

## **Ishrat Husain: Globalisation, regional integration and national development. Where does South Asia stand?**

Inaugural address by Mr Ishrat Husain, Governor of the State Bank of Pakistan, at the South Asian Federation of Accountants International Conference on the Transformation of Accounting Profession organised by the Joint Committees of ICAP and ICMAP, Karachi, 6 May 2005.

\* \* \*

I would, at the outset, like to welcome the foreign delegates and particularly those from the countries in the South Asia Region. I am extremely happy to join you on this occasion and thank you for inviting me, once again, to this important event.

The views that I would like to share with you this evening will focus on the economic situation globally, regionally within Asia and South Asia and nationally within the South Asian Countries. I will then briefly examine the prospects and challenges that face our region in moving forward in this age of globalization and integration to bring prosperity to the lives of more than 1.5 billion ordinary people living in this region – more than one third of them living below the poverty line.

World economic growth was quite buoyant in 2004 recording 5.1 percent growth in World GDP – the strongest in three decades. It will moderate in 2005 but, to a more sustainable level of 4.3 percent. Growth has been strong in most emerging economies led by China. Inflationary pressures remained subdued and monetary tightening underway in most countries will keep these pressures well contained. This benign and favourable outlook is likely to persist if the key risks are mitigated adequately.

The key risks to the global outlook are (i) a further sharp increase in oil prices; (ii) continued fiscal and current account imbalances in the United States and (iii) sluggish demand in European Union and Japan.

There is no doubt that the U.S. is living beyond its means. Whether it is the relative attractiveness of the U.S. economy that is attracting foreigners to place their savings at the disposal of the U.S. businesses, consumers and the Government or it is the lack of demand in other global centers is beyond the scope of this discourse. All I have to say is that, unlike the past, the financing of US Current Account deficit is at present largely being provided by the Central Banks of the Asian Countries who have accumulated large reserves and have invested these reserves mainly in the U.S. paper. This has enhanced the overall risks to the global economic system. The abrupt and simultaneous withdrawal of the Asian Central Banks out of the U.S. financial instruments may lead to destabilization in foreign exchange markets and a hard landing within the U.S. The second order effects of a recessionary U.S. economy on the rest of the world, particularly the emerging markets are not likely to be pleasant.

With regard to oil prices, non-oil producing emerging market countries will have to watch the movements in oil prices and they are likely to forego some buoyancy if the prices continued to remain tight in the foreseeable future. The volatility in oil markets and the risk premia prevailing do not permit us at this stage to make any helpful prognosis.

Growth in other industrial countries has fallen short of expectations and the chances for an upturn remain weak in the Euro area and Japan. Structural reforms have to be undertaken in the EU Countries, sooner than later, to remove rigidities in goods and labour markets and provide a boost towards a more balanced expansion of the global economy. Japan has once again shown a faltering performance and can no longer be relied as a possible stimulant for global economic expansion. As the combined weight of the OECD countries in the global output and trade remains quite high, the above risks will have to be mitigated in order to create a benign external environment for the emerging market countries to prosper.

On the international trade front, agriculture and improved market access for developing countries remain critical to sustain growth. For South Asian Countries the transition from Multi-Fiber Agreement (MFA) to Agreement on Cotton and Textiles (ACT) will have serious consequences in the coming years. The impact is likely to be highly differentiated contingent upon the response capacity of each country to the changed market conditions. The onus lies mainly on the governments and the exporters in these countries to capture increasing market share by enhancing productivity, improving quality, cutting costs and reengineering logistics supply chain. As cotton textiles are relatively labour intensive,

a rising share in the world market will not only help expand their exports and foreign exchange earnings, but also help in mitigating the unemployment problem in the region.

Coming to the region – the larger Asia and the sub-region of South Asia – we remain extremely optimistic about the economic prospects and outlook. Led by China, the Asian Countries remain the front runner in the race for economic growth, international trade and capital flows. High savings and investment rates, competitiveness of exports, growing domestic market size, favourable business environment and sound economic management have reinforced the strengths of these economies to take full advantage of the opportunities provided by globalization. I do not see any serious signs of slack in the Asean +3 Group. Of course, the question of currency alignments will remain highly contentious in the near term.

In South Asia, liberalization and deregulation have, by and large, removed the incentives for rent seeking activities although the debris has not been completely thrown off the grounds. Removal of subsidized credit, reduction in import tariffs, current account and partial capital account liberalization, increased dependence on market mechanism to allocate resources, withdrawal of the Government from running businesses have ushered in higher rates of investment, greater efficiency in resource use and promoted more rapid export growth in most of our countries. This raised platform has, therefore, heightened the potential of the South Asian economies to achieve accelerated growth and reduction in poverty. While continuation of sound policies and prudent macro economic management is a pre-requisite, there are several challenges ahead which have to be confronted by each of our countries.

South Asia is still way behind the East Asian countries on almost all economic and social indicators. Although we started from the same place the divergence over the last forty years has created enormous disparities in the per capita income growth, incidence of poverty, share in global trade, adult literacy, enrolment ratios, status of females, health and well being, physical infrastructure, etc. To give you just one example: our region has almost the same number of people as East Asia. But FDI flows to East Asian in 2004 were about ten times as high as those to South Asia. We have, therefore, a lot of catching up to do and that too, quite fast. The paradigm shift that is taking place in our region makes me confident that we will be able to meet these challenges successfully. But all of us, in whatever capacity we are working, will have to strive hard to bring about the result.

In the short run, the impact of uneven monsoons and higher oil prices will have to be managed carefully and inflationary pressures arising from these shocks have to be moderated. Fiscal deficits will have to be brought down to manageable levels and business climate will have to be improved by removing bureaucratic controls, hassles and irritants to allow the private sector to operate in a healthy competitive environment. Financial sector which is now exposed to international interest rate and exchange rate risks has to be further solidified.

The structural reform agenda of tax administration, trade and tariff policy, labour markets, capital markets, energy sector will have to be implemented more vigorously than has been the case so far.

Infrastructure bottlenecks, shortages, congestions in form of frequent power break-downs, inadequate gas supplies, inordinate delays in the inland transportation of goods, backlog in clearance at the ports, etc. will have to be tackled effectively in order to allow the growth trajectory to remain on track.

Intra-regional trade, capital flows, technology transfer and dissemination, exchange of teachers and students at the top universities and research institutions and opening of bank branches among the countries of this region will have tremendous externalities and spillover effects over the long run. The changed perception that the South Asian Countries are living at peace with each other, facilitate flows of goods, services and people easily, are integrating themselves in the global economy actively will not only reduce the risk premium but pay higher dividends.

One specific example which pertains directly to you, the participants of this Conference, is the production of qualified accountants and auditors for supply to the advanced countries. Since the Sarbanes-Oxley Legislation and the unfortunate demise of Arthur Andersen, the demand for accountants and auditors in the USA, UK, and European Union has risen substantially. The high quality of professionals from this region has endeared the South Asians among the employers in the advanced countries. We should, therefore, attract, train and produce more of them without compromising on the quality. I found out that in Pakistan the major constraint was the lack of qualified teachers. I suspect that this may be the case in Bangladesh, Nepal while India and Sri Lanka have a surplus of qualified teachers and I stand to be corrected if this is not true. Even if there is no overall excess supply of qualified teachers, why can't a body such as SAFA pool their teaching resources,

develop a common curriculum and testing and evaluation procedures, make increased use of videoconferencing, broad band connectivity, electronic discussion groups, virtual teaching and economize on physical presence of the teachers. I am quite sure that if you put your heads together you will be able to come up with a process that will increase the production and supply of qualified professionals in your field ending up with a win-win situation for all the member countries of the South Asia Region. I leave this thought for your exploration and consideration and, if you are able to do nothing but to accomplish this particular goal or make headway on it, this Conference would have been highly successful from my narrow viewpoint.

In the end, let me once again thank the organizers conferring the honour of inaugurating this Conference. I wish all of you a pleasant stay in Karachi and successful deliberations during the next two days.