



Conference on Global Banking: Paradigm Shift
Hotel Grand Hyatt, Mumbai, India
09 September, 2009

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Financial Integration in South Asia- a few thoughts on how best to go about it

1.1 Introduction: People feel more attracted to ideas of regional cooperation and integration in unstable crisis situations (like the still lingering global financial turmoil) than in periods of stable serenity. Like larger ships in turbulent seas, regional economic unions and regional currencies are likely to fare better than individual economies (particularly smaller ones) and their currencies in turbulent, volatile global economic situations.

European Union (EU) is the most conspicuous success story thus far in regional integration,, with the Euro adopted by all but a few of the EU members as their common currency. While occasional voices of discontent are heard in EU member countries about ceding of decision making to remote supranational bureaucracies, no member has ever walked out of EU, and the queue of countries awaiting full membership is quite long.

1.2 Integration initiatives in South Asia- present status: In our region, the South Asian Association for Regional Cooperation (SAARC) comprising Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka is mandated for broad based cooperation in social and economic development. Under its aegis the South Asian Free Trade Area (SAFTA) is working for promotion of intraregional trade, and the SAARC Development Fund (SDF) has a USD 300 million regional investment program with three windows: i) a 'Social window' for poverty alleviation and social development projects, ii) an 'Infrastructure window' for projects in energy, transportation, telecommunications, environment, tourism etc., and iii) an 'Economic window' for other projects.

The SAARC has not as yet explicitly declared total financial and monetary integration as ultimate cooperation goal. Protracted SAFTA negotiations for lowering tariff and non tariff barriers to trade have been beset with complications of existence of input and output subsidies on many produces, and with concerns of producers in negotiating countries about preserving their current and future market shares. There has been no announced strategy statement of SAFTA for systematically allaying these concerns; say, with priority for exploiting complementarities in mutual enhancement of competitiveness of members in intraregional exports as well as in exports to the rest of the world. In absence of a clear strategy statement for the opening up processes, negotiators tended to remain stuck to overcautious positions with long negative and sensitive lists.

Conceived in 2005 as reconstitution of the earlier South Asia Development Fund (SADF), the SDF is yet to complete its formative phase, there has so far been no investment in any actual project from the SDF or the erstwhile SADF.

The Asian Clearing Union (ACU) with Bangladesh, Bhutan, India, Iran, Maldives, Myanmar, Nepal, Pakistan and Sri Lanka as members is another regional forum conducting multilateral settlements of intraregional trade transactions. Annual ACU board meetings mull over the state of

cooperation and intraregional trade, but the ACU is not mandated to undertake any specific new program for deepening cooperation towards a monetary union.

2.1 Path towards South Asian financial and monetary integration- the Dos and Don'ts: Integration of intraregional trade with harmonization of tariffs is the first phase in integration providing the base for financial integration, the next phase with freed up factor (capital, labor) movements; this in turn providing the base for monetary union, the final phase with some degree of fiscal integration (fiscal transfers to worse off member economies from fund pool contributed by better off members), and some extent of political integration in terms of social policies as well.

The EU example shows how truly remarkable the gains from full integration can be; nations with history of being at each other's throat in hostility for centuries and triggering two world wars are united in harmonized laws and regulations for socio-political and economic life, making new armed conflicts between regional members look very unlikely. The disputes and differences between South Asian neighbors look minor and insignificant seen against past hostilities between major EU members. Resolute, meaningful steps towards an explicitly announced goal of full monetary union in South Asia over the medium to longer term would facilitate ironing out of these relatively minor political disputes and differences, reducing the risks of armed conflicts and channeling resources to combating deprivation and poverty from wasteful expenses on arms buildups.

Alongside the potential large benefits there are also significant costs to be managed with skill and wisdom in the progression path through successive phases of integration; such as the needed adjustments in domestic production structures with shift out of activities rendered unviable by intraregional trade integration (which can be minimized but not altogether avoided), and diminished options for policy intervention at individual member economy level in responding to internal or external shocks. Policies of large member economies in a union typically have substantial negative or positive impact on economies of smaller members; to create and preserve an atmosphere of mutual trust and confidence the larger member economies need to demonstrate sensitivity and gestures of generosity in addressing concerns of smaller members. Because the spillover effects of policies of larger members are higher; their generosity gestures need not necessarily be large in absolute terms.

There is ample scope of substantially scaling up and speeding up the ongoing SAARC initiatives, with an explicitly announced longer term goal of full economic and monetary union. This would be a long haul even in most favorable circumstances; and care will need to be exercised, especially by the larger members, not to impede progress in integration with unhelpful policy steps guided by other concerns. Erecting barbed wire fencing along state borders with neighbors does not resonate well with integration priorities; there can be other feasible options for dealing with illegal movement of goods and people (harmonization of tariffs towards cross border price parity, permitting limited border trade, streamlining of immigration procedures and so forth). Looking for transit facilities through smaller members to remoter regions of larger economies instead of further facilitating trade of these remoter regions with neighboring smaller economies may likewise raise concerns unhelpful in promoting integration.

Regional central banks in their deliberations in ACU and other forums are active in carrying forward regional cooperation and integration in various dimensions; non governmental people to people contact and consultation forums (like the present session organized by FICCI) can likewise be active in explicitly articulating the longer term aspirations for full regional integration for faster progress towards prosperity of people of our region.