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SPOTLIGHTS

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Economic Integration and Infrastructure Investment in South Asia with Dr. Selim Raihan

Interviewed by Adam Collins*

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The Lakshman Kadirgamar Institute (LKI) recently interviewed Dr. Selim Raihan as part of the LKI Spotlight series. The LKI Spotlight series features interviews with thought leaders around the world, on key and emerging issues of international relations. This LKI Spotlight highlights some of the key issues related to economic integration and infrastructure investment in South Asia.

Dr. Raihan is a professor at the Department of Economics at the University of Dhaka, Bangladesh and the Executive Director of the South Asian Network on Economic Modeling (SANEM). He possesses vast expertise in empirical research on international trade, economic growth, poverty, labour markets, macroeconomic policies, political economy, and climate change. He also has more than 15 years of experience in conducting international and national training programmes on economic modelling globally. Dr. Raihan contributed extensively to the preparation of the Sixth and Seventh Five-year National Plans of Bangladesh and has worked for several national and international organisations. He has published 19 journal articles, 25 books, 35 book chapters and 45 working papers.

See below for a lightly edited transcript of the interview, featuring Dr. Raihan's responses to questions posed by Adam Collins, Research Fellow at LKI. The questions and other aspects of this interview are not the institutional views of LKI, and they do not necessarily represent nor reflect the position of any other institution or individual with which the parties are affiliated.

LKI: In your opinion, *what is the key driver behind the low level of intra-regional trade in South Asia? Is it structural (i.e. due to the similar structure of economies in the region) or is it mainly due to political issues undermining regional integration efforts?*

Dr. Raihan: Effective regional integration in South Asia is constrained by a number of factors including tariff and non-tariff barriers, weak infrastructure, poor awareness among stakeholders, a lack of political will, and low level of intra-regional investment. There are also some important structural differences among the South Asian countries. While, Afghanistan, Nepal and Bhutan are the landlocked countries, the Maldives and Sri Lanka are islands. Being landlocked countries and having the land-boundary with only India, both Nepal and Bhutan are heavily dependent on India with respect to their exports and imports. Also, the majority of the trade among South Asian countries happens through land borders with inadequate infrastructural facilities. There are problems of easy cross-border movement of goods, vehicles and people, leading to a time-consuming and costly process. This results in a high-degree of trade costs between countries and thus restricts smoother transactions and discourages trade.

In my research I have explored four other factors which have not been discussed much in the regular discourse on regional integration process in South Asia. These are 'size-imbalance,' 'start-up stage,' 'convergence of development process,' and 'regional political settlement.' While tariff and non-tariff barriers, and lack of trade facilitation have their usual restraining effects, the aforementioned four factors may be quite fundamental in understanding the unsatisfactory outcomes of the regional integration process in South Asia. To better understand this, I've compared SAARC, ASEAN (Association of Southeast Asian Nations), NAFTA (North American Free Trade Agreement), EU (European Union) and some African regional trading blocs.

LKI: The economic links between Bangladesh and Sri Lanka are growing, but remain small. *Is the proposed bilateral free trade agreement a good way to rectify this or would greater regional integration be a more effective way of linking the two economies?*

The bilateral trade between Bangladesh and Sri Lanka is still very small. In 2017, exports from Sri Lanka to Bangladesh was USD 125 million while exports from Bangladesh to Sri Lanka was only USD 31.6 million. However, there is potential for enhanced bilateral trade between these two countries. Although Bangladesh and Sri Lanka are members of SAARC and BIMSTEC, the regional integration processes under both these initiatives are very slow, and, therefore, haven't contributed much to enhance the bilateral trade between these two countries. The slow and ineffective regional integration process in South Asia has also led countries to opt for bilateral free trade agreements among themselves. In this context, the proposed bilateral free trade agreement, if carefully designed, can help boost the trade dynamics between Bangladesh and Sri Lanka.

However, a few important points can be considered while designing the bilateral FTA agreement between Bangladesh and Sri Lanka. This FTA agreement should be a comprehensive one focusing more on promoting bilateral investment and trade nexus. In addition to trade in goods, emphasis should be on trade in services too. It is also necessary to enhance the connectivity between sea ports of these two countries, which will immensely help increase the global competitiveness of the exporters of these countries and integrate them more in the global value chains.

LKI: *How important are infrastructure investment initiatives like the Belt and Road Initiative (BRI) for the long-term development of countries in South Asia, including Bangladesh and Sri Lanka? Specifically, is infrastructure the binding constraint on economic development in these countries?*

Dr. Raihan: In countries like Bangladesh and Sri Lanka, infrastructure investment initiatives like the Belt and Road Initiative (BRI) can be helpful for their long-term development. The deficiency of infrastructure services is an important dimension of poverty and inequality. Furthermore, while economic diversification is necessary for sustained and long-term economic growth and job creation, lack of infrastructure development works as a binding constraint for economic diversification in these economies. Both Bangladesh and Sri Lanka are also facing the challenges of implementing the 2030 Agenda. The major challenge is the uphill task to make a transition from a 'growth-centric' framework to sustainable development so that social and environmental issues are considered upfront, along with economic factors, in a holistic manner.

The BRI is expected to directly boost economic growth through greater goods and services trade, investment, and employment in China and other participating countries along different economic corridors. It is also expected to indirectly contribute to output growth through higher productivity as a result of better infrastructure, eased access to technology, and greater energy security. However, there is a need to build a clearer sense of demand from BRI partner countries, and BRI needs to develop a clarity of vision and a shared sense of purpose.

BRI also has to tackle some notable challenges, which countries like Bangladesh and Sri Lanka must be aware of. To ensure the sustainability of any BRI corridor development, there is a need to consider its costs and benefits from the economic, social, and environmental perspectives. The economic risk includes possible macroeconomic instability, underpinned by a debt burden of large foreign loans. From a social perspective, displacement of local communities, the influx of Chinese workers, and the uncertainty regarding the distributional impacts of economic gains, are some of the key concerns. On the environmental front, construction of large-scale infrastructure projects is likely to result in land-use changes, poorer air quality, and reduced biodiversity. For BRI to realise the large benefits that accrue to each economic corridor, the social and environmental impacts must be well managed.

LKI: You have written about the problem of entitlement failure in relation to infrastructure investment initiatives – meaning that many sectors cannot take advantage of new infrastructure due to a number of smaller issues. *How can policymakers maximise the economic benefits of these projects? Or is it a question of building the right institutions as the right policies are already known?*

Dr. Raihan: While most of the countries emphasise on investing in raising the quantity (and quality) of infrastructure, there is a fundamental concern whether increasing the supply of infrastructure ensures the access to infrastructure. This problem is manifested through the fact that due to a variety of reasons enhanced supply of infrastructure may not solve the problem of ‘entitlement failure’ in terms of effective access to infrastructure, as the people/sectors in dire need of improved infrastructure may not have the access even with an increased supply.

If inclusive growth is defined as the inclusiveness in economic opportunities, economic diversification can help attain inclusive growth. However, several supply-side constraints related to weak infrastructure can restrict economic diversification in countries like Bangladesh and Sri Lanka. Some of these constraints are broadly ‘general’ in nature and some are critically ‘sector-specific.’ Interconnection and complementarities between general and sector-specific infrastructure are key elements for increasing service efficiency, supporting the adoption of innovative technologies, promotion of economic diversification and supporting inclusive growth.

Yet, policymakers in the developing countries, like Bangladesh and Sri Lanka, are so inclined to the improvement of broad general infrastructure (enhanced supply of electricity, improvement in roads, improvement in port facilities) that development of critical sector-specific infrastructure is largely overlooked. Embarking on developing broad general infrastructure is relatively easy, whereas solving sector-specific infrastructure problems involves identifying priorities in the policymaking process and addressing a number of political and economic issues. Failure to deal with sector-specific infrastructure problems leads to a scenario where a large number of potential inclusive-growth enhancing sectors fail to enjoy the benefit from the improvement in broad general infrastructure, and thus end up with 'entitlement failure.'

How to deal with this entitlement failure? A major part of the sector-specific infrastructure problems needs to be solved through public investment. The priorities in the industrial and related policies need to be realigned to the country's long-term economic growth strategy in the changing world economy. There is a need for generating political capital for such realignment. However, the task of developing such infrastructure facilities cannot be left to the government alone. It is binding on policy makers to come forward with strategies and mechanisms to encourage the participation of the private sector in such sector-specific infrastructure development. Such mechanisms should not only provide strategies that are rarely implemented, but practical ways of turning them into tangible projects through the provision of adequate finance.

LKI: Given your extensive experience in economic modelling, *what do you think is the most effective way of modelling the economic impact of BRI? Do you think existing modelling approaches capture all the different channels through which large scale infrastructure projects impact the economy?*

In the absence of detailed information on the economic, trade and investment agreements with respect to any economic corridor under the BRI, modelling the economic impacts of BRI is a challenge. Existing economic models, whether partial equilibrium or general equilibrium, are not able to capture all the dimensions of BRI. However, between the partial equilibrium and general equilibrium models, the general equilibrium models (popularly known as the CGE models) would be preferable as the CGE models are able to capture the economy-wide effects of any policy shock.

In one of my recent papers on BRI, I have applied the Global Trade Analysis Project (GTAP) CGE model to estimate the economic impacts of selected economic corridors. For each economic corridor, five parameters in the GTAP model—bilateral imports, transaction cost in bilateral trade, factor productivity in the participating country, efficiency of shipping in the participating country, and the value-added productivity in the participating country—have been impacted. Two things have been considered in this modelling exercise. First, due to the absence of any detailed information, reasonable assumptions have been made on the magnitude of the shocks. Second, the magnitudes of the shocks for the bigger countries like China, India and Russia were lesser than those of the smaller countries. The reason for such differentiation is that economic corridor might have a greater impact on any specific geographic regions of those bigger countries, but in the context of the economy as a whole such impact might be small. In contrast, for smaller countries, the impacts at the national level would be large.

Further Reading

Hahm, H. and Raihan, S. (2018). The Belt and Road Initiative: Maximising Benefits, Managing Risks- A Computable General Equilibrium Approach. *Journal of Infrastructure, Policy and Development*. [online] 2(1). Available at: http://file:///C:/Users/admin/Downloads/140-679-5-PB%20(1).pdf

Asian Development Bank. (2019). *Next Steps to South Asian Economic Union: A Study on Regional Economic Integration (Phase II) Commissioned the by the SAARC Secretariat*. [online] Available at: https://www.adb.org/publications/next-steps-south-asian-economic-union-study-rei-phase-2.

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