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The Challenges and Opportunities of the 1990s

William R. Thomson

INTERNATIONAL CENTER FOR ECONOMIC GROWTH

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South Asia

The Challenges and Opportunities of the 1990s

William R. Thomson

An International Center for Economic Growth Publication

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PREFACE

The International Center for Economic Growth is pleased to publish William R. Thomson's *South Asia: The Challenges and Opportunities of the 1990s*, as the thirty-third in our series of Occasional Papers, which feature reflections on broad policy issues by noted scholars. The work first appeared as the keynote address given at the "International Conference on South Asia as a Dynamic Partner: Prospects for the Future," sponsored by the Asian Development Bank (ADB), and focusing on the many issues crucial to extending the success of the newly industrialized nations of Asia to the less-developed South Asian nations.

The developing member countries (DMCs) of the ADB have experienced rapid growth during the last two decades, mostly as a consequence of a move toward outward-oriented economic policies and a gradual shifting of economic power into the hands of the private sector. In addition to these reforms, reduced import controls, the introduction of realistic exchange rates, and fiscal discipline have attracted direct foreign investment. As liberalization and foreign investment have increased the production capacities of these nations, an interdependence has emerged, as in Japan's shifting of labor-intensive industries to other Asian countries where wages are lower, investing heavily in them, and eventually acting as an export market for the goods produced. William Thomson's overview of this success leads to a discussion of how the "next tier" of developing nations—Indochina and South Asia—might learn and benefit from the industrial linkages and continued economic liberalization responsible for the rapid growth of East and Southeast Asian countries.

Thomson comments favorably on recently initiated reforms in South Asian countries seeking to open up their economies further, strengthen market forces, and provide a greater role for the private sector. He mentions in particular India's efforts to bring short-term crisis situations under control as well as to implement longer-term structural reforms aimed at improving efficiency and accelerating economic growth. Consistent and sustained measures, however, will be required to meet transitional costs and minimize imbalance, assure macroeconomic stability, and provide the physical infrastructure and skilled human resources needed for successful reform.

The Asian Development Bank has played an active role in the advances South Asia has made thus far and continues to provide crucial financial and technical support throughout the region, striving to hasten development and meet the objectives of sustainable economic reform.

William R. Thomson is vice president in charge of operations at the Asian Development Bank. He has been actively involved in economic policy making, including sixteen years of service in the United States Department of the Treasury. We are pleased to publish his insightful analysis of the economic outlook for the nations of South Asia.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
August 1992

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ABOUT THE AUTHOR

William R. Thomson has been vice president in charge of operations at the Asian Development Bank (ADB) since 1990. ADB is a development finance institution comprising fifty-two member countries, with its headquarters in Manila, the Philippines.

Mr. Thomson worked in the United States Department of the Treasury in various capacities for sixteen years. He has held the positions of financial economist in the department's Office of Debt Analysis and senior economist in its Office of International Development Banks. He has also served on the executive boards of the African Development Bank and the Asian Development Bank. Before beginning his work with the Department of the Treasury, Mr. Thomson held various private sector positions, including operations research analyst, economist, and investment analyst.

Mr. Thomson holds the degrees of master of philosophy in economics from George Washington University in Washington, D.C., master of science in engineering from the University of Washington in Seattle, and bachelor of science in mathematics from the University of Manchester in England.

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WILLIAM R. THOMSON

South Asia

The Challenges and Opportunities of the 1990s

Ladies and Gentlemen:

It is a great pleasure to address such a distinguished gathering at this important conference on South Asia as a dynamic partner. I will begin by briefly reviewing the development experience of South Asia relative to the experiences of other Asian countries. Then I will discuss the recent economic reforms undertaken by South Asian countries and the challenges and opportunities which they will confront in the 1990s. Finally, I will offer a few words on the role of the Asian Development Bank (ADB) in assisting the South Asian countries in becoming dynamic partners in developing Asia.

Asian Dynamism and South Asian Development Performance

Over the past two decades or so, Asia has emerged as the most dynamic region in the world. For the past twenty-five years, the Asian

The views expressed in this speech are those of the speaker and do not necessarily reflect the views and policies of the Asian Development Bank. I would like to acknowledge the assistance of my colleagues in the Asian Development Bank, particularly Messrs. J. M. Dowling, N. Hamid, and J. S. Lee, in preparing the speech.

Development Bank's developing member countries (DMCs) grew at the remarkable average annual rate of 6.6 percent. This compares with an average annual rate of less than 3 percent for the rest of the developing world. Trade has played an important role in Asia's rapid development. The bank's DMCs' share in world trade has increased from less than 6 percent in 1970 to more than 13 percent in 1990.

In spite of improved growth performance in the 1980s, however, South Asia so far has not shared in the economic dynamism of the rest of Asia. Over the past twenty-five years, the average annual growth rate for South Asia was only 4.6 percent. This compares with 8.8 percent for the newly industrializing economies (NIEs) of Korea, Hong Kong, Singapore, and Taipei, China and about 7 percent for the People's Republic of China and for the ASEAN-4—Indonesia, Malaysia, the Philippines, and Thailand. The difference between the trade performance of South Asia and the rest of Asia is even more striking. Between 1970 and 1990, on aggregate, the other DMCs of Asia increased their share of world trade by about 180 percent. South Asia's share declined by 25 percent.

This slower economic growth, along with faster population growth, has sharply increased income differentials between South Asia and the other regions of Asia. For example, in 1966 average per capita income in South Asia, at $94, was 80 percent of the per capita income of the ASEAN-4 and more than 40 percent of that of the NIEs. By 1990, average per capita income in South Asia had increased to $337, but was only about 40 percent of the ASEAN-4 and less than 5 percent of the NIEs. With these differing growth rates, differentials in social indicators such as education, life expectancy, birth rate, and infant mortality have also widened significantly.

The sharp differences in the development performance of the South Asian countries and the performances of other countries in Asia are largely the result of differing economic policies. While the South Asian countries pursued an inward-oriented, import substitution-led, public sector-dominated development strategy, the NIEs, and subsequently the ASEAN-4, have increasingly adopted more outward-looking, market-oriented, private sector-led strategies. Since the late 1970s, China similarly has pursued an increasingly export-oriented and market-based economic policy mix.

Recognizing the limitations of their development strategies in the past several years, most South Asian countries have embarked on ambitious reform programs aimed at making their economies more outward looking and market oriented Before I discuss these reforms, let me outline the development strategy pioneered by the NIEs and say a few words on why it proved so successful.

In the early stages of their development, the NIEs undertook a number of reforms that shifted the emphasis of trade policy away from import controls and toward export promotion and exposed industry to international competition. The NIEs also maintained realistic exchange rates and exercised fiscal discipline and monetary restraint. Such policies were subsequently adopted by the ASEAN-4. The ASEAN-4 countries also provided incentives to attract foreign direct investment.

The policies of the NIEs and the ASEAN-4 not only promoted rapid and efficient industrial development in these countries, but also fostered a dynamic process of interdependence among the developing economies of East and Southeast Asia. The ongoing process of economic restructuring in Japan, which gained momentum following the currency realignments resulting from the 1985 Plaza Accord, resulted in the transfer of labor-intensive industries to other Asian countries where labor costs were lower. This led to sharp increases in Japanese investment in Asia and in Japan's imports from within the region. A similar process occurred in the NIEs a few years later as their currencies appreciated and as wages increased rapidly. Thus the NIEs also became major investors in export oriented, labor-intensive manufacturing in the ASEAN-4 and China.

The importance of the rapid growth in intraregional foreign direct investment goes far beyond an increase in financial flows to a few countries This new pattern of investment and trade is assisting in the extensive restructuring of industry in the region and in the development of a sophisticated intraregional division of labor in Asia. These growing trade and investment linkages in the region are likely not only to sustain the rapid pace of development in the NIEs, the ASEAN-4, and China during the 1990s, but will also help in extending development to the next tier of countries in the region. Given the appropriate economic policies, I am sure the next beneficiaries will be countries in Indochina and South Asia.

Economic Reforms in South Asia

It is against this background of economic policy in the NIEs and the ASEAN-4 that we look at the recently initiated reforms in a number of South Asian countries. These reforms are aimed at opening up economies, strengthening market forces, and providing a greater role for the private sector. Sri Lanka began this process of trade liberalization and market-oriented reform in 1977. Unfortunately, the momentum of economic growth in Sri Lanka resulting from the reforms was interrupted by political problems. In recent years, however, Sri Lanka has again begun to pursue economic reform through programs for short-term stabilization and medium-term structural adjustment. The focus of structural adjustment has been to promote foreign direct investment and strengthen the role of the private sector in the economy.

The recent reforms in India are particularly impressive. These include short-term measures taken to bring the crisis situation of June 1991 under control, as well as longer-term structural reforms aimed at improving efficiency and accelerating economic growth. The longer-term reforms include abolition of industrial licensing for most industries; relaxation of regulations relating to foreign direct investment and technical collaboration; measures to improve the efficiency of public sector enterprises; reduction of nontariff restrictions on imports; and steps to achieve convertibility of the rupee in the near future. These reforms have greatly increased the role of the market and the private sector and have opened the economy to greater external and internal competition. The government has also introduced measures to restore fiscal discipline and restructure the tax system to improve incentives.

Pakistan has undertaken a number of economic reforms with emphasis on privatization, investment deregulation, and foreign exchange decontrol. The measures so far include the sale of a number of state-owned manufacturing enterprises and banks; the setting up of a number of investment and commercial banks and other financial institutions in the private sector; the elimination of investment sanctioning; and the abolition of most restrictions on foreign direct and equity investment, outward remittance of profits and capital, and payment of royalties and technical fees.

In Bangladesh, a recently introduced industrial policy places greater emphasis on participation of the private sector and encourages foreign investment, export-oriented industries, and privatization of public manufacturing enterprises. The government also improved macro stability, eliminated quantitative restrictions on the import of a number of items, and announced plans for the implementation of a phased program of import liberalization. In Nepal, steps are being taken to foster the private sector by opening up new areas for investment, removing licensing and other controls on businesses, and simplifying investment rules and regulations.

The impact of market-oriented reforms in South Asia can already be seen in the stock markets and in private and foreign investment in the region. In 1991, the stock markets in South Asia were the top performers in Asia, with the Karachi Stock Exchange showing the third highest gain in U.S. dollar terms among the emerging markets of the world. In 1992, the Bombay Stock Exchange, in spite of the recent problems, showed the largest gains. Rising share prices along with relaxation of government rules regarding pricing of new issues have produced a record number of new issues that are expected to raise $5 to 7 billion in capital this year alone. In Pakistan, private sector investment in manufacturing for the current fiscal year is expected to increase by 40 percent, with foreign investment showing an even faster rate of growth. Foreign direct investment in India doubled in 1991; it is estimated that if expected portfolio equity investments are allowed, with the ongoing reforms undertaken by the Securities and Exchange Board of India, the stock exchanges in India alone could attract $3 to 4 billion a year from international sources.

It is clear that economic policies in South Asia are moving away from the old inward-looking, highly regulated, public sector-led approach to economic development, and are beginning to have a positive economic impact. The reform process, however, needs to be continued and expanded if South Asian countries are to grow significantly faster and become dynamic partners in the transformation taking place in the rest of developing Asia.

Let me now briefly touch on some of the areas in the reform process that undoubtedly will be the focus of attention of policy makers in South Asia for the next few years.

South Asian countries, with the exception of Sri Lanka, continue to have a highly protective tariff structure, with maximum tariff rates generally exceeding 100 percent. This gives the trade regime an extreme anti-export bias that direct export incentives cannot overcome. At the same time, there are a large number of tariff exemptions for selected industries and other special interest groups, which distort market signals and result in misallocation of resources. Therefore, if South Asian countries want to follow the strategy of efficient, export-led industrialization, on one hand they must undertake radical tariff reforms that over the next few years would reduce the anti-export bias and other distortions by eliminating most tax exemptions, and on the other hand lower the maximum tariff rates to the 30 percent to 40 percent range. While such reform would no doubt pose adjustment problems for some existing industries as well as for the government, adjustment problems for industry can be minimized by planning the reforms carefully and announcing them well in advance, so that entrepreneurs have time to make necessary changes. During the transition period, multilateral financial institutions, including the ADB, could help mitigate the impact of the reforms on the budget and the balance of payments.

Tariff reforms, investment deregulation, and efforts to strengthen the market mechanism are meant to increase investment and channel it into more productive uses. Investment and saving, however, are mediated through the financial sector, and, in most South Asian countries, the financial sector is dominated by state-owned financial institutions that do not respond well to market forces. In the past, governments in most South Asian countries have used financial institutions as captive sources of cheap funds to finance budget deficits or inefficient public enterprises. For example, until recently commercial banks in India and Pakistan were required to hold more than one-third of their net liabilities in government securities at artificially low yields. This kept the real rate of return on savings low, most of the time actually negative. This has been an important factor in the low rates of savings observed in the region. In 1990, for example, the average domestic savings rate in the South Asian countries was 18 percent—only 11 percent if India is excluded—as compared with more than 30 percent in the NIEs, the ASEAN-4, and China. In addition, in Pakistan, the lack of an adequate regulatory framework and the poor service and low deposit rates offered by state-owned commercial banks led to several episodes of rapid growth followed by sudden collapse of private finance companies, which resulted in losses to depositors of billions of rupees and severely undermined saver confidence.

While the savings rate in India relative to its per capita income was not low, savings have not been efficiently utilized. In other countries as well, the limited funds that were left for the private sector were mostly allocated by the state-owned financial institutions on political or bureaucratic grounds. This not only adversely affected the efficiency of private sector investment, but also resulted in the accumulation of a large number of bad debts in the system, which in some countries threatens the viability of most state-owned financial institutions.

To raise the savings rate and channel investment into the most productive uses, broad-based reform of the financial sector is necessary. This should include privatization, or establishment of complete managerial autonomy with accountability, of the state-owned financial institutions with a level playing field to allow the entry and development of private sector competitors It should also include changes in the legal system to expedite loan recoveries; introduction of market-based interest rates for all government borrowing and for lending to the private sector; and promotion of financial institutions in the private sector and development of the capital markets. For the last, it would be necessary to strengthen monitoring and supervisory mechanisms and improve accounting and disclosure practices. In brief, the primary role of government should change from one of ownership and control to one of regulation, in which protection of the interests of the depositors and small shareholders should be the major objective. A process of financial sector reforms is currently under way in many South Asian countries, but it is important that the reforms are comprehensive and that implementation is consistent and sustained.

For economic reforms to work, governments in South Asia must strive to provide a supportive environment. In this regard, the three main elements are macroeconomic stability, adequate physical infrastructure, and an educated and trained labor force. Let me say a few words about each of these.

A stable macroeconomic environment requires reducing fiscal and external imbalances to sustainable levels. Fiscal deficits as a proportion of GDP are much higher in South Asian countries than in most other Asian developing countries. In addition, the pressure on budgets is likely to increase because, on one hand, a major increase in public investment in infrastructure and human resource development is needed. On the other hand, tariff reforms are likely to adversely affect custom revenues, which are the most important source of government revenue in most South Asian countries. Therefore, if governments are to succeed in reducing fiscal deficits, they must improve collection of existing taxes, find alternative sources of revenue, and cut nonproductive expenditures.

The broad areas for fiscal reform, without underestimating the administrative and political difficulties of implementation, are relatively easy to identify. The yields from existing taxes are low largely because of too many tax exemptions and high tax rates, resulting in tax evasion. For example, in many countries agricultural incomes are not subject to income tax. A reduction in tax rates along with the elimination of tax exemptions should not only increase tax revenues but should also make the tax rates in South Asian countries more competitive with those in the rest of Asia.

To replace the revenue lost when custom duties are reduced, a broad-based value added tax (VAT) is the obvious choice. All over the world, including in many developing countries, the VAT has proved extremely effective in generating large amounts of revenue for the government. Most countries in South Asia have also introduced a VAT in one form or the other. In South Asia, however, there are generally too many exemptions. As a result, the base is too narrow. To make a VAT an effective revenue source, and to reduce tax induced distortions in the economy, it is essential that VAT be extended to almost all economic activities, with exemptions limited to only a few key areas such as exports, unprocessed foods, education, and health. Experiences of other countries show that when this approach is taken, VAT receipts increase quickly and permit the pace of tariff reforms to accelerate.

In most South Asian countries, nonproductive expenditures as a proportion of the budget are large relative to the rest of developing Asia. In this context, military expenditure, which on average accounts for more than 15 percent of the budget (almost 30 percent in Pakistan), stands out. During the 1980s, South Asia was the only region in Asia where growth in military expenditure was higher than growth in GDP. In the past couple of years, some welcome steps in slowing the growth of military expenditure have been taken. The task has hardly begun, however, and much more needs to be done. With the recent dramatic events in the former Soviet Union and the end of the cold war, the world expects, and requires, a peace dividend. If countries in South Asia were to move together towards reducing military expenditures, the peace dividend could be as large as anywhere else in the world. It would make the task of reducing fiscal deficits while increasing spending on physical infrastructure and human resource development relatively easy. It would also reduce tensions in the region and induce increased flows of foreign investment, which would promote rapid growth in intraregional trade and investment. This may well be one of the great opportunities for South Asia in the 1990s, and I shall come back to it later.

As far as external imbalances are concerned, while more realistic fiscal policies will help, they cannot be eliminated in the absence of a realistic exchange rate policy. In fact, during the 1980s, most South Asian countries introduced more realistic exchange rates. Recently, India took an important step to institutionalize this by initiating a move to convertibility on the current account. Other countries in the region may also consider moving toward current account convertibility. The opening-up of the economy is likely to initially increase pressure on the balance of payments, and market-based exchange rates are the best way of dealing with this pressure. External pressures can also increase as necessary steps are taken to reduce tariffs and the negative export bias that remains in most South Asian countries.

The two other elements important for the success of an outward-oriented development strategy are adequate physical infrastructure and educated and skilled manpower. In most South Asian countries, infrastructure bottlenecks and shortages are widespread. In addition, the quality of service in critical areas such as electricity supply and telecommunications is extremely poor. This is the result not only of limited resources, but also of inefficiencies inherent in protected state-owned monopolies. Recently in a number of South Asian countries, attempts have been made to attract foreign investment on a build-operate-transfer or build-own-operate basis and promote competition by allowing private sector participation. This approach needs to be adopted more widely.

ADB is willing to play the role of a catalyst, first by providing technical assistance in developing such projects, and then by helping locate and attract foreign investors.

I may mention that for an export-oriented economy, international communications are very important. One problem in many South Asian countries is the unduly restrictive international landing rights for foreign airlines because of the fear that the state-owned national airline would otherwise not be able to survive. Similarly, foreign companies are kept out of international telecommunications to allow state monopolies to charge high rates and make large profits, which frequently are used to subsidize domestic operations Such policies under the changed circumstances are inappropriate because they place South Asian exporters at a disadvantage.

In human resources, South Asia has the lowest literacy rate—42 percent—of any region in Asia. Studies show that the export success of the NIEs has been based on building up human capabilities by raising levels of health and education. Some South Asian countries, however, spend less than 5 percent of the budget on education and health. South Asian countries must give greater emphasis to human resource development, if for no other reason that without it they will find it increasingly difficult to compete successfully in the global manufactures market. Also, the availability of a well-educated labor force is necessary to attract foreign direct investment and absorb new technologies. Finally, human resource development is the best way to slow down the rate of population growth, which is very high in a number of South Asian countries. Without a slowing of population growth, the benefits of economic growth will continue to be greatly diluted. For example, in the 1990s, Pakistan's economy will have to grow at least 1.5 percent faster per annum than China or Thailand to achieve the same rate of growth in per capita income.

Challenges and Opportunities of the 1990s

The challenges facing South Asian countries in the 1990s are many. Internally, the most important challenge will be to complete the transition to outward-looking, market-oriented economies. This will involve a major economic restructuring in each country, and is likely to be resisted by groups that are beneficiaries of the present system. These include inefficient, import-substituting firms that would have to improve their efficiency or else close down; employees of overstaffed public enterprises who have become accustomed to job security, high wages, and low work pressure; and those bureaucrats who have low salaries but enjoy enormous economic and regulatory powers. It will also be a challenge for the South Asian countries to maintain fiscal discipline, reduce military expenditures, build up their physical infrastructure, and develop their vast human resources.

In all these areas, the ADB stands ready to assist, for example, by providing technical and financial assistance for setting up retraining and credit programs for affected public sector employees or project loans for physical infrastructure and human resource development. Ultimately, however, the success in making the transition will depend on the will and commitment of the people of South Asia to eradicate poverty, illiteracy, and underdevelopment from the region. Other countries in Asia have shown that it can be done in decades rather than centuries. I am confident that the 1990s will prove to be the turning point for South Asia, just as the 1970s were for the NIEs and the 1980s appear to have been for Indonesia, Malaysia, the Philippines, and Thailand.

The external challenges are no less daunting. The world economy is currently experiencing only weak growth, and the major industrialized countries are expected to grow more slowly in the 1990s than in the 1980s. This means that it will be more difficult, but not impossible, for South Asia to expand exports rapidly than it was for other Asian countries in the past two decades. Recent developments in Eastern Europe and the former Soviet Union are also likely to have an adverse impact on South Asian economies. The immediate impact has been on trade. In particular, India's exports to Eastern Europe and the former Soviet Union, which represented about 20 percent of its total exports in 1990, were almost halved in 1991 and may decline further this year. The longer-term impact is likely to be on official development assistance (ODA) to South Asia. Although net disbursements of ODA to Eastern Europe in 1990 were small relative to all developing countries, commitments were significant. Also, recent commitments to Russia have been quite large, and new demands for concessional resources will arise in the poorer republics of the former Soviet Union. Coupled with tighter supplies of such funds from the traditional donors because of slower economic growth in the industrialized countries, these additional demands could have an adverse impact on ODA to South Asia in the 1990s.

Finally, the worldwide tendency toward trading blocs and the long-delayed GATT Uruguay Round are sources of concern. A slide toward protectionist trade practices could seriously impede world economic growth. An open trading system is essential for the success and sustainability of market-oriented reforms in developing countries. Although the formation of regional economic blocs in itself does not increase protectionism, there is the possibility that such blocs might adversely affect the access of some countries to their traditional markets. Rapid growth in intra-Asian trade in the 1980s helped insulate the fast-growing economies of Asia from both cyclical declines in world trade and increasing protectionism. South Asian countries, as a result of ongoing reforms, should strengthen linkages with the rest of Asia, including the SAARC (South Asian Association for Regional Cooperation) region and the Central Asian republics, and thus benefit from Asian dynamism.

While there are numerous challenges in the 1990s for South Asia, there are also many opportunities. As I mentioned earlier, in the 1980s the rise in labor and other costs in Japan and the NIEs resulted in massive flows of foreign direct investment to the ASEAN-4 and China. In recent years, rising costs and infrastructural shortages in some of the latter countries have prompted investors to start looking for alternative locations for labor-intensive industries. South Asia, with its abundant labor and large consumer markets, could easily attract large amounts of foreign direct investment. Thus, given the appropriate policies, South Asia could be in the next tier of countries to benefit from the ongoing process of shifting comparative advantage that has characterized Asian economic development.

Another opportunity for South Asia is the unexploited potential for intraregional trade and tourism. In 1990, intraregional trade in South Asia was less than $1 billion. According to one study of international trade, a common land border between countries on average increases trade by a factor of 2.5. In South Asia, however, overland trade between some countries is discouraged and even banned. If such barriers to trade were eliminated, intraregional trade could easily increase. The possibilities for growth in intraregional tourism are even greater because of the cultural and linguistic linkages. As a result of various administrative restrictions, however, these possibilities remain largely unrealized. Expansion of intraregional trade and tourism, which could be an important side benefit of a coordinated reduction in military spending in South Asia, can be one of the engines of growth for South Asia in the 1990s.

Finally, just as the possibility of the failure of the Uruguay Round is a matter of concern, its success could prove to be a tremendous opportunity. It is estimated that the successful completion of the Uruguay Round could result in about $50 billion in additional developing country exports to industrialized countries, with South Asia expected to account for about 10 percent of this. If the economic reforms are in place, however—and they are a sine qua non for progress given the rapid changes in economic policies elsewhere—there is no reason why South Asia could not get a much larger share of the total, particularly since more than half of the $50 billion increase is expected to be in exports of textiles and clothing—industries in which South Asia should have a comparative advantage.

Role of the Asian Development Bank

In view of the challenges and opportunities facing South Asian countries in the 1990s, I have no doubt that the ADB will play a catalytic role in promoting economic development in South Asia. The bank's strategic development objectives are the promotion of economic growth, the reduction of poverty, an improvement in the status of women, progress in population planning, and the promotion of sound management of resources and the environment. With the private sector seen as the engine of growth, the bank encourages DMCs to remove, in a coherent way, unnecessary restrictions on private sector activity, and supports the development of physical, financial, and social infrastructure, including human resource development, to facilitate private sector-led growth.

However, economic growth by itself may not be enough to raise the living standards of the poor, women, and other disadvantaged groups. Therefore, the bank specially targets such groups through projects aimed at improving access to employment and income generation opportunities and social services. The bank's project assistance concentrates on sectors that are likely to have a substantial impact on economic growth, but is designed to address the bank's strategic development objectives such as poverty reduction, women in development, environmental protection, and social infrastructure improvement. Some recent projects aimed at employment and income generation for the disadvantaged groups, particularly women, include the Rural Women Employment Creation Project in Bangladesh, the Small Farmers Development Project in Nepal, the Barani Area Development Project in Pakistan, and the Southern Province Rural Development Project in Sri Lanka. The need for better access of such groups to social services and housing is addressed in recent projects on health and family planning, public health, and primary and higher secondary education in Bangladesh, primary education for girls in Pakistan, and low-income housing development in Sri Lanka.

The bank's program lending facility has been a major instrument for aiding the policy reform process in the bank's DMCs. In recent years the bank has provided program loans to most countries in South Asia. For example, an industrial program loan to Bangladesh supported the government's plan to stimulate industrial growth and efficiency by reducing government ownership and management of manufacturing activities. In India, programs were provided to support policy reforms in the energy and hydrocarbon sectors. Pakistan received program loans to support the government's policy reforms in agriculture aimed at resource mobilization and increased productivity, and in industry for industrial restructuring and strengthening of administrative and institutional capabilities for implementation of the government's economic adjustment program. A financial sector program loan to Sri Lanka is intended to promote policy reforms, strengthen institutions, and help develop the capital market.

Recognizing the critical role of capital markets in the mobilization of resources and their efficient allocation, the bank has commissioned two rounds of expert studies of capital market development covering twelve DMCs, including most South Asian countries. Some of the recommendations from these studies have been implemented by the various DMC governments and others are being discussed through policy dialogue with the bank. The bank has also sponsored various regional investment funds, such as the $100 million Asian Development Equity Fund, for investment in equities in Asian developing countries, and the $65 million Asian Convertibles and Income Fund, dedicated to the development of markets for diversified securities in the bank's DMCs. A Pakistan Investment Fund sponsored by the bank is also due for launching shortly. A large part of the international capital that South Asia needs in order to accelerate development can come through the vehicle of portfolio investment, as major pension and life insurance companies in the industrialized countries look to diversify their portfolios internationally.

The bank's assistance is also focused on the identification and elimination of institutional gaps and deficiencies in capital markets in the DMCs. Thus the bank is involved in the establishment and development of a diversified range of financial intermediaries. In South Asia, these include leasing companies and venture capital companies in India and Pakistan, an insurance company and unit trust in Sri Lanka, and a credit rating agency in India The last is a rare example of a rating agency in a developing country and should contribute to investor protection in India. The bank also approved unguaranteed loans for six private leasing companies and an investment bank in Pakistan. In 1991 the bank approved technical assistance grants to finance studies on the leasing industry in Nepal and the mutual fund industry in India. Technical assistance was also approved for strengthening the institutional capabilities of development banks in Bhutan and Nepal and of state-owned banks in Sri Lanka

In closing, let me say that the ADB will continue to assist the South Asian countries in their efforts toward economic reform and development. I am confident that with these efforts, South Asia will become a dynamic partner of developing Asia in the 1990s and that in this, the bank will be a dynamic partner of South Asia. At the bank we are looking forward to working with you in these cooperative ventures.

I thank you for your attention.

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