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South Asia Cannot Afford to Deglobalize

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Is globalization really dying?

The death of globalization has been greatly exaggerated (apologies to Mark Twain).[1] It is true that global trade in goods and services peaked in 2008, at 61% of global GDP—it was 52% in 2020 and 56% in the pre-COVID year of 2019. However, this broad statistic obscures many important trends (see Wolf, 2022).

One, many major trading countries/groups have not yet peaked in terms of trade openness. The European Union, the largest trading group, saw its trade ratio at an all-time high of 93% of GDP in 2021. Vietnam, a rising star in global trade, continues to see exponential trade growth. Brazil's trade ratio was at a record high of 39% GDP in 2021. On the other hand, China, the United States, and Japan—the three largest economies in the world—have peaked.

[1]. This note refers only to trade, the most frequently used dimension of globalization. It does not discuss, for example, foreign direct investment or other cross-border capital flows. However, since FDI is highly correlated with trade, FDI issues do come up in the discussion

Two, trade in services continues to rise because services are growing from a small base and are very diverse, with many capable of being delivered online. In the pre-COVID year of 2019, services trade was at an all-time high of 13.6% of world GDP.

Thus, even though some major trading nations have reduced their exposure to world trade, there are continued and growing opportunities in goods and services for other countries that seek to deepen their trade integration.

South Asia is at an early stage of globalization

Given the size of their economies, stage of development, and a lukewarm approach to openness, South Asian countries are at an early stage of globalization. This is supported by the following facts.

South Asia has been very hesitant to embrace globalization. Average applied tariffs in South Asia were 12.8% in 2019, the highest of any region, against a world average of 5.7% and an East Asia and the Pacific average of 4.38% (WITS, n.d.). This is despite the widespread evidence that trade has been a key factor in global poverty reduction. Indeed, in South Asia, Bangladesh and India are two prime examples of countries that have witnessed the power of trade in stimulating demand, creating better quality jobs, and improving living standards.

If anything, South Asia's regional embrace is even more hesitant than its global embrace. The world's most prosperous regions—Europe, North America, and East Asia—enjoy the benefits of proximity through trade in goods and services and interlinked supply chains. By contrast, South Asia is the least integrated region in the world, with regional goods trade forming only 5.8% of total trade in 2020, compared with 21.1% for ASEAN and 35.9% for East Asia.[2]

Barring India, none of the other South Asian economies are large enough to justify their low trade penetrations. Indeed, in most cases, their trade to GDP ratios have been declining; trade to GDP peaked in Pakistan in 1996 (38%), in Bangladesh in 2012 (48%), and even in the small island nation of Sri Lanka in 2000 (89%). This experience is contrary to that of the larger middle-income countries in East Asia, whose development path South Asian countries seek to learn from. As Table 1 shows, Thailand, Indonesia, Malaysia, and the Philippines peaked at *high* or *very high* trade ratios, ranging from 88–220% of GDP. And despite peaking, their current trade ratios are much higher than their South Asian counterparts. Vietnam has still not peaked.

Led by Bangladesh and especially India, South Asia has increased its share of world exports of goods and services, from 0.8% in 1990 to 2.72 percent in 2021. Given their incipient globalization relative to East Asian countries, countries of South Asia have significant room—with the right policy focus—to increase this share significantly.

[2]. This picture does not change even when Pakistan is excluded from a regional calculation. Within the South Asia Subregional Economic Cooperation, or SASEC (Bangladesh, Bhutan, India, Maldives, Myanmar, Nepal, and Sri Lanka), for example, intraregional trade was only 5.6% in 2020, and it was 6.3% in Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, or BIMSTEC (Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, Thailand). Data sourced from ARIC database (ADB, n.d.).

Table 1.

Peak and current trade-to-GDP ratios: Selected South Asian and East Asian countries

	Current trade-to-GDP ratio, 2021 (%)	Peak trade to GDP (%) and year
Bangladesh	28	48 (2012)
Pakistan	30	38 (1996)
Sri Lanka	43	89 (2000)
India	44	56 (2012)
Thailand	117	140 (2011)
Vietnam	184	184 (2021)*
Philippines	64	88 (2003)
Indonesia	40	96 (1998)
Malaysia	131	220 (2000)

Note. Trade includes goods and services; for Vietnam it includes only goods. The peak indicates the year when the trade-to-GDP ratio was at its highest.
*Is not a peak but the highest to date.

Source: World Bank Open Data.

Impact of rising economic nationalism

Economic nationalism has been rising globally, and Brexit and the U.S.–China trade war are only two, albeit telling, examples of this. But it is hard to blame global economic nationalism or the slowdown in global growth for the antiexport bias[3] in most, if not all, countries in South Asia. South Asian countries have been unable to address the political economy of trade liberalization or to create a positive narrative for trade. This approach has left them vulnerable to domestic protectionist pressures. Thus, at different points of time over the last 15 years, Bangladesh, Pakistan, and Sri Lanka, among others, have reversed the course of trade liberalization and resorted to rising tariffs (and paratariffs) and reducing the transparency of their trade regimes. In India, the share of its tariff lines with duties in excess of 15% rose from 5.8% in 2015 to 10.6% in 2020. India has also started in 2020 a “production-linked incentive scheme” to boost domestic production, increase exports, and cut down on imports in key sectors such as electronics.

The globalization imperative for South Asia

Despite its size, and its growth, India’s domestic market is still not large enough for global companies, across many sectors. Using a lower-middle-income poverty line of 3.65 USD per day (2017 PPP), India’s poverty rate was, according to the World Bank’s poverty calculator, 44.8% in 2019 (World Bank, 2022). One estimate of India’s middle-class market size put it at between 0.5–1.3 trillion USD in 2019.[4] Compare this with world imports of 24.3 trillion USD in 2019. Moreover, exports have been a significant catalyst for overall growth during the high growth years of the Indian economy, during the period 2002–2018 (Chatterjee & Subramanian, 2020). More generally, access to the world’s deep and elastic market can help Indian companies to enhance scale, innovation, and productivity.

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[3]. See Kathuria (2018) for a detailed account of trade policies in South Asian countries.
[4]. See Chatterjee & Subramanian (2020).

Another way of looking at this is to see some comparative numbers between India and China, countries with a similar population. In 2021, China attracted 181 billion USD in FDI, compared with India's 45 billion USD (UNCTAD, 2022). China's domestic consumption was 8.1 trillion USD in 2020, India's was 2.2 trillion USD. And the relative export numbers (goods and services) in 2021 were 3.55 trillion USD and 0.66 trillion USD, respectively. In order to get closer to Chinese levels of innovation, productivity, and scale, India will need to reduce the gap on FDI and exports, among other things.

For the rest of South Asia, globalizing is an imperative. For one, three countries—Bangladesh, Bhutan, and Nepal—are due to graduate from least-developed-country status over the next one to four years and will need to make much more efforts to secure global market access. Another imperative for globalization is that countries in the region have barely begun to engage with the world, and reap the efficiency and welfare gains from trade. There is a long way to go before they can declare that they have achieved their peak globalization levels. Indeed, Sri Lanka and Pakistan, currently in the grip of economic crises, have demonstrated the folly of neglecting—indeed, being averse to—international trade and commerce.[5]

South Asia's opportunity

World trading patterns are going through ferment.[6] China has been at the heart of many of these changes. Its wages have been rising for a while now. It is turning more inward, reducing its participation in global value chains over the last three years. Its exports as a share of its economy peaked in 2006, at 36% of GDP. For some time, many countries have been seeking to diversify their supply chains away from overreliance on China, and this pressure has intensified after the experience of COVID-19. On top of all this, there is the ongoing U.S.–China trade war.[7]

All of these factors provide trading opportunities for the rest of the world, including South Asia.

In addition to diversification, supply-chain resilience and sustainability concerns have forced a discussion on shortening of supply chains. This provides additional impetus to the case for greater regional economic integration in South Asia—including developing regional supply chains—which, as seen earlier, is far short of potential.

Can India seize the moment and, in the process, also boost the economic fortunes of its neighbors? At one level, it could be argued that India is the only country that can match China for size and so should be the natural favored destination for a world that seeks a China-diversification strategy—India cannot only provide scale but also lower wages and technological capacity in many different sectors. Moreover, the impact of digitalization, huge investments in renewable energy, and a favorable geopolitical environment pushes the India case further.[8] Should India be able to capitalize on its opportunity, can adjacent countries benefit from their giant neighbor's dynamism?

Bangladesh, the second largest economy and exporter in South Asia, also hopes to become a favored investment destination for global diversification seekers. It has the benefit of scale, at least in the apparel sector, but it needs to diversify beyond apparels and also create a more hospitable environment for investments and level playing field for foreign investors.[9]

5. See Kathuria (2022).
6. See Kathuria (2021a) for a discussion of these issues.
7. See also Nicita & Razo (2021).
8. See, for example, the Economist (2022).
9. See Kathuria (2021b).

The way forward

The average tariff in the European Union was 1.7% in 2020. South Asian countries, all of whom have high income aspirations, would do well to remember that high-income countries, except for some small islands, do not levy high tariffs.

South Asian countries need to attract more FDI, especially of the efficiency-seeking kind, so that they can deepen participation in global value chains. Attracting such FDI would require low tariffs, and an efficient trade-facilitation environment to speed up the trade in parts that is the hallmark of value chains.[10]

The rest of South Asia can also gain significantly from India's dynamism and favorable geopolitical situation. Regional value chains and intraregional FDI can play a big role in achieving this goal. In turn, this would require policy interventions to reduce the costs of information flows among firms, ensure more efficient targeting of regional firms by investment-promotion authorities, and lower the very high costs of intraregional trade. These and many other recommendations, based on a detailed study of regional investment pioneer firms in South Asia, are discussed in Kathuria et al. (2021).

Of course, every policy decision has a tradeoff. Trade liberalization will always have winners and losers, and the transition can be difficult and long for inefficient sectors. In this case, it is important for countries to strengthen their social-protection mechanisms and, if some sectors are particularly sensitive, to delay their liberalization, preferably with a sunset clause.

Conclusion

South Asia cannot afford to deglobalize. In fact, the countries of the region, including India, need to deepen their engagements in global as well as regional commerce. Most of them are too small, in terms of GDP, to call a halt to the rise in their trade-to-GDP ratios. Even India, with its ambitions to become a 5-trillion-USD economy by 2026–27 and an upper-middle-income country by 2047, will need a huge boost from trade, FDI, and global technologies to achieve that goal.

South Asia is still a relatively untapped market with a strong upside potential. With the right policy mix and vision, the region can capitalize on the very real opportunities that the global environment is now presenting.

[10]. See World Bank (2020).

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