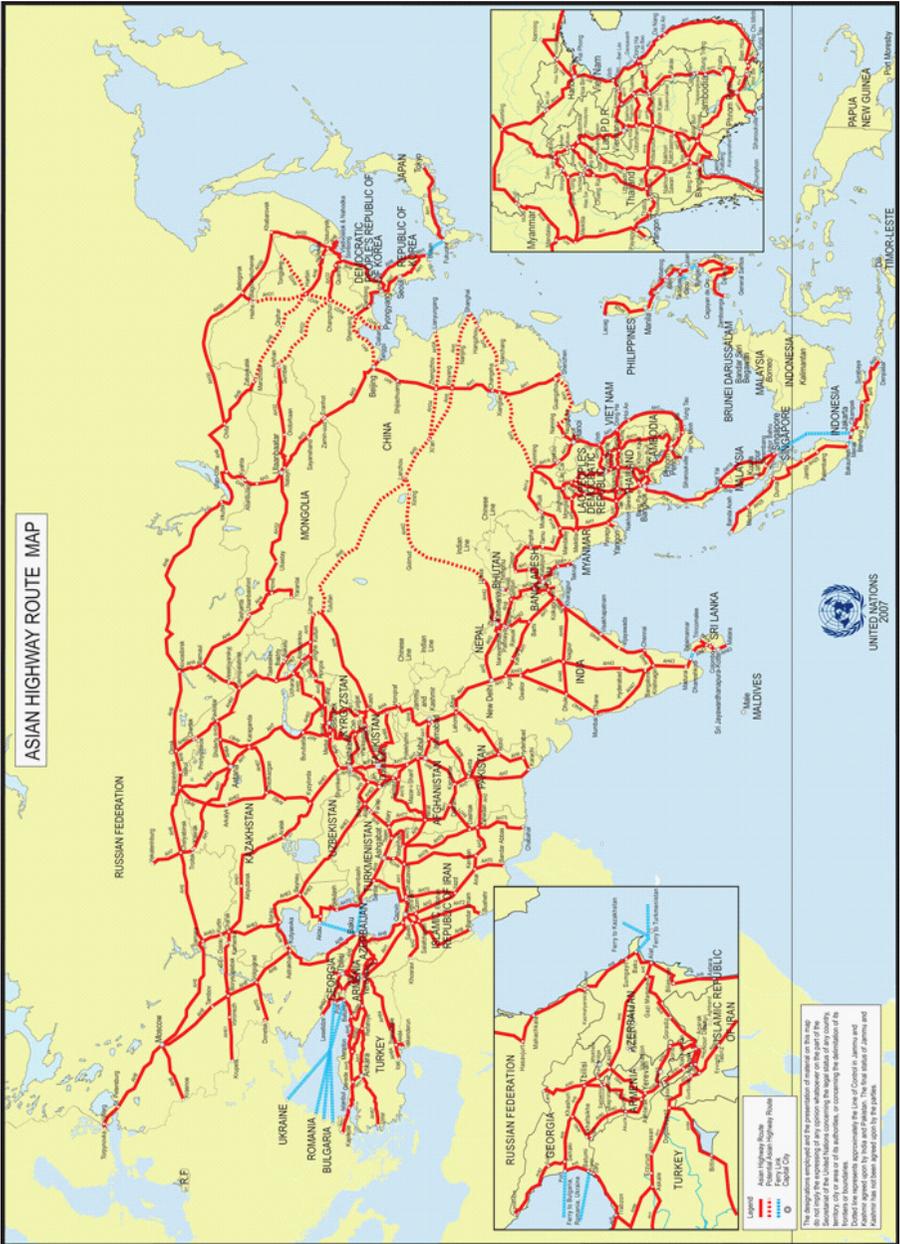


Table 5: Intra-regional Aviation Traffic

Region	Intra-Regional Passengers Carried (Million)
Africa	6.3
Asia/Pacific (Incl S Asia)	47.6
Europe	125.4
Middle East	10.3
North America	125.4
South America and Caribbean	19.0
Total	334
SAARC region	1.8

Source: SAARC Regional Multimodal Study, June 2006.

Energy, Water and Food Security

South Asia shares a common problem of being resource deficient in per capita terms. Given the adverse man/land ratio, the relatively low deposits of hydrocarbons in the region and the shortage of water and arable land relative to population, South Asia requires a regional strategy to facilitate the movement of energy, food and water from other regions. Improved cross-border transport connectivity will be a key game changer. This apart, SAARC needs investment in infrastructure to draw energy and other natural resources from Central Asia and South-east Asia to South Asia. This requires long-term capital that the ADB can provide. It also needs rational economic policies, especially with respect to energy, water and food pricing, that would facilitate long-term investment as well as rationalise the consumption of these scarce resources.

The SAARC Summit at Dhaka (2005) approved the creation of a SAARC Energy Centre with an objective to establish an ‘Energy Ring’ in South Asia. Currently, a number of bilateral energy trade agreements exist among the SAARC Member States (SMS), as well as with neighbours Iran and Central Asia. These agreements are focused on hydropower, electricity and petroleum products. A significant amount of trade in electricity is going on between India-Bhutan and India-Nepal. Afghanistan has various agreements in place with its Central Asian neighbours and with Iran for energy supply.

Of all the proposals on the table, the one that has progressed most until now and holds promise for the western region is the Turkmenistan-Afghanistan-Pakistan-India (TAPI) Gas Pipeline project. It aims to bring natural gas from Dauletabad and its adjacent gas fields in Turkmenistan to India through Afghanistan and Pakistan. The ADB is the lead developer and coordinator for the project. The TAPI project faces significant hurdles in terms of security concerns, in addition to the fact that the pipeline will pass through regions of Afghanistan and Pakistan that are strife torn; there are doubts about the adequacy of Turkmen natural gas supplies to meet its proposed export commitment in the

Map 4: The MBI Gas Pipeline Project



In electricity generation and distribution as well as river water sharing, South Asia has several bilateral agreements in place and most of these have worked well. The India-Bhutan and India-Nepal agreements on electricity trade, and the India-Pakistan and India-Bangladesh treaties on river water sharing are examples of successful bilateral cooperation. The Indus Waters Treaty is a good example of a successful bilateral agreement on water sharing.²⁴ A regional energy and water security treaty would be an important element of the SAEU, with bilateral treaties offering a template for a regional agreement on river water and energy sharing.

The SAARC Food Bank is the first step towards a regional food security initiative. Given the sensitive nature of energy, food and water security issues, these milestones will have to be reached after the initial building blocks of regional cooperation in the fields of trade and connectivity have been put in place.

Culture

South Asia has been a continuum of cultural interaction for millennia. Freer flow of cultural products, including books, films, television programmes and media content should be the final milestone of regional economic integration. Already there is considerable cross-border flow of cultural products. However, a large part of such interaction is still illegal under existing, highly restrictive regimes. A South Asian regional framework for cultural, academic and media interaction is necessary. The setting up of the South Asian University (SAU) is the first step in this direction, though the project has not got off to a good start and requires special attention for a re-launch. India must pay special attention to ensure that 'regional' institutions grow and develop as truly pan-regional institutions and retain that character. This is not an easy task as we have seen with the SAU. By willy-nilly allowing the SAU to become a mediocre Indian institution, rather than develop as a regional centre of excellence, India may have missed an opportunity in this vital field of regional cooperation and institution building.

There are several non-governmental initiatives in place. However, official rules and regulations continue to restrict the movement of peoples, ideas, entertainment and other cultural products. Intellectual property rights protection is an important requirement for greater regional integration. A South Asian Intellectual Property Rights (IPR) protection regime will be necessary for confidence building and ensuring that there are no copyright violations or cross-border stealing of intellectual property. Regional institutions for IPR protection and assurance of competitive market conditions are vital to the development of the services, knowledge and entertainment businesses. The free cross border flow of entertainment products will only help divert existing business away from the underground market to legal trading activity, especially between India and Pakistan.

India as an Opportunity

South Asia's two-decade-old institutional attempt to re-integrate its markets and infrastructure has yielded some results for all and therefore, arrived at a decisive stage when India should take the initiative to impart greater momentum to the process. The Indian 'sub-continent' has been a 'natural' region of inter-connected development for millennia. Even in the early 20th century, as the regional industrialised, natural economic links were built up that later were disrupted by the political restructuring of the region. After more than a half century of development, the region has acquired adequate political maturity despite unresolved bilateral political differences to re-integrate the region economically, for the benefit of all.

Towards this endeavour India must take a more pro-active role enabling increased cross-border economic transactions as well as intra-regional economic

integration. The SAARC member nations must establish regular channels for policy communication on trade, monetary and fiscal policy, infrastructure development, policies pertaining to regulatory institutions, intellectual property rights protection and the smooth functioning of factor markets.

The acceleration of economic growth in India has not only imparted self-confidence to India to enable her to play the role of a regional engine of growth, but it has also enabled her neighbours to view India as a land of opportunity. Notwithstanding the recent deceleration of economic growth, India is on a long-term trajectory of around 8.0 per cent growth in the medium term. Sustaining this growth process will further bolster India's role as a regional engine of growth.

Being the region's biggest economy, India's economic growth must be viewed as a source of opportunity for all her neighbours, certainly for the less developed and smaller ones. Regional re-integration spanning the sub-continent will in fact facilitate pan-Asian re-integration of the sub-continent as a whole with Asia to its west, north-west and southeast. Then the Indian sub-continent will become the crossroads of Asia and the Indian Ocean region once again.

Summing Up

History weighs heavily in South Asia. Unlike the EU and the ASEAN, SAARC is a unique association of hitherto integrated regions that have since been politically separated. India's Prime Minister Manmohan Singh put it very pithily when he said:

I dream of a day, while retaining our respective national identities, one can have breakfast in Amritsar, lunch in Lahore and dinner in Kabul. That is how my forefathers lived. That is how I want our grandchildren to live.²⁵

This vision of free movement of people recapturing the lost continuities of South Asia informs the search for an SAEU. The integration of markets through liberalisation of trade, investment and capital flows is only the first step in this journey. Efficient connectivity is the next step. Regional structures for energy and food security are the third step. Greater cultural connectivity or P2P interaction is the final step.

There are many policy initiatives that governments can take at the G2G level. The challenge lies in creating a policy environment that will facilitate increased B2B and P2P interaction. It is not always easy to quantify the gains from trade and regional economic integration, much less the distribution of gains. However, in the case of South Asia, the re-establishment of regional economic connectivity is only one way, albeit an important way, in which the economies of the region can reconnect and rediscover long standing economic and social links.

NOTES

1. This essay is based on a paper written for the Asian Development Bank on the roadmap for the creation of a South Asian Economic Union 2012. I am grateful to Suvi Dogra for assistance in writing this essay.
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10. Ibid.
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12. The success of the India-Sri Lanka FTA in benefitting both partners, especially Sri Lanka, has added to this understanding. Also see Burki (2006) on Pakistani attitude to SAFTA.
13. Gowher Rizvi, *South Asia in a Changing International Order*, Sage Publications, New Delhi, 1993, p. 153.
14. For detailed history of South Asian regionalism and the evolution of SAARC, see among others, K.K. Bhargava, H. Bongartz and F. Sobhan (ed.) *Shaping South Asia's Future: Role of Regional Cooperation*, Vikas Publishing House, New Delhi, 1995; Kishore C. Dash, "The Political Economy of Regional Cooperation in South Asia", *Pacific Affairs*, 69 (2), 1996; Kishore C. Dash, *Regionalism in South Asia: Negotiating Cooperation, Institutional Structure*, Routledge, New York, 2008; Eric Gonsalves and Nancy Jetly (eds.), *The Dynamics of South Asia: Regional Cooperation and SAARC*, Sage Publications, New Delhi, 1999; Vernon L.B Mendis, *SAARC: Origins, Organisation and Prospects*, Indian Ocean Centre for Peace Studies, Perth, 1991; S.D. Muni, and Anuradha Muni, *Regional Cooperation in South Asia*, National Publishing House, Delhi, 1984; Gowher Rizvi, No.13.
15. Sanjaya Baru, no.8.
16. Ibid.
17. Recent ADB Papers on SAARC, P.V. Srinivasan, "Regional Cooperation and Integration Through Cross-Border Infrastructure Development in South Asia—Impact on Poverty", ADB, February 2010; K Moinuddin, "The Provision of Regional Public Goods in South Asia", ADB, February 2010; Prabhu Ghate, "The Institutions of Regionalism in South Asia – Do Institutions Matter?", ADB, April, 2010; Manu Bhaskaran, "Can Regional Cooperation Thrive in a Challenging Political/Security Environment in South Asia", ADB, April 2010; Shahid Kardar, "South Asia-Intra Regional Cooperation: The Way Forward", ADB, June 8, 2010; Cuong Minh Nguyen, "South Asia is not too far behind South-east Asia in Regional Cooperation and Integration", ADB, November 2010; V.V. Desai, "The Political Economy of Regional Cooperation in South Asia", ADB, 2010.
18. Cuong Minh Nguyen, No.17, p.34.

19. Shahid Kardar, No.17, p.10.
20. See "Emerging Asian Regionalism—A Partnership for Shared Prosperity", ADB, Manila, 2008; Shahid J.Burki, "Facilitating Freer Trade Under SAFTA: Issues in Pakistan, India and Afghanistan", USAID, Washington D.C., May 2006.; Manu Bhaskaran, No.17, and Sadiq Ahmad and Ejaz Ghani, "South Asia: Growth and Regional Integration", World Bank, Macmillan, 2007.
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SAARC and South Asian Stability and Growth: Potential and Promise

Sheel Kant Sharma

Stability in South Asia consists of the sum total of stability in each of its populous constituents, as also stability in their inter-relationships. Growth comprises individual national growth figures, where the regional dimension comes in through trade and economic relations among the eight countries that make the region. In addition, stability nationally comprises stability of society, polity and government, in regard to each of which, in the present times of 24x7 TV and mobile phones, regional cross border influences are inevitable and can be substantial. The South Asian Association for Regional Cooperation (SAARC) was originally conceptualised to straddle interdependence, engagement and cooperation across these diverse facets of peace and development, well-being of the people, growth and stability—but with strict red lines and guiding principles. These redlines and principles essentially aimed to maximise comfort levels of all, with the assurance that together the member states would do nothing to any single member's distress or discomfiture—in other words, consensus would rule. It is within these broad parameters that the SAARC agenda has evolved over the past 27 years. Given the vast populations and the drags on virtually all indices of social development in the region, it seems to make sense to engage, coordinate and cooperate regionally for mutual benefit. SAARC stands for this track and is manifestly complementary to all other tracks that pursue the same goals including bilateral, multilateral and trans-regional.

The SAARC Potential

The unique features of the region are its 1.62 billion people comprising the largest working age population in the world, as also almost 45 per cent of the world's bottom billion. It has had better than average global growth rates at above 6% for past two decades. It has commonalities of languages, legal systems, education,

bureaucratic institutions and jurisprudence, and dormant legacies of an infrastructure that sustained a more or less uniform economic space even a decade after independence, a space where people had reasonable freedom to seek livelihood and well being. These are ingredients for regional cooperation and SAARC's progress so far has shown some promise, though much of its potential remains yet to be tapped.

As the SAARC Charter acknowledged, "In an increasingly interdependent world, the objectives of peace, freedom, social justice and economic prosperity are best achieved in the South Asian region by fostering mutual understanding, good neighbourly relations and meaningful cooperation".¹

It therefore aimed "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 realise their full potential".² These elements in the SAARC Charter are the key to stability and growth. The prescience of the founding fathers of SAARC was reaffirmed half way through in its journey, when a Group of Eminent Persons (GEP) set up in 1997 stated in its report that:

SAARC region must rediscover for itself the compelling logic underlining a process of constructive regionalism. The stability in South Asia and the sustained development of the countries of the association in such a complex setting continues to hinge on their ability to fully realise the full potential derived from regional cooperation in the widest possible sense.³

Over the past decade, many recommendations of the GEP have been adopted by the SAARC summits e.g. South Asian Free Trade Area (SAFTA), SAARC Agreement on Trade and Services (SATIS), SAARC Development Fund, SAARC Regional Standards Organisation, SAARC Finance, and a broad goal of South Asian Economic Union paved by a customs union, an agreement on investment, monetary and fiscal coordination and so forth. Promising beginnings have been made towards project-based cooperation under the SAARC Development Fund, including a modest but very significant project on empowerment of home-based women workers in all member-states, and a slew of small starts in regard to maternal and child health, e-governance, food preservation and productivity.

Need for Cooperation

Progress as regards implementation on all these areas, however, has been much less than desired, not much unlike everything else that South Asians do, even on urgent priorities be that national, bilateral or multilateral. Critical to success in this path is a focus on the habits of cooperation.

Broadly, one can say the regional paradigm would rest on three axes, namely,

- (i) *Interactive or What's in it for me*: Interactive engagement as in trade, economic relations, investment, and connectivity through transport, communication and tourism;

- (ii) *Best practices or What can I learn from my neighbour*: Coordination of national actions under the rubric of social development goals, including human resource development and empowerment of disadvantaged groups; and
- (iii) *Imperative or What's the ineluctable diktat of common geography*: Cooperative preparation to face common imminent challenges of pandemics, scarcity of food, water, energy and the climate change crunch, in terms of increasing vulnerability of people to natural disasters.

The European Union (EU) had commenced with modest but doable collaboration at a smaller scale, with the coal and steel community, to develop “habits of cooperation”, as Jean Monnet put it in 1953. South Asians singly or plurally were wont to grandiloquence and therefore their forays into formal regionalism began with a full manifesto, albeit with more abstractions than tangibles, in order to overcome the estrangement, tension and conflicted mindset in the region, and the cost of opportunities forfeited. Thus, SAARC’s birth in the nineteen eighties was with more evocations to shared history and commonalities, than convergences. One cannot miss the rhetoric about commonalities in summit after summit over the past quarter century. Even a sub-optimal efficiency of common commitment to habits of cooperation with regard to these three streams of endeavour will make more credible, a worthwhile vision for this unique Asian sub-region, for the Asian century. The vision they must have for its absence, or the cynical berating of its diverse strands of cooperation, would be most unbecoming to the leadership of the South Asian countries not only in government, but also in business, industry, media, academia and civil society. Elsewhere in the world, when active regionalism has been pursued with tenacity of purpose, it has brought forth considerable gains in growth and stability. EU and ASEAN have been exemplary in their ability to transcend hostility and disputes through tangible action and in containing rather than tom-tomming every little sign of tension. That this is doable is borne out by the savvy of the South Asian diaspora. What is needed is for their national counterparts back home to show similar savvy and enterprise. Regionalism has promise to be a smart thing to do.

Attempts continue to revitalise SAARC to come up to expectations from it and perhaps another eminent group of advisors to the summit leadership, comprising all stakeholders, may be worth considering. In fact, the lack of tangible action puts paid to extraordinary consistency in the lexicon of regionalism through 17 SAARC summits, in the declarations and statements of leaders. The disconnect in this regard makes one wonder whether the speechwriters of leaders and drafters of summit outcomes were from Venus, while those in charge of tangible action from Mars.

The South Asian Effect on Global Development

That this process would not be an isolated one can be seen in what the latest World Bank report on economic prospects has to say for the region: “South Asia will play an important role in the global development story, as it takes its place in the Asian Century. It has the world’s largest working age population, a quarter of the world’s middle-class consumers, the largest number of poor and undernourished in the world, and several fragile states of global geopolitical importance. With inclusive growth, South Asia has the potential to change global poverty.”⁴

“Regional economic cooperation holds the potential for considerable gains in growth and increased security for South Asia region. The strategy for regional cooperation rests on five main pillars:

- (i) Build on the emerging view in the region that regional cooperation is key to being part of the Asian Century;
- (ii) Support regional networks to promote cooperation by sharing information and build institutional capacity through analysis and dialogue, and capacity building;
- (iii) Focus on trade in goods, services, and electricity, people-to-people contact, and cooperation in water resources management among Bangladesh, Bhutan, India, Pakistan and Nepal;
- (iv) Strengthen regional cooperation in wildlife protection, water resource management, food security, and disaster risk management;
- (v) Leverage partnerships...”⁵

It is no mean achievement that much of the strands identified in the World Bank report have been envisioned and pursued in the course of last two decades within the SAARC process. The agenda of SAARC spans the full spectrum.

So, wherein lies the rub? Take, for instance, what the World Bank calls. “A portfolio of 223 IDA/IBRD projects and total commitments of \$36 billion” as of September 2012. “The bank’s strategy for South Asia was updated in March 2012. With a lending programme of about \$8 billion in fiscal year 2012, the strategy comprises of four pillars: (i) creating more and better jobs by mitigating constraints on growth; (ii) building skills and improving health and nutrition outcomes, both closely linked to a focus on women; (iii) promoting regional cooperation; and (iv) strengthening governance. The bank’s strategy also provides a road map to accelerate growth and foster human development. In fiscal year 2012, the World Bank approved 54 projects in the region.”⁶

Contrast this with what SAARC member-states can do or have done together. Total expenditure on SAARC over the past 27 years by SAARC governments, despite an extensive agenda, has scarcely approximated \$ 100 million. For the private sector, the record is even more frugal. The achievements are bound to reflect this paucity of inputs. Regionalism as bankrolled by the World Bank or

Asian Development Bank (ADB) or some of the observer states of SAARC, will not mean the same thing in terms of ownership and stakes unless concomitant inputs by way of funds, determination and mainstream action are forthcoming from within. Speed of delivery is also of essence. When SAARC had started, much of the world was still analogue. In the digital age today, SAARC's decision making and setting of priorities should leave behind the abacus and analogue. SAARC need not come in the way of the individual narrative of its member states, but is the expression of wisdom in growing in sync with each other.

Engagement through trade is the straight route to attain interdependence, to spawn and attract diverse stakeholders, and subsequently produce gains that would make sense in the immediate term all along the value chain. In the past 20 years or so, massive transformation was witnessed internationally in the economies in the North and South interacting under the latest round of globalisation. In his book *The Next Convergence*, Nobel laureate Michael Spence⁷ refers to the drivers of developing country growth as “an open global trading system and relatively free flows of foreign direct investment and cross-border learning...” While South Asian states individually have benefited from it through linkages far and wide, within the region itself the story has lagged behind.

The policy change at government level has been way too little to tap regional potential, despite appeals from business and industry, the recommendations of several studies by think tanks and international funding agencies, and repeated commitment of leaders at the summit meetings. On the one hand, there is ample scope to turn this situation into one of rapid forward movement, drawing upon the work already done. On the other, persisting drag to opening of trade may frustrate options for the long term. Forceful leadership is needed to remove roadblocks and to clear cobwebs in the minds of those who harbour fears about regional free trade. Instrumentalities are at hand—SAFTA, SATIS, South Asian Regional Standards Organisation (SARSO), the standing mechanisms to remove tariff and non-tariff barriers, for harmonisation of standards, customs harmonisation and wider measures in the related fields of investment, finance, communication, transport and border management. *Moving forward on as many as possible of these mutually reinforcing strands is the priority of the highest order.*⁸ The constant emphasis on trade is all too familiar in the SAARC discourse. However, reasons for limited progress are often overlooked in the euphoric, but unimplemented, summit declarations, including the one in Maldives in November 2011.

Strengthening the SAARC Secretariat

As the SAARC Secretariat is the only dedicated body to follow up on summit decisions and accords, it needs to be stronger in its mandate for action, personnel to carry forward such a mandate, and focus and earmarking of funds by capitals

to back SAARC activities—in each of these respects, pleas have either been unheeded, or relegated to endless committee work. This has been so during a period when global market conditions and dynamics have evolved speedily, and brought emerging economies close to developed countries in an interdependent way. The impact of this global dynamic on the region has been elusive, and so has been the progress in creating enabling conditions to reflect the growth story of interdependence in South Asia. ASEAN, in contrast, with one-third population, has progressed to aggregate trade figures touching US\$ 3 trillion, of which intra-regional trade is almost 27 per cent.

According to a study done by Research and Information System for Developing Societies (RIS) in 2006, the total trade gains in South Asia, from trade in manufacturing goods could be about US\$ 8 billion under a full tariff liberalisation scenario. If SAFTA unofficial trade were also included in the official trade flows, the gains could be as much as three times the present level of trade. These estimates were revised in 2010 by the RIS to suggest that formal trade could have grown to the level of US\$ 28 billion by 2010, to US\$ 44 billion by 2020 and to US\$ 63 billion by 2030. Besides, it is suggested that in terms of distribution of trade gain estimates, that smaller and least developed economies like Bangladesh, Nepal and Sri Lanka would tap the larger economies, relatively more gainfully, than larger economies. The impact of trade growth can also be on development of sub regions within each country falling close to borders.⁹

The textbook path of tariff and non-tariff reduction is strewn with obstacles while the associated policy actions to transform intra-regional trade seem to recede from grasp—investment, communication, information flows, movement of people, goods and services are all lagging behind. The private sector has been the vehicle of massive change worldwide in trade relations, but in South Asia it remains shackled by policy disconnect and is left looking up to governments for lead. Even in India, despite its huge size, demonstration of private sector interest in South Asian trade is not commensurate with the potential—productive exchanges need to be far greater, than those happily evidenced in the past two years under government initiatives. The stewardship of the SAARC Chambers of Commerce and Industry has come to India for two years, from 2012-13. The minister of commerce, industry and textiles is fully committed to expanding and deepening regional cooperation. Every effort should be made to remove the obstacles and open the policy frame for regional trade. Business-to-Business (B2B) interactions under the SAARC banner too are also necessary in synergy with the bilateral tracks of trade relations.

Trade facilitation has two overarching facets, namely policy and governance. Even zero tariff may not overcome, for instance, governance deficit at the national level in terms of road transportation or customs facilitation. SAARC needs to place a number of priority items on auto pilot. If official forums do not engage with adequate speed, business and industry should come forward, and also be

enabled to proceed as regards the unfinished work of trade facilitation in various dimensions, as well as follow up on official contacts. Transport connectivity too should be given to sub-regional business interests to devise the steps for time-bound action. Perhaps Public Private Partnership (PPP) may be the order of the day, but for a change let private business come forward and lead it. Knowledge is the key to economic upliftment of the region. Information flows should be uninhibited by hangovers of the past. Trade portals, databases, IT and communication links are flourishing worldwide. It is time they grew faster and more substantive in South Asia.

Pursuit of Regional Engagement

Steps already taken toward bringing students and academia closer must be supported wholeheartedly. South Asia University is the first step toward envisioning the youth dividend of this region in the coming decades. Even a modest level of a spirit of connectedness among youth across borders will be preferable to the strongest forms of alienation that some seek to engender.

There is no half way house in pursuit of regional engagement. Full development of economic integration through trade, investment, monetary and financial coordination and the creation of a common market will require thousands of dedicated professionals to work to build what EU and ASEAN have crafted over preceding decades. Education and training of such *SAARCists* is going to be the categorical imperative for all member-states—*SAARCists* who would not have to begin from the beginning whenever they commence work, who would be familiar with the essentials of regionalism as attuned to South Asia and who could respond to doubters and cynics.

A SAARC brand has been espoused by summits and the ministerial council meetings. In a modest way, a project under the SAARC Development Fund (SDF) has sought to bring together South Asian home-based women workers to pool their experiences, craft and products towards progressively better returns from trade. These women from humble backgrounds in all SAARC nations have easily taken to “made in SAARC” when describing their wares. Such endeavours should be facilitated and allowed to flourish. This will go a long way towards forging a South Asian identity.

On the wider development agenda, a different take is possible in the wake of the latest indices of development, in individual members of South Asia. These indices¹⁰ have thrown light on where the region and its big economies are lagging. In terms of progress from 1990 to 2010, on basic social indicators like life expectancy, child survival, fertility rates, vaccination and immunisation and average years of schooling, Bangladesh, Nepal, Bhutan and Maldives figure better than India and Pakistan. Sri Lanka has been ahead of all in any case for considerable time. India’s high growth rate in the past two decades has not translated into

better social development indicators. Pakistan's performance has been similar probably a shade worse due to many factors. Question marks may be raised in this respect about the human development agenda within SAARC, since the smaller member-states may be doing better individually.

As mutuality of interest and benefit remain the guide and motivator, energy trade and electricity grids are fields ripe for taking up, and also where some preparatory work has been done. This needs to be accelerated with clarity as to what the region can achieve. Developing countries do not have the luxury of enduring opportunities; the windows of opportunities that open must be exploited with dispatch. Crises of diverse nature often push out well conceived initiatives. For example, in 1999, India and Pakistan broached the subject of an electricity grid and optimisation of differential power loads across each other's borders and to mutual advantage; While work may have progressed lackadaisically in this regard, the power situation in the intervening years has since deteriorated immensely on both sides of the border, highlighting the primacy of supply augmentation over distribution. In the process, delays are inevitable in implementing the original initiative. Fresh impetus was given to the process by bilateral developments in the case of India-Pakistan, India-Bangladesh and India-Bhutan-Bangladesh which may have a positive impact on SAARC processes. If an idea takes root and leads to timely engagement, howsoever limited, the mutual confidence generated could pave way for larger collaboration.

Habit of cooperation is the watchword with regard to energy in South Asia, be it in the North East, or the North West or for that matter across the Palk Straits. Several proposals have been actively explored. These proposals should go past the technical committee meetings and there should be clear timelines for doable components in each sub-region. Progress should be demanded by higher leadership from experts and technical task forces. Progress in one sub-region should catalyse that in other regions. Encouraging news has come from the North-East about joint development of power projects among India, Bangladesh, Nepal and Bhutan. A multilateral SAARC Market for Electricity (SAME) can be within reach. India-Bhutan set a good example and so will the success of on-going efforts between India-Nepal and India-Bangladesh for work in all sub-sectors.

Time for Action

The mainstreaming of selected priorities for action is overdue. Regional cooperation should not remain a helpless appendage to a host of other preoccupations and ineffective multi-tasking. Trade, transport, communication and energy need specially focussed action on a regional scale, with clear target setting and accountability of those charged to take action. Likewise, disaster risk reduction and management, and the prevention and control of pandemics and famines should be high on the regional agenda. The sixteenth SAARC summit

in Bhutan in 2010, for instance, had identified four areas for specific climate related work, a timely decision whose follow-up should have progressed. If, indeed, there is too much on the plate, a short list of priorities for a defined timeframe is warranted, but prevarication and procrastination must be avoided. SAARC will flourish on manifest equality among its members. But such equality should show up through constructive engagement and participation. Equality through exercise of a veto is hardly an option for regional engagement.

The nine observer states to SAARC are viewing South Asia with increasing interest. The UN system agencies such as UNDP, UNODC, ESCAP and FAO as also ADB as well as the World Bank (as explained above) are forthcoming, to contribute to South Asian integration. Imparting traction and sustaining momentum to regional cooperation calls for focus and push at levels far lower than just SAARC summits. These levels should be empowered and held accountable. Some SAARC countries have time and again harped on expanding SAARC to include more countries, most particularly China. While introduction of counties from outside South Asia and well-wishing regional cooperation makes ample sense, premature enlargement of membership is hardly likely to impart momentum, which may be lacking due to internal or bilateral handicaps. There is a very simple Hindi adage—*aadhi chhod poori ko dhawe, aadh rahe na poori pave*—i.e. those who leave a half finished dish in hand, to run after some other full dish, forfeit what they have, nor get what they run after. No one from outside is likely to solve your problems for free, if initiative and will are lacking. The observers who joined SAARC since 2007 have contributed funds: Japan is the largest donor, having given about 15 million dollars over the last decade, South Korea has extended funds up to several million dollars, EU too offered project-based technical assistance of about US\$ 4 million, Australia extended US\$ 1 million for agricultural development while China gave US\$ 0.3 million. All of these are in the slow process of utilisation through SAARC mechanisms, as is the US\$ 300 million SAARC Development Fund, the latter having cleared projects worth less than US\$ 20 million over the past five years. These facts tell a sad tale of lost time and opportunity.

Conclusion

In the end, stability and growth for this humungous mass of humanity in South Asia is as much a battle for hearts and minds. Be that bilateral track or regional, there is a crying need for mass buy-in for cooperation and building of bridges and fostering interdependence. The media's role in this process is crucial. It is unhelpful, for instance, when SAARC summits get drowned in the media glare on India-Pakistan optics which, when the chips are down, should be no less vulnerable to the same disdain with which media bigwigs tend to dismiss SAARC—in one case its lack of tangible action, in another a woeful lack of tangible progress and circumlocution. On the other hand, a viable regionalism

can go hand in hand with bilateralism, and in good time can be handy in marshalling assistance which may not be so easy bilaterally, as is the case, for example, with regard to the crisis in Greece and EU's role in alleviating the problems.

Stability in South Asia is not likely to emerge from balance of power abstractions, since these are frail when pitted against large populations and can exacerbate tension. Nor of any help are great game theories or professions of realpolitik, where gains may be too short-lived and carry a price. Even a modicum of traction in the direction of rediscovering people-to-people empathy and connectivity may be preferable to vaulting tomes on realpolitik. Thought leaders are much too often tethered to imagination, which may be rich but is remote from local interests; interests that may be penurious, but are explosive if ignored and neglected. This applies to growth where impresarios of the growth rope trick take too much space, but deliver too little where needed.

As regards South Asians wanting to get China into SAARC to lend the endeavour greater relevance, a simple leaf from the Chinese book about focused action, quick decision-making and less grandstanding may go far for both growth and stability in the region. Instead of dreaming of China's great success story, they should learn from China's experience for which the observer status can suffice.

India, the biggest country and economy in the region, has followed a proactive approach to its neighbourhood in South Asia as a vital component of its diplomacy. For India, harmonious relations within South Asia constitute a valuable public good, the soft power of which may transcend the boundaries of the region, and have a positive impact on Asia. In that sense South Asia's prognosis will be critical to global stability. Regional cooperation in South Asia has so far had SAARC as the vehicle; its quarter century was celebrated in 2010. It needs renewed efforts today to energise it and perhaps a promise too. Indian promises to contribute asymmetrically to SAARC have been consistent for the past decade.

In conclusion, regionalism in South Asia must be pursued effectively. Rhetoric should be dispensed with and member states should stay the course on priorities once set. SAARC work warrants strengthened SAARC institutions, mainstreaming in government departments, and the accountability of those engaged. Private sector and other stakeholders should show greater involvement and may be facilitated to contribute in diverse ways, but integrally to the whole process, and even lead certain areas where official action tends to be tardy. The template of engagement should comprise more and more interactive agenda, so that gains are visualised and felt across the board, and in the immediate term. For longer-term social charter issues, project-based cooperation must be speeded up. Intangibles such as a South Asian identity and a tangible SAARC brand are worth pursuing. SAARC has expanded almost four-fold in terms of population

in a quarter century, and its success stories must be commensurate with this demographic challenge.

I would like to end invoking the lines of Mir Taki Mir, the great the nineteenth century Urdu poet, which are so apt even today:

*Qafle mein subah ke ek shor hai,
Yaani ghafil ham chale sota hai kya.
Sabz hoti hi nahin yeh sar zamin,
Tukhm-e-khwahish dil mein tu bota hai
kya.*

Deluded day dreamer, What fancies you farm?
No green sprouts ever grow, in the land of reverie.
There is tumult of the daybreak outside,
As the world is on the move,
Wake up.

NOTES

1. Text of the SAARC Charter, 8 December, 1985, available at <http://saarc-sdmc.nic.in/pdf/charter.pdf>
2. Ibid.
3. "SAARC Vision Beyond the Year 2000", Group of Eminent Persons Report, SAARC Secretariat, 1999.
4. "South Asia Regional Brief", The World Bank, September 25, 2012 at http://www.worldbank.org/en/news/feature/2012/09/25/South_Asia_Regional_Brief
5. Ibid.
6. Ibid.
7. Michael Spence, *The Next Convergence: The Future of Economic Growth in a Multispeed World*, Random House India, 2011.
8. Copious studies and reports have brought out various facets of regional trade integration in South Asia; notably those by RIS, SACEP, other eminent regional think tanks, the ADB and the World Bank.
9. Both the studies mentioned were conducted by RIS, Delhi, quoted in paper presented by Ram Upendra Das presented at the first meeting of the South Asia Forum held in September 2011, (proceedings unpublished).
10. Jean Dreze and Amartya Sen, "Putting Growth in its Place", *Outlook*, November 14, 2011 at <http://www.outlook.india.com/article.aspx?278843>.

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Prospects for Stability and Growth in South Asia

Arvind Gupta

Several of the South Asian countries have had remarkable achievements over the last few years. However, there have been substantial problems as well, with which they are all struggling. These are related to inequalities, politicisation of institutions, weak institutions, judicial activism, questions of sustainable development, culture of violence, nature of coalitions in our part of the world, corruption, unemployment, etc. And unless they are tackled properly, the danger to stability and, hence, growth will remain.

Individually, the countries have achieved a lot in the last decade. Democracy is now a norm. Growth has been consistent: 6 per cent per annum has generally been the trend for the last many years. However, we have not yet done enough to deal with the key problems confronting us. For example, we haven't yet really been able to tackle the problem of eradicating poverty and providing security in its wider sense. One of the stark statistics of South Asia, which has been often spoken about, is that nearly 350 million children suffer from malnutrition. Widespread unemployment is another major challenge facing the South Asian countries. Thus, the first dimension of South Asian stability is the lack of development. That is, if the development deficit is not removed in the next few years, the seeds of instability would have been laid in South Asia.

The second dimension of South Asian stability is the lack of security. One cannot brush aside the very substantial problems of security, to which now many aspects of human security have also been added. Many countries face problems on the internal security front as well. Terrorism, energy, food, water, etc. are now big challenges, and we haven't yet been able to comprehend these problems, let alone devise solutions. Moreover, the region will have to cope with the consequences of climate change, which will be a problem multiplier in a way and also a source of instability.

Another issue is whether South Asians really think and act as South Asians. We have common history, common heritage, common culture and common concerns. But do we agree on these challenges? We term the region as South Asia; in India, of course, South Asia is a fairly common term, but in other countries, do we have a South Asian identity? One feels that perhaps the South Asian identity is missing, and that's why questions are raised about: What is South Asia? Should it be Southern Asia? The South Asian region is interconnected, but probably we do not think as South Asians. As a result, although we have an initiative such as the South Asian Association for Regional Cooperation (SAARC), not much progress has been made. We are, perhaps, not thinking about South Asia passionately: most people are looking for opportunities in other regions, and South Asians, in large numbers, are looking for livelihood abroad. The flight of human capital in droves to other parts of the globe does not augur well for the region in the long run.

The role of external powers is another factor to be taken into account. How will the US-China relationship pan out, and what impact will it have on South Asia? South Asia is very vulnerable to these external challenges. South Asia is not a region in isolation; it is buffeted by other regions which are undergoing great transformation: be it in West Asia, Central Asia or East Asia. Our destinies are linked with these regions. We do not have control on these regions. The negative fallout from these regions can affect us adversely.

Furthermore, developments in the Indian Ocean region are a matter of great importance for us. Presently, the concept of Indo-Pacific Ocean, or the confluence of the two oceans, is gaining currency. South Asia is vulnerable to the great power game that is unfolding in this vast oceanic strategic region. Is South Asia going to play a role in shaping the game or will it be a mute spectator? The external environment around South Asia will affect the prospects of growth and stability here.

One disappointment has been that we have not been able to inculcate the culture of cooperation. South Asia is one of the least integrated regions in the world. Regional integration trends in Central Asia, East Asia, Africa and even South America are unfolding. Union of South American Nations (UNASUR) is the latest example of an ambitious regional integration project in South America. It is a new organisation whose constitutive treaty came into force in 2011. Already nine ministerial councils have been formed, including a defence council where they are looking at government defence budgets, or the kind of Confidence Building Measures they should have. The ministerial councils pertain to currency, trade, investment, tourism, education and other such issues. They meet regularly, and there is a great desire, although they may or may not achieve it, to bring an European Union kind of a model in South America. All the ambassadors, despite the problems and historical baggage, are very optimistic about it. Efforts are being made to deal with common problems head on: be they of development or

security. Dialogues of various types have been instituted where nothing is taboo for discussion. Thus, integration trends are unfolding in other parts of the world but in our region they are not, despite the fact that we were one of the pioneers. SAARC was set up in 1985. In South Asia, integration processes have barely moved, despite the existence of SAARC and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). Regional cooperation is beset with trust deficit.

South Asia is passing through an extraordinary period of change and transformation. Many positive changes have taken place undoubtedly, but we have not been able to deal with the core issues of development and security. We are just going around in circles. The prospects of growth and stability in the region are worrisome. Regional integration should be given high priority. Time has come to step up regional cooperation, then perhaps we may be able to solve these problems; otherwise, all these efforts will be essentially individual efforts or some kind of bilateral efforts, which may not take us very far.

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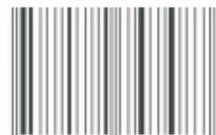


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