Advanced Research in Asian Economic Studies – Vol. 3

International Economic Integration and Asia

edited by
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Johns Hopkins University
SAIS-Bologna, Italy

2006
World Scientific
NEW JERSEY • LONDON • SINGAPORE • BEIJING • SHANGHAI • HONG KONG • TAIPEI • CHENNAI

CHAPTER 7

SMALL CHANGE: A CRITICAL EXAMINATION OF THE ECONOMIC RELATIONSHIP BETWEEN SOUTH ASIA AND THE EUROPEAN UNION

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South Asia constitutes one of the world's poorest regions. By contrast, the European Union (EU) is one of the richest. This chapter examines the nature of the economic relationship between these two different regions from the perspective of South Asia. In other words, we examine how South Asia's economic relationship with the EU contributes to economic growth and the alleviation of widespread poverty.

National policies for economic growth and development in South Asia today rest, in large part, on three pillars: trade, investment and migration. This has not always been the case, as South Asian markets were relatively protected before the mid 1980s. While individual countries could liberalize even more, South Asia as a whole has strived to develop export platforms that can better exploit their comparative advantages; they have liberalized domestic capital markets with an eye at encouraging foreign investors; and they have actively encouraged short-term labor emigration. All in all, countries in South Asia rely increasingly on foreign labor-, capital- and goods markets as a means for reducing domestic poverty and high unemployment levels while encouraging economic growth and development. As one of the richest regions of the world, we might expect the EU to figure prominently in the development designs of South Asian policy-makers. Although it is unreasonable to expect the EU to bear responsibility for South Asian poverty and underdevelopment, we

* We acknowledge the helpful comments of Indra de Soysa. Obviously, any errors or shortcomings that remain herein are our own doing.

assume that it has a moral commitment to open its markets, in order that South Asia might pull itself out of its poverty. This commitment should be especially strong, given the colonial ties that once bound South Asia to Europe's individual member states. Unfortunately, our study reveals a remarkably modest role played by EU-markets in accommodating South Asia's exports.

This study proceeds in five steps. We begin with some theoretical reflection. While policy-makers in South Asia recognize that migration complements trade and investment as important tools in each country's development basket, economic theoreticians — true to form — cannot agree whether migration complements (or substitutes for) trade and financial flows. This section discusses how we might conceptualize the relationship between different types of economic integration and their effect on development.

The main body of the paper is empirical and is itself divided into four parts. The first part describes South Asia with a brief overview of economic conditions in the individual countries that make up the region: Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. As the quality of data varies substantially across countries, the remaining sections will mostly discuss developments with reference to the first four countries. This discussion is separated into three distinct categories: trade, investment and migration.

Theoretical Backdrop

Trade-based approaches to economic development are increasingly common, so we see little point in describing the posited mechanisms that link international trade to national economic development.[1] Our more immediate concern is to sketch the ways in which economists perceive of the role played by migration in this process, as migration has become increasingly important in recent years. Despite this increased importance, migration's role in international factor price equalization and/or for the process of development is under theorized and studied.

[1] For a review, see McCulloch, Winter and Cetera (2001).

In this light, there are two theoretical perspectives from which we might survey the nature of South Asia's economic relationship to the European Union. The first is more common and is already familiar to most students of economics: neo-Ricardian trade theory associated with Eli Heckscher, Bertil Ohlin and Paul Samuelson. We call this a trade-based approach to economic development, and it arguably dominates today's development agenda. The second approach is less familiar and more radical: a migration-based approach to development.

Due to the general nature of this project (comparing two diverse regions), the lack of systematic data across countries, and the remarkable dearth of economic exchange between the two regions, these theoretical approaches will not be tested in any rigorous fashion in the pages that follow. Rather, we use these approaches to guide an empirical description of the relationship between these two regions and to help us better understand why policy-makers in South Asia today, if often implicitly, employ both approaches in their drive to economic development.

Trade-Based Frameworks

In a now classic paper, Mundell (1957) used a Heckscher–Ohlin framework to show how trade and international factor mobility could substitute for one another. While this neo-Ricardian framework has proved ineffective at explaining the bulk of world trade (among industrialized countries), it does an adequate job of explaining North-South trade. This, in itself, has provided great comfort to academics and policy-makers in the developed world, as it has legitimized the erection of substantial barriers to immigration from the developing world. In short, international trade is seen as a tide that can lift all boats (both rich and poor) on the basis of comparative advantage. Because of this, international migration is unnecessary: trade itself can reduce the rich-poor wage differentials that are often assumed to drive international migration. Similar substitution effects are seen to exist between trade and capital flows.

On the other hand, several authors have shown that by changing some of the underlying assumptions in the Heckscher–Ohlin framework, migration, trade and capital flows (including foreign aid) could complement one another.[2] While some of these assumed conditions would seem more relevant to understanding North-North trade (e.g., economies of scale and sector-specific technological differences), others are directly relevant to understanding North-South relations (e.g., the potential costs of migration and constraints on credit). For example, under the conditions described by Markusen (1983), free trade without factor mobility does not bring about factor-price equalization, as the relatively high-priced factor in each country is the one used intensively in the goods being exported. Hence, factor mobility is seen to increase the supply of the factor that is used intensively in the goods being exported, which results in an increase in the volume of trade.[3]

Indeed, the Heckscher–Ohlin framework (with migration costs and financing constraints) does seem to explain the sort of trade flows, migration flows and wage convergence that occurred in the Atlantic economy prior to World War I. The recent work by a handful of economic historians has documented the remarkable convergence of European and American wages that resulted from economic integration across all three fronts (trade, investment and migration).[4]

To conclude, trade-based approaches assume that economic integration will benefit both rich and poor countries and each recognizes that different groups will benefit (and suffer) from increased integration. These approaches differ in terms of the role played by factor mobility as a complement to trade. For some, trade by itself may be insufficient for economic development.

Migration-Based Frameworks

Another, more radical, approach focuses squarely on the role of migration for alleviating economic and political ailments in the developing world. As this approach is largely inspired by the historical accounts of

[2] This issue is examined in Markusen (1983) and Wong (1983). See also Jones and Neary (1994), Razin and Sadka (1995), Markusen and Melvin (1981), and Markusen and Svensson (1985).

[3] Alternatively, factor mobility is seen to decrease the supply of the factor that is used intensively in the goods being imported into a country.

[4] E.g., Hatton and Williamson (1992) and O'Rourke and Williamson (1995); Williamson (1995); and O'Rourke, Taylor and Williamson (1996).

economic convergence prior to WWI (described above), it tends to assume (implicitly) that migration complements trade and investment. Its focus, however, is on the relative lack of international migration in the postwar period, and how this may have stifled the potential development benefits from trade.

Generally, migration can influence international development in four inter-related ways. First, international migration allows for a more efficient matching of international supplies and demand for labor. This generates enormous efficiency gains internationally, as described in the paragraph that follows. Second, emigration tightens the sending country labor markets (albeit often at the regional, not national, level), strengthening the bargaining position of the labor that remains.[5] Third, immigrant labor provides a large and dependable source of development capital in the form of remittances. Finally, returning migrants bring capital, skills and market access that benefit the sending economy.[6]

One wing of this approach is highly stylized and draws from the influential (and provocative) work by Hamilton and Whalley (1984) to show the potential economic gains from a more liberal international migration system. Using computable general equilibrium models, recent work has suggested that the efficiency gains from free migration could absolutely dwarf the gains from other, more traditional, development approaches.[7] For example, Moses and Letnes (2004) find that even a small liberalization of international migration restrictions can yield sub-

[5] The logic here is akin to that of the Nobel laureate, Arthur Lewis' (1954) two-sector approach, but backwards. Lewis was interested in how to attract labor from the agricultural to the industrial sector (and how high industrial wages had to be in order to do this). In this context we are interested in how much wages in the sending country need to increase in order to stave off potential emigration.

[6] The traditional argument for countering international migration builds on posited 'brain drain' effects. However, recent work suggests that these concerns may be exaggerated. Either way, most migration from South Asia is in the form of unskilled labor, where concerns about brain drain are not particularly relevant. Conversely, the recent hyperbole about 'outsourcing' to India in the 2004 US presidential elections suggest that South Asian concerns about brain drain may be overblown. For more on development and migration, see Massey (1988) and Skeldon (1997). For a brief introduction to the new revisionist work on brain drain, see Faini (2005).

[7] E.g., Winters (2002); Iregui (2005); and Moses and Letnes (2004, 2005).

stantial gains: they estimate that a 10 percent increase in international migration corresponds to an efficiency gain of about 774 billion (1998) dollars!

This section is meant to show how migration can be seen as an integral part of South Asia's development strategy, and to illustrate how some theoretical frameworks have managed to ignore the subject for so long. Recently, policy-makers and academics alike have come to recognize the significant and stabilizing role played by migration remittances (see, e.g., Kapur and McHale 2003 and World Bank 2003) and international organizations have come to embrace the potential of temporary migration (e.g., the WTO has introduced temporary migration to the international trade agenda — so-called Mode 4 trade).

South Asia and its Relationship to the EU

The Asian Development Bank describes South Asia in terms of eight states: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. With the exception of Afghanistan, these states are the signatories of the South Asian Association for Regional Cooperation (SAARC), which was formed in 1985 to promote economic, social and cultural development across the region.

Poverty is the most common (and obvious) defining characteristic of the countries of South Asia. In addition, the region's sheer demographic size draws attention. The countries of South Asia constitute 22.5 percent of the world's population, totaling 1,395 million people (see Table 7.1). However, among this group there are important differences separating the most populous (India) from the least populous (the Maldives) states. Worst, the region's population is growing at almost twice the rate of the world's annual average. Indeed, only Sri Lanka seems to have turned the demographic corner, while Bangladesh and India have only recently entered the fertility-declining phase of the demographic transition.

Table 7.1. General Economic Features

	Population, 2002			*GDP growth rates, annual averages*		
	Millions	% world	Annual growth rate, 2001-2	1994-97	1997-01	2001-03
Afghanistan	21.8	0.35	1.7	-	-	-
Bangladesh	131.2	2.12	1.5	4.6	5.4	4.9
Bhutan	0.7	0.01	2.4	6.3	6.6	7.2
India	1,055.0	17.02	1.8	7.7	5.5	5.0
Maldives	0.3	0.00	1.6	7.6	8.1	4.7
Nepal	23.7	0.38	2.0	5.6	4.7	2.1
Pakistan	143.7	2.32	2.2	5.3	3.3	2.8
Sri Lanka	19.0	0.31	1.5	4.8	5.2	4.6
South Asia	1,395.4	22.51	1.8	7.1	5.2	4.6
WORLD	6,198.3	100.00	1.0			

Sources: Asian Development Bank (2004b); and RIS (2004: 21).

Over the past decade or so, the South Asian economies have embarked upon major reforms aimed at liberalizing their external (and, increasingly, their domestic) sectors. While the relationship between these reforms and economic growth is complicated and unclear,[8] what is clear is that the annual GDP growth rate in South Asia has declined over the same period: averaging 7.1 percent annually in the period 1994–97, falling to 5.2 percent in the 1997–2001 period, and falling further to 4.6 percent in most recent years.[9] In 2001, the aggregate GDP for the SAARC region was €711 billion, or €538/capita (DG TRADE 2002).

Consequently, the region suffers from a dismal human development profile, as exhibited in Table 7.2: about 41 percent of the region's population finds itself below the income poverty line, as defined by 1 US$/day (1993 PPP US$). About one third of the populations of Bangladesh, Pakistan and India are estimated to live below the poverty level, as defined in each country. Indeed, on average, South Asian countries rank relatively low on the UNDP's Human Development Index (HDI): only the Maldives, Sri Lanka and India are defined as Medium Human Development countries, the others find themselves toward the bottom of the UNDP's HDI country ranking (i.e., in the category 'Low Human Development').

The result is a regional population mired in poverty and facing a number of intimidating challenges. These include an enormous population (of 1.4 billion people, 60 percent of whom are working-age); a labor force participation rate that is only about 60 percent of the working age group; employment growth rates across the region that are lower than both GDP and labor force growth rates (and a labor market that is characterized by pervasive unemployment, especially among the young and educated); and the region continues to be swamped by poverty and illiteracy (Mahbub Ul Haq Human Development Centre 2004).

[8] See Round and Whalley (2002) for a discussion of the potential linkage mechanisms between trade liberalization and poverty reduction in South Asia.
[9] Recent projections by the World Bank suggest that this trend will change in the near future, because — in part — of the influence of massive remittance inflows (World Bank 2003).

Table 7.2. Human Development Profiles

	India	*Pakistan*	*Bangladesh*	*Nepal*	*Sri Lanka*	*Bhutan*	*Maldives*	*South Asia, weighted average*	*Developing countries*
Population below income poverty line (%)									
• $1 a day (1993 PPP US$) 1983-2000	44.2	31	29.1	37.7	6.6	-	-	41	-
• national poverty line 1997-2000	26.1	34	35.6	42	25	-	-	-	-
Population without access to health service, 1995									
• number (millions)	143	63	68	-	1.3	0.6	0.1	276T	910T
• % of total population	15	45	55	-	7	35	25	22	20
Population without access to safe water, 2000									
• number (millions)	122	17	4	5	3	0.8	-	151T	-
• % of total population	12	12	3	19	17	38	-	11	22
Population without access to sanitation, 2000									
• number (millions)	700	54	61	18	3.2	0.7	0.13	835T	2439T
• % of total population	69	39	47	73	17	31	44	63	48
Illiterate adults, 2000									
• number (millions)	434	78	76	14	1.6	-	0.01	604T	-
• % of total adult population	42.8	56.8	58.7	58.2	8.4	-	3.3	45.5	26.3
Illiterate female adults, 2000									
• number (millions)	270	48	44	9	1	-	-	372T	-
• % of total adult female population	55	72	70	76	11	-	-	58	31
Child malnutrition (weight for age), 2000									
• % of children under 5	47	38	61	47	33	-	-	47	-
Under 5 mortality rate (per 1000 live births), 2000	96	110	82	100	19	100	80	95	59
People living with HIV/AIDS, 2001									
• Adult (% age 1-49)	0.79	0.11	<0.1	0.49	<0.1	<0.1	0.06	-	1.32
UNDP Human Development Index, 2002									
• Score	.577	.499	.478	.49	.741	.494	.743		
• Ranking	124	138	145	142	89	140	84		

Source: RIS (2004: 94); UNDP (2002).

Notes: See original sources for further clarification and detail.

The Relationship Defined

This paper addresses the nature of the economic relationship between South Asia and the European Union. To be perfectly honest, it is an exaggeration (or perhaps premature) to speak of a relationship here. There are remarkably few formal links at the level of regional organizations (although nation-state links, steeped in history, continue to be important for individual member states in both regions). As we shall discuss in the empirical section that follows, the level of economic integration between these two regions is surprisingly small.[10] Having said this, the EU has made official offers of assistance and cooperation,[11] and SAARC countries depend increasingly on the export markets of the world, including (but not confined to) those of EU-member states.

Indeed, Europe's institutional attention seems to be placed elsewhere in Asia. In the early 1990s, as the Asian tiger economies began to experience double-digit economic growth, Europe's interest in Asia increased phenomenally. Within the EU, at a number of levels, one could find a growing awareness of the need to intensify and deepen Europe's relationship with Asia on a number of fronts (economic, political, strategic, etc.). Toward that end, the European Commission submitted a communication to the Council of Ministers on the need for a new Asian strategy in

[10] On the other hand, this level of integration is not too surprising when we consider that the SAARC countries themselves have not come very far in their own internal economic integration.

[11] Of course, the European Union has maintained cooperation agreements with SAARC member countries before the formation of SAARC. At the formation of SAARC, the European Parliament (EP) expressed its intention for economic cooperation. In October 1988, the EP adopted a resolution in which it called the Commission to contact the SAARC institution and the member countries in order to examine possibilities of cooperation and completing a cooperation agreement with SAARC. SAARC countries, however, showed little interest at the time, arguing that they needed to establish better links within the region before establishing them with third parties (Quddus 2001: 66). As a consequence, the EU's relationship to SAARC is limited to signing a 1996 Memorandum of Understanding with the SAARC Secretariat, offering them technical assistance. There were two main results of this otherwise limited co-operation: the inclusion of SAARC in the General System of Preferences (GSP) Cumulative Clause of the Rules of Origin and an exploratory mission in the autumn of 1999 to launch an assistance program ('Assisting SAARCs Integration Process').

order to maintain Europe's leading role in the world economy (European Commission 1994).

These concerns were heightened when the Asia Pacific Economic Council (APEC) held its first summit in Seattle, in 1993. When it was launched in 1989, APEC had been largely ignored by Europe. Now that world leaders were gathering to discuss Asia's economic potential, Europe saw itself increasingly isolated from developments in Asia. Indeed, the European Commission sought, but did not receive, formal representation at the Seattle summit.

Europe's response to this institutional lacuna was the 1996 launching of the Asia Europe Meeting (ASEM), which brought together 26 European and Asian partners in a dialogue that covers political, economic and cultural affairs.[12] For us, the most noteworthy aspect of the ASEM is the absence of representation from any South Asian countries. Although the ASEM is meant to capture and strengthen Europe's relationship to Asia, South Asia is not included amongst its members.

This paper describes the nature of the economic relationship between the European Union and the states of South Asia, all of whom find themselves outside of the ASEM framework. Unfortunately, the neglect of this relationship is not confined to regional agreements such as the ASEM. There is surprisingly little work done, and data collected, on the nature of the economic relationship between South Asia and Europe. As a result, the remainder of the paper is largely descriptive and exploratory.

Trade

Since the mid 1980s, the liberalization of foreign trade has become a fundamental part of South Asia's economic development strategy; each country in the region undertook unprecedented reforms. This new emphasis is clearly shown in the reduction of tariff rates across South Asia

[12] On the European side the membership includes the European Commission and the (then) 15 Member States of the European Union — Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom. The Asian side has ten partners, seven from South East Asia - Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam and three from East Asia — China, Japan and the Republic of Korea. See O'Brien (2001) for a description and overview.

during the 1990s (RIS 2004: 19), as well as in the region's growing trade shares. While trade represented just 41.2 percent of South Asia's GDP in the mid 1980s, it rose to over 71.4 percent in the new millennium. Of course, these aggregate figures conceal large differences across the region: differences that we should expect to see with country size (i.e., smaller countries such as the Maldives and Bhutan rely much more heavily on trade than does the largest country, India). The general picture, however, is one of a region that has become increasingly integrated in the world's trading economy.

These rising trade shares resulted from an unprecedented growth in the value of both exports and imports across South Asia since 1992 (combined with a drop in GDP as shown in Table 7.3, below). Over the past twenty years, SAARC member countries have managed to increase their level of both imports (from 17,509 million ECU/euros in 1980 to 83,940 million in 2001) and exports (from 9,046 million ECU/euros in 1980 to 72,268 million in 2001). In doing so, the region's share of world trade has improved (while its share of world imports has dropped from 1.7 percent to 1.5 percent, the region's share of world exports has actually increased from 0.9 percent to 1.4 percent) (DG TRADE 2002). While the growth is encouraging, it totals to a pittance: a world export share of 1.4 percent is not very encouraging for a region that is home to about 23 percent of the world's population![13]

Unfortunately, the European share of South Asia's exports is only a little bit larger. According to the EU's statistical yearbook of external EU trade (European Communities 2002), only four countries from South Asia have any measurable trading relationship with EU member states: India, Pakistan, Bangladesh and Sri Lanka, and the extent of these relationships are shown in Table 7.4.

[13] Given the enormous size of India's domestic market, and the region's traditional emphasis on inward-looking development strategies, it is somewhat misleading to use world per capita trade shares. Having said this, however, the region's world trade share is still remarkably small.

Table 7.3. South Asian Trade Shares (as % of GDP)

	1985-87	*1990-92*	*1996-98*	*2000-2001*
Bangladesh	24.7	19.8	30.5	35.5
Bhutan	61.5	75.1	76.2	89.5
India	14.1	18.8	25.5	29.8
Maldives	60.3	88.5	167.1	168.9
Nepal	31.9	36.3	59.6	55.1
Pakistan	34.0	37.5	36.4	35.8
Sri Lanka	61.9	68.4	79.2	85.4
SAARC average	41.2	49.2	67.8	71.4

Source: RIS (2004).

Table 7.4. EU Trade with South Asia (million ECU/Euros, and % share in parentheses)

	Exports			*Imports*		
	1980	1990	2000	1980	1990	2000
India	2,432	6,408	13,384	1,840	4,765	12,372
	(1.10)	(1.60)	(1.40)	(0.60)	(1.00)	(1.10)
Pakistan	929	1,528	1,918	465	1,555	2,621
	(0.40)	(0.30)	(0.20)	(0.10)	(0.30)	(0.20)
Bangladesh	349	416	701	157	523	3,091
	(0.10)	(0.10)	(0.00)	(0.00)	(0.10)	(0.20)
Sri Lanka	298	368	1,580	234	479	1,907
	(0.10)	(0.00)	(0.10)	(0.00)	(0.10)	(0.10)
S Asian total	3,918	8,720	17,583	2,696	7,322	19,991
	(1.86)	(2.23)	(1.87)	(1.01)	(1.67)	(1.93)
Total EU	211,124	390,555	942,044	268,036	439,411	1,033,436

Source: European Communities (2002: Table 2B).

The largest European trade partner, India, captured just 1.1 percent of Europe's imports in the year 2000. Indeed, together, South Asian states delivered just under 2.0 percent of Europe's imports in the year 2000 (and imported about the same amount from Europe!). In 2003, when we can measure the European market in terms of 25 member states (EU25), the SAARC share has remained about the same: 2.5 percent of EU25's imports and 2.2 percent of EU25's exports (DG TRADE 2004).

Table 7.5 provides a glimpse of how European markets play an important, but not the sole, destination for South Asian exports. As a whole, in the year 2002, European markets captured just 25.3 percent of South Asian exports to the world. However, this share has dropped from where it was a decade earlier in 1990 (29.9 percent). The US share of South Asian exports, by contrast, have grown significantly over the same period, from 16.3 percent to 24.7 percent, with sizeable increases across all countries (the exception being Bangladesh, where the US share actually fell).[14]

When we break down this trade into product groups, we see that European countries tend to import mostly textiles and clothing from South Asia (worth €10,598 million in 2001), followed by agricultural products (worth €2,134 million in 2001), chemical products, machinery, transportation material and energy. Even in the sector where South Asian imports to Europe are strongest (textiles and clothing), SAARC imports constituted only 14.5 percent of the EU's total import of these products (DG TRADE 2002). Two years later, with the European market extended to include 25 member states, SAARC's share has, if anything, gotten worse. While the regional balance of trade in transport, energy and chemical products has stayed about the same, the trade deficits in South Asia's most important export sectors (textiles and clothing, machinery and agricultural products) has gotten worse (DG TRADE 2004).

[14] To give the reader a rough indicator of the relative size of these two important markets, the US GDP in 2001 was US$11.2 trillion (in current prices), while the comparative figure for the EU15 was $8.7 trillion. See http://www.eurunion.org/profile/EUUSStats.htm.

Table 7.5. Direction of South Asian Exports (% of total)

To:	*DMCs*		*China*		*Japan*		*US*		*EU*		*Others*	
From:	1990	2002	1990	2002	1990	2002	1990	2002	1990	2002	1990	2002
Afghanistan	14.3	57.6	0.4	0.1	1.5	1.6	3.4	4.3	61.7	19.0	18.7	17.3
Bangladesh	8.6	4.7	1.5	0.2	3.9	1.0	30.5	27.6	31.5	42.9	24.0	23.5
Bhutan	-	-	-	-	-	-	-	-	-	-	-	-
India	11.3	16.4	0.1	4.2	9.3	3.8	15.1	22.9	27.7	22.9	36.5	29.8
Maldives	38.5	28.9	0.0	0.0	8.5	7.5	24.2	50.7	26.2	9.1	2.6	3.7
Nepal	11.6	49.7	2.3	0.9	0.8	1.1	23.4	28.0	53.3	15.4	8.6	5.0
Pakistan	17.2	15.6	1.2	2.4	8.2	1.4	12.4	24.5	36.0	27.2	25.0	28.9
Sri Lanka	9.1	7.5	0.2	0.2	5.4	3.5	25.9	40.8	26.3	29.7	33.2	18.3
South Asia	12.3	15.2	0.4	3.3	8.4	3.2	16.3	24.7	29.9	25.3	32.8	28.2

Source: Asian Development Bank (2004a: 287, Table A11).

Note: DMC stands for "Developing Member Country" of the Asian Development Bank.

For its part, the EU exports a variety of goods to SAARC countries, including machinery (€4,733 million in 2001) and chemical products (€2,039 million in 2001), followed by transportation material, agricultural products, textiles and clothing, and energy (DG TRADE 2002). As we saw on the import side of the equation, the South Asian market is not very important for European exporters: it constitutes less than 2 percent of the total export share in any one of these product groups. Still, in the area of machinery, transport and chemical products, the EU exports more than it imports from South Asia.

To get a better picture of the character of South Asian export trade to the EU, we can briefly trace developments in the textile and garments sector — the fastest growing export sector in South Asia. This development has been encouraged by changing domestic policies (often in response to international pressure for liberalization) as well as international agreements (such as the Multi-Fibre Arrangement [MFA]) that provide some limited access to developed country markets. In addition, South Asia was able to move upstream to fill a niche left vacant by the first generation of garment exporters who had lost their labor-cost advantage when they developed into Newly Industrialized Countries.

As a result of this happy coincidence of events, South Asian export earnings from textiles and garments have been growing faster than the region's total export growth since the mid 1980s. For most South Asian economies, the textile and garment sector emerged as the mainstay of industrial growth and employment creation. This development shows the importance of market access for South Asian exports as a potential development tool. It also shows how South Asian countries have been able to exploit their comparative advantage in cheap labor when provided with that market access. While the EU (along with the US) are the main export markets for most of these readymade garment products, this section has shown how South Asia's access to these markets remains remarkably limited.

Capital Flows and Investments

For many years, South Asia was the poster child for foreign aid from the industrialized world (Sobhan 2004). Between 1980 and 2001, $17 billion

worth of Official Development Assistance (ODA) flowed into South Asia, as shown in Table 7.6. In recent years, however, these flows — in both per capita and percent of GDP terms — have declined significantly, as has South Asia's share of the world's ODA. As is common elsewhere, these developments reflect the changing perspectives of aid donors, and a new emphasis on the role of private capital to meet developing country needs.

Until quite recently, international investors were not particularly interested in investing in South Asia — neither were they particularly welcome. Before the 1990s, Foreign Direct Investment (FDI) flows were miniscule, and the level of portfolio investment was even smaller because of the region's capital account restrictions and relatively underdeveloped capital markets. As the countries of South Asia began to pursue more liberal and open economic policies in the mid 1990s, many of which were driven by international donors and their institutional agents (see appendix to IPSSL 2000), more FDI began to flow into these countries.

Under these new conditions, where developing countries compete over world FDI flows, South Asia has managed to increase its level of FDI substantially. Still, its level and share of world (and even developing world) FDI remains quite small. As evidenced in Table 7.7, South Asia attracted about 4.58 billion dollars worth of FDI in 2002, but this was just 0.7 percent of total global flows (and most of this went to India). This table also reveals that South Asia relies much less than the world (or developing country) average on FDI as a share of its gross fixed capital supplies. Indeed, only Pakistan seemed capable of attracting as much as 10 percent (the developing world's average) of its investment needs from foreign suppliers in 2002.

While the conditions for FDI appear to be improving in South Asia, none of these countries scored well on the UNCTAD's Inward FDI Performance Index ranking (1999–2001), which ranks countries by the FDI they receive relative to their economic size (see UNCTAD 2003). In this ranking of 140 countries, Belgium and Luxembourg tops the list (1), while countries such as Surinam (140) and Gabon (139) find themselves at the bottom.

Table 7.6. Official Development Assistance (ODA)

	Total ODA (millions USD)			Per capita ODA ($)		ODA as % of GDP	
	1980	1990	2001	1990	2001	1990	2001
Bangladesh	1,282	210	1,023.9	19.7	7.3	7.0	2.2
Bhutan	8	47	59.2	32.7	27.9	16.5	11.1
India	2,147	1,586	1,705.4	1.9	1.7	0.4	0.4
Maldives	-	-	25	-	83.2	9.8	4.3
Nepal	163	429	388.1	22.7	16.1	11.7	7.0
Pakistan	1,130	1,152	1,938.2	10.3	13.2	2.8	3.3
Sri Lanka	390	665	330.2	39.1	17.6	9.1	2.1
Total S. Asia	5,120	6,174	6,032.1	5.4	4.2	1.1	0.8
S. Asia as % of world total ODA	18.50	12.58	11.73	-	-	-	-

Source: Sobhan (2004).

Table 7.7. Foreign Direct Investment (FDI) Inflows

	Annual average 1991-96		2002		
	Millions USD	% Gross fixed capital formation	Millions USD	% Gross fixed capital formation	% world total
Bangladesh	8	0.1	45	0.4	0.0
Bhutan	1	0.6	-	0.2	-
India	1,085	1.3	3,449	3.2	0.5
Maldives	8	8.5	12	6.5	0.0
Nepal	8	0.9	10	0.9	0.1
Pakistan	501	5.3	823	10.7	0.1
Sri Lanka	125	4.6	242	6.6	0.0
South Asia	1,736	3.04	4,581	4.07	0.7
Developing countries	91,502	6.5	162,415	10.5	24.9
World	254,326	4.4	651,188	12.2	100

Source: RIS (2004: 40, Tables 5.1 and 5.2).

It is closer to this end of the ranking that the countries of South Asia find themselves: Sri Lanka ranks best (111), while Nepal does worst (with 130), with the other countries placed somewhere in between.

As with the trade figures, we find that Europe does play a role in supplying FDI to South Asia (along with the US). In Table 7.8 we have ranked the most important investors in five South Asian countries. In this ranking we see the predominant role played by the United States (except in the cases of Nepal and Sri Lanka): the US delivered about a third of all FDI to Pakistan and Bangladesh, and a fifth of India's FDI supply. The measure of the EU share is illustrative of the EU's larger relationship to South Asia, as it is a composite indicator of member state activity in this area (i.e., it is based on investments originating in Germany, the UK, France, the Netherlands, Italy, Denmark, Sweden, Belgium and Luxembourg). The EU presence is strongest in Pakistan (delivering 32.8 percent of all FDI) and Bangladesh (25.8 percent), with the United Kingdom supplying the lion's share of this investment in both countries.

We began this paper by suggesting that it was reasonable to depict the European Union as a world region that was relatively rich in capital, and that South Asia could be characterized as a region rich in labor (but poor in capital). Given this depiction, it is rather disappointing to see such a small share of FDI coming from EU-member states (or, for that matter, from the richer countries altogether). It is unreasonable to place the sole blame for this rather dismal showing on European or American markets. Obviously, the South Asian economies could improve their attractiveness to international investors. Still, this section shows how difficult and problematic it is for countries in South Asia to rely on FDI as an engine for economic growth and development — just as the previous section showed with regard to trade.

Table 7.8. Leading Investors in South Asia

Source	Bangladesh	India	Nepal	Pakistan	Sri Lanka
USA	*29.5*	*22.1*	*4.4*	*41.6*	
EU	*25.8*	*16.1*	*9.3*	*32.8*	*11.9*
Japan	*7.6*	*4.4*	*6.1*	*15*	*11.6*
Korea, Rep.	2.8	4.5		1.6	32.7
Hong Kong	7.5		2.1		11.9
Singapore	5.9				6.4
Malaysia	-	2.75			
Australia	-	*3.0*			*15.0*
China PR	1.3		7.5		
Mauritius	-	10.4			
Bermuda	-		14.6		
Philippines	-		9.6		
New Zealand	-		*2.1*		
UAE	-			1.6	
Intra-SAARC	3.9	.04	37.6	Na	2.1
Others	15.7	36.71	6.7	7.4	8.4
Non-industrial, total	37.1	54.4	78.1	10.6	61.5

Source: IPSSL (2000: 15-16, Table 7).

Note: Investment amounts are in terms of percentages, based on the top ten investors in each country as reported by different national authorities. See the original source for details. For the EU-share, we combined the 9 EU states that were represented in the top ten categories (Germany, UK, France, Netherlands, Italy, Denmark, Sweden, Belgium and Luxembourg). Of course, the EU-share may be larger, as other EU-member states may have contributed. Non-industrial totals are the total percentage, minus investment shares from the US, EU, Japan, Australia and New Zealand.

Migration

Despite significant attempts at reform and a push to exploit international markets, trade and investments have proven insufficient for meeting the region's development needs. As a result, the region has been drawn, increasingly, to the potential offered by international migration. Thus far, we have seen that the EU's share of South Asian trade and investment needs is remarkably small. Given the possibility that labor flows may actually complement trade and capital flows, the European Union could provide an outlet for some of South Asia's migrant workers. This could also benefit Europe: its total population is only growing because of the net inflow of international migrants (in the year 2000, these totaled 680,000) (Eurostat 2002: 1), and there are growing concerns in Europe about the shortage of young workers to pay for future pension schemes.

On the South Asian side of the equation there is also a realization of the role that emigration can play in national development strategies. Indicative of this realization is the recent claim by the (then) Bangladeshi Prime Minister, Sheikh Hasina, that the solution to the country's problems of poverty lay in migration: 'We'll send them to America...Globalization will take that problem away, as you free up all factors of production, also labour. There'll be free movement, country to country. Globalization in its purest form should not have any boundaries, so small countries with big populations should be able to send population to countries with big boundaries and small populations. Already, we have nearly two million working abroad' (*Migration News* [June 2001], cited in Watkins and Nurick 2002: 68). Indeed, Islam (1995: 360) holds that, 'The export of manpower and the resultant in-flow of remittances have largely been acclaimed as the crucial factors in keeping the Bangladeshi economy afloat in recent years'.

And South Asians are definitely on the move. Emigration is pervasive to the region, and the remittances it generates are one of the most important sources of foreign exchange for each South Asian economy. Across the region, countries have benefited considerably from migration and they are positioning themselves to exploit these markets all the more in the near future. Only India seems to have seen a serious decline in its

number of registered emigrants recently, as witnessed in Figure 7.1 below.

Sri Lanka and Bangladesh have the region's most explicit and active emigration policies.[15] Sri Lanka has introduced a range of policies and institutions that encourage and actively support migrants leaving to look for work. The result has been a rapid growth in the number of migrants (especially female migrants)[16] and a growth in the importance of remittances to the Sri Lankan economy. Bangladesh also encourages emigration actively, but here we find a large number of people who are choosing to (or are forced to) migrate illegally as well. On the other hand, India and Pakistan employ a more 'hands-off' policy stance with respect to emigration: they have largely removed restrictions to emigration and do relatively little to support and protect migrants once they leave the country.

Figure 7.1 draws on data collected largely by Wickramasekera (2002: 15) to show the size and trends of recent emigration from the largest states in South Asia: Bangladesh, India, Pakistan and Sri Lanka. Here we see that the annual outflow of migrants has been increasing phenomenally over the past three decades, although it has appeared to drop off in India and Bangladesh in the most recent years (recent data for the other countries was more difficult to obtain). As we shall see below, events in the Gulf region have a significant impact on these trends.

This outflow in people corresponds to a rise in annual remittances, as shown in the Table 7.9. Because of the patchy nature of this data, cross-national and temporal comparisons are tricky. Still, we see a phenomenal rise in the amount of remittances that are returning home to each South Asian country from their emigrant workers abroad. This trend is clearly

[15] See IOM (2003) and Watkins and Nurick (2002) for useful descriptions of national sending country policies.

[16] Countries in South Asia have responded in different ways to the demand for women migrants. USAID in Bangladesh has estimated that between 10-20,000 women and children are trafficked from the country to India, Pakistan and the Middle East each year to work in the sex trade, as domestic labor, or as camel jockeys and beggars (USAID/Bangladesh website, cited in Watkins and Nurick 2002: 76). As a result, Bangladesh has actually banned the travel of unskilled women workers overseas. Sri Lanka, on the other hand, has actively nurtured (and monitored) the market for female labor overseas in countries such as the Philippines and Indonesia.

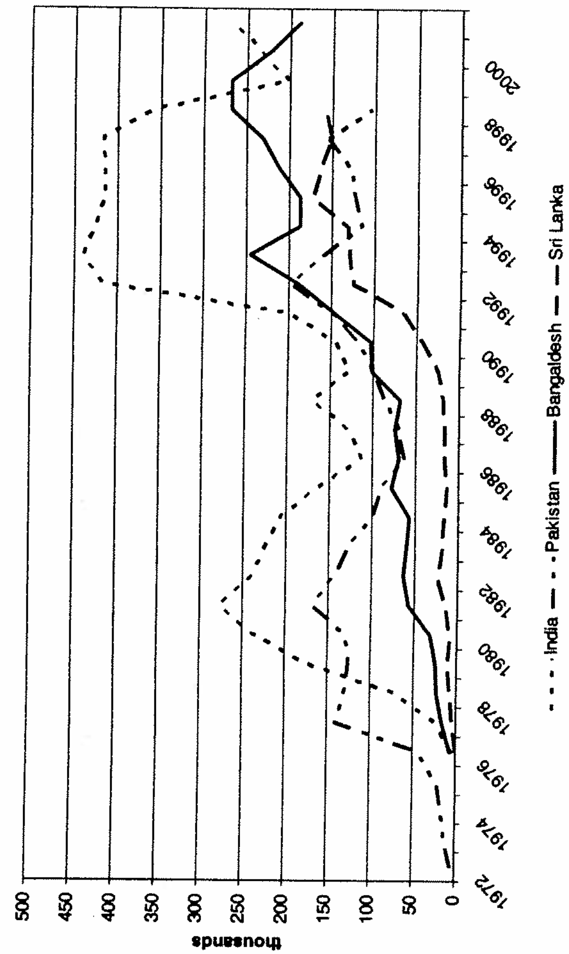
evident in Figure 7.2, which provides a longer time series of Indian remittances since the mid 1980s.

In fact, a recent World Bank report, *Global Development Finance 2003*, noted that home remittances are a hugely important source of development capital and foreign reserves across South Asia: in Sri Lanka, remittances account for over ten percent of GDP; in Nepal, it would be appear, the economy would be in dire straits but for remittances; India was the world's second-largest recipient of remittances worldwide; in Pakistan, remittances tripled between 2001 and 2003; and in Bangladesh, remittance flows increased by nearly 50 percent during the same time period. In 2001, Indian workers abroad sent home a remarkable US$10 billion in remittances!

Indeed, as a region, the size of workers' remittances dwarfs other sources of external financing, as shown in Table 7.10. In 2002, the region of South Asia received $16 billion in remittances. This is the second highest among developing country regions and equals 2.5 percent of the region's GDP. More significantly, this injection of capital dwarfed more traditional sources of foreign investment (and touched different lives): cf., the 5 billion dollars that entered the region (net) in terms of foreign direct investments, and/or the 0.8 billion dollars of portfolio equity inflows.

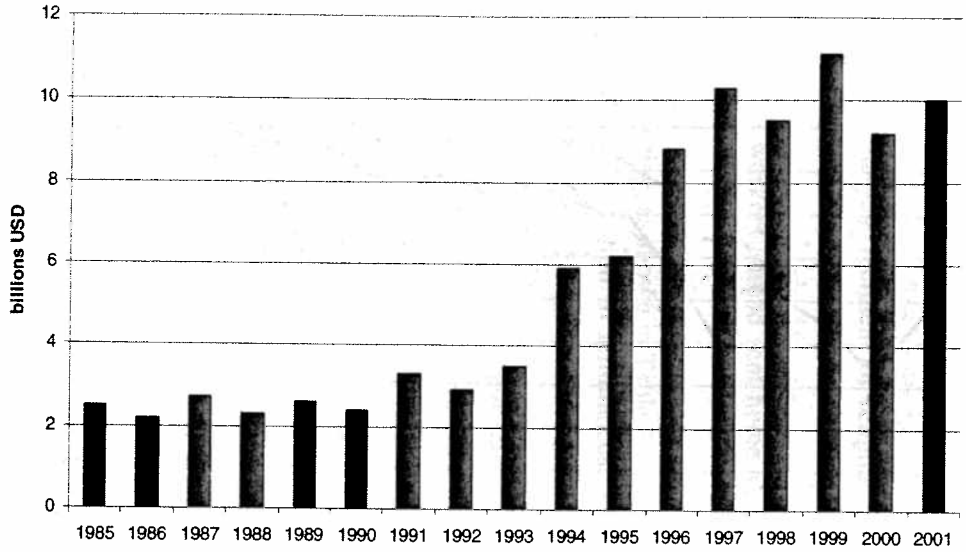
But this bonanza of foreign exchange is not coming mostly from Europe. Indeed, it would seem that Europe has little room for South Asian migrants. In 2000, the European stock of foreign population from these countries was almost non existent, except for in the UK, Italy and Denmark. In the UK, because of its colonial ties, there was a fairly significant stock of Indians (132,000), Pakistanis (82,000), Bangladeshis (70,000) and Sri Lankans (50,000), representing several years of previous immigration. Indeed, these four nationalities captured about 13 percent of the foreign population in the UK (SOPEMI 2003: B.1.5). Yet recent flows are relatively small: in 2001, only 33,700 Indians and 13,800 Pakistanis immigrated to the UK, representing 10 percent and 4 percent of the total immigrant inflows that year (flows from the other countries were not large enough to score in the top ten) (SOPEMI 2003: 39, chart 1.3).

Figure 7.1. Officially Reported Outflows of Migrant Workers



Sources: Wickramasekera (2002: 15); Skeldon (2003: 5).

Figure 7.2. India's Remittances, 1985-2001



Source: IMF *Balance of Payments* Yearbook.

Table 7.9. Average Annual Remittances (US$ billions), Selected Years and Countries

	1977	*1980*	*1986*	*1990*	*1995*	*1999*	*2000*	*2001*	*2002*
Bangladesh	.079	.339	.502	.779	1.202	1.807	1.949	1.882	2.501
India	.934	2.757	2.469	2.384	6.223	11.124	9.2	10	
Nepal	-	-	-	-	.057	.443	-	-	-
Pakistan	.868	2.038	2.525	1.997	1.712	1.06	.984	1.087	2.389
Sri Lanka	.018	.152	.292	.401	.801	1.068	1.16	1.155	1.287

Sources: Watkins and Nurick (2002: 11-12) for 1977-1999, respective central banks for most recent years.

Table 7.10. South Asian External Financing Sources (US$ billions)

	1997	*1998*	*1999*	*2000*	*2001*	*2002*
Worker remittances	14.6	13.3	15.1	13.5	14.9	16.0
Net inward FDI	4.9	3.5	3.1	3.1	4.1	5.0
Net inward portfolio equity flows	2.9	-0.6	2.4	1.7	1.6	0.8

Source: World Bank (2003: 185, Table a6).

Table 7.11. Average Annual Number of Migrant Workers and Share by Region of Destination

	1980-84	*1980-89*	*1990-94*	*1995-99*
Bangladesh				
• Number of clearances (land)	53,000	78,000	174,000	262,000ª
• % Gulf (western Asia)	92.0	95.9	83.5	
• % Other Asia	1.0	0.5	15.6	
• % Outside Asia	7.0	3.6	0.9	
India				
• Number of clearances	223,500	139,800	297,225	400,275ª
• % Gulf (western Asia)	92.4	95.8	96.0	
• % Other countries	7.6	4.2	4.0	
Pakistan				
• Number of clearances	124,500	76,800	143,000	127,075ª
• % Gulf (Western Asia)	97.2	99.9	99.6	
• % Other Asia	0.0	0.0	0.2	
• % Outside Asia	2.7	0.1	0.2	
Sri Lanka				
• Number of clearances	31,300	18900	52,300	164,312
• % Gulf (Western Asia)	-	94.5	95.4	94.0
• % Other Asia	-	4.3	3.3	4.0
• % Outside Asia	-	1.2	1.3	2.0

Source: IOM (2003: 16).

Note: Average annual number of migrant workers originating in each country; ª1995-98.

In Italy, the South Asian immigration figures were much smaller and confined to Sri Lanka (33,700) and India (30,300), totaling just 5 percent of the stock of foreign population in 2000. In Denmark, 7,100 Pakistanis made up less than 3 percent of the total stock of foreigners in the year 2000. In neither country did South Asians make a noticeable dent on the immigration inflow statistics for that year (SOPEMI 2003).

As evidenced in Table 7.11 (above), the vast majority of emigrants from these countries are going to the Gulf region, with only very small shares going to regions 'outside Asia'. Saudi Arabia hosts (by far) the greatest number of migrants from Bangladesh, India, Pakistan and Sri Lanka, while Kuwait, the UAE and Oman struggle over second, third and fourth positions. The majority of Nepalis are still going to traditional destinations such as India, but increasing numbers of Nepalese migrants are heading for the Gulf. Most early emigration from Pakistan went to the UK, but this began to dry up in the mid 1970s. Since that time, Pakistan has relied almost entirely on migration to Western Asia or the Middle East. The figures for Bangladesh, India and Sri Lanka from the 1980s also show the growing importance of other destinations in Asia (e.g., Malaysia), though these are still relatively small.

What these emigration figures reveal is a remarkable, mostly untapped, development potential. South Asian labor markets are swamped, and a significant number of their workers are willing to work abroad to improve their circumstances. Indeed, worker remittances have become the most stable and significant source of investment and aid in these countries, and yet most of these remittances are coming from non-European and non-American markets. It is in these markets that we find the greatest potential for South Asia to exploit its comparative advantage in cheap labor.[17] Obviously, this will require a significant change of attitude in the developed world.

[17] By pointing to the economic potential of emigration and remittances, we do not mean to belittle the social and human costs associated with migration, in both sender and receiver countries. These can be considerable. Our point-of-departure is the improved welfare of the poor in developing countries, and we assume that it is better for the poor, themselves, to decide which is worse: to live in an area mired in poverty and with little economic recourse, or to escape to a labor market that can put food on the family's table.

Conclusion

This empirical overview of South Asia's economic relationship to the European Union has revealed a remarkably small web of interconnections. Despite strong historical ties that have linked individual countries in both regions, today's economic ties are hardly sufficient to pull South Asia from the poverty in which it is mired. There is simply not enough economic exchange between the two regions to make any noticeable difference in South Asia.

Still, two cautious conclusions might be drawn from this review. First, there is much room for improvement across all three fronts of economic integration. South Asian exporters have shown themselves competitive in exporting labor-intensive manufactured goods, when provided with market access. They have also — increasingly — managed to attract more foreign capital to the region. Finally, emigrant remittances are providing a much needed injection of foreign capital. If continued, these trends are encouraging. By providing greater market access and information about market opportunities in South Asia, the European Union can offer continued opportunities for South Asian economic development.

Second, more attention might be paid to the role of migration in helping poor countries escape from their poverty. Policy-makers in South Asia seem to recognize the importance of migration as one arm of a three pronged strategy for development and poverty reduction. Increased trade and foreign direct investment are the others. Recent developments in economic theory and a growing realization among international policy-makers (and their host institutions) provide hope that migration may one day join trade and FDI as an equal partner in the triumvirate of development policy options.

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