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FINANCIAL INTEGRATION AND ECONOMIC GROWTH OF SOUTH ASIA

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Abstract

Throughout the past few decades, South Asia has experienced significant growth. Even amid the global financial crisis, South Asian growth remained steadfast. One of the world's fastest-growing areas, South Asia is expected to see average GDP growth of 7% in 2015. Furthermore, many South Asian economies are thought to have followed a high development path as a result of their outward-looking policies. The expansion of South Asian economies between 1980 and 2015 is examined in this study along with the relationship between global financial integration and capital flow. Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka are the next eight nations. The study made use of the random effect model and the system generalized method of moments (GMM). The findings of the empirical research show that there is conflicting data regarding how capital and growth are impacted by global financial integration. Except for Afghanistan, Bangladesh, and the Maldives, the South Asian economies were noted in the research to be less open to the outside world than developing nations like Bhutan and India. Yet, there was a developing tendency in the external financial integration of South Asian economies.

Despite the fact that many people in the region are concerned by increased levels of poverty, many countries in the South Asia region are global participants in many respects due to the nature of emerging markets and their status as democratic nations. Regulation in the South Asian region for many years has slowed economic growth and decreased the level of efficiency in nearly all economic activity. However, since the early 1980s, market deregulation has been implemented in many areas, which has helped the majority of the countries in the region in a variety of ways. One of the most important advantages is the integration of markets in the financial and other economic sectors, which leads to improved economic successes. The integration of the financial and economic markets, as well as its costs and benefits, are examined in this paper. We feel that the region will greatly benefit from the integration of the financial and economic markets.

Keywords: Financial integration, South Asia, Market, Economic Markets**.**

Introduction

Numerous trade and economic alliances, including the Association of Southeast Asian Nations (ASEAN), the Asia-Pacific Economic Cooperation (APEC), the Common Market for Eastern and Southern Africa (COMESA), the Gulf Cooperation Council (GCC), and the Southern Common Market (MERCOSUR), were established primarily for the benefit of their member countries' economies. Numerous nations have been inspired by globalization to take part in effective economic operations on a global scale. Benefits of successful globalization that are widely acknowledged have led to ongoing support for economic integration between nations and areas of the world. The majority of the time, multinational, regional, or bilateral political agreements form the basis of the integration process. These agreements enable nations to conduct trade and business in more open markets. Perera, A., & Wickramanayake, J. (2012)

Most macroeconomic models take into account the level of financial integration or capital mobility. Interest parity and the Feldstein and Horoika saving-investment correlations can be used to measure the level of market economy integration (1980). According to the, real interest must persist when there is a weak link between savings and domestic investment (Frankel, 1992). As the first study to do so, the current study adds to the body of knowledge by using both of these methods in South Asian nations. In the early 1990s, South Asian countries began the process of financial liberalization (Bekaert, Harvay, & Lundblad, 2001). Global Development Finance (2006) reports that since the turn of the century, private financial flows to South Asia have more than doubled. For instance, capital flows increased from \$9.7 billion in 2000 to \$23.6 billion in 2005. Foreign Direct Investment climbed to \$8.4 billion in South Asia, up \$1.2 billion from the previous year. According to the research, India has received a sizable portion of financial flows to South Asia. South Asian countries are particularly fascinating to analyze due to a 1990s liberalization initiative and subsequent fluctuations in capital flows. Aizenman, J., Jinjarak, Y., & Park, D. (2013).

The financial markets of every nation in the South Asian area have already started to undergo reform in order to establish a stronger groundwork for achieving greater economic growth. One essential element for creating a robust financial industry is accelerating changes in this area. Financial integration ought to occur spontaneously subject to government interferences when a region's member states have robust financial markets. Because economic agents will be better able to spot chances for profitable company ventures as a result of the integration of the financial markets, investment and growth will increase. Because of the effects of consolidation, financial market integration typically has the potential to synchronize the economic operations of nations within a region. Moreover, more effective mobilization and aggregation of funds will result from financial integration. Corporate governance might get even better once financial markets are linked. The core economic theory will be strengthened by all of these actions, which will lead to a more effective allocation of resources. Didier, T., Llovet, R., &Schmukler, S. L. (2017).

Growth and Capital flow of South Asia

One of the world's least economically integrated regions continues to be the South Asian region. In the global economy, the South Asian continent is becoming more significant. It is gaining a larger share of the global economy thanks to its rapid expansion. Afghanistan's growth is anticipated to reach 1.8 percent in 2018 and 2.5 percent in 2015 in order to recover from the election with better agricultural conditions and political stability. Bangladesh's GDP is anticipated to rise at a slower rate of 7.9 percent in 2018 and 8.1 percent in 2016, although the country's economy is still expected to expand by more than 7 percent thanks to a stable macroeconomic foundation, significant public investment, and political stability. In 2017, Bhutan's GDP is projected to grow at a rate of 4.6%. After a widespread slowdown in the first three months of current fiscal year, India's growth is expected to drop to 6.8 this year. Following that, growth is anticipated to gradually slow to 6.0 percent in the following fiscal year. Due to a slowdown in construction following the completion of the connecting bridge and international airport, the growth rate in the Maldives is predicted to reach 6.7 percent in 2017.

In Nepal, the next fiscal year, the GDP growth rate is anticipated to be 7.1%. Pakistan's growth is predicted to be 5.5 percent in the upcoming fiscal year, but the IMF program is predicted to help growth slow down starting in fiscal years 2016–17. In Sri Lanka, the growth rate is anticipated to slow to 3.2% in 2018. But it is anticipated to reach 2.7 percent in 2017, helped by declining exports and investment.

Regional Integration of South Asia

The region of South Asia has already made enormous efforts toward economic connectedness and will continue to do so in the years to come. The following three industries stand to gain the most money over the next five years. The energy sector has the most promise. South Asian nations currently rely significantly on imported coal and oil. Significant differences exist across South Asian nations in the energy industry, it should be noted. If one considers the geography of the area, for instance, one country may have an abundance of energy while another does not. Siddique, H. M. A., & Majeed, M. T. (2015).

Several of the largest rivers in the world flow through the area. However, there hasn't been much advancement in the shared management of these resources. The Brahmaputra, Ganges, Indus, and Sundarbans Delta problems are being addressed by the World Bank and its partners by bringing together the governments. The World Bank Group is supporting initiatives to increase organizational capability and the body of knowledge for improved management of shared rivers, including the preservation of species. The private sector is crucial for consumers, civil society, and others, even though governments can establish laws, rules, institutions, and infrastructures that encourage more integration. More energy, free trade, the sharing of natural resources, and participation in this process can all be advantageous to everyone. Bhaskaran, M. (2010).

Data and Methodology

From 1980 to 2015, panel data from 8 of South Asia's largest economies were used in this study. The nations are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. The variables employed in this study came from a variety of sources, including I real per capita GDP, (ii) investment GDP ratio, (iii) inflation, and (iv) current account balance.

Overall capital outflows and inflows. The information was obtained from the World Development Indicator and the International Monetary Fund.

Analysis and Interpretation

Most studies include a capital account liberalization indicator to a fundamental growth model. The findings demonstrate that beginning income positively enters the equation, demonstrating conditional convergence. The conclusion that IFI does not promote quicker growth is not refuted by the results. When gross capital flow to real per capita GDP ratio is employed as a proxy for IFI, IFI has a considerable impact on growth. With real per capita GDP, inflation and capital flow are more highly important, with respective values of 0.0198% and 0.0000%, and an R2 value of 0.450484 for system GMM estimate displaying table 01 below. IFI only produces a positive link with growth when taking into account the ratio of gross capital inflow to real per capita GDP. These kinds of findings are consistent with not rejecting the null hypothesis that there is no statistically significant association between IFI and economic growth.

Table: 01: System GMM estimation Result.

Dependent Variable: **RPC (Real per capita GDP)**

Variable	Coefficient	P- Value	R^2	DW
Cons	-4.043173 (3.1214)	0.27	0.360575	2.030786
INV	-1.403239 (1.483021)	0.3122		
INF	-0.614897 (.0.206987)	0.0187*		
CAB	-0.246743 (0.335729)	0.5904		
CF	0.397822 (0.069332)	0.0000*		
CINF	-1.224278 (0.678024)	0.0875		

*Significant at 1%,

Source: World Development Indicators 2017.

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Interpretation

The results are shown in table 02 below. The real per capita GDP was regressed on several types of capital flows. Also, the usage of various types of capital flows alters the impact of capital flows on growth. There is a favorable and significant link when the overall influx of capital is taken into consideration. The association between growth and inward portfolio flows and inward direct investment is also favorable and significant. For a different kind of flow, the outcome is favorable but inconsequential.

Table: 02: OLS regression estimation result.

Dependent Variable: **RPC (Real per capita GDP)**

Variable	Coefficient	P- Value	R^2	DW
Cons	-6.048168 (6.1517)	0.37	0.3891	2.120764
INV	-1.146576 (1.667895)	0.485		
INF	-0.313516 (0.13542)	0.067		
CAB	-0.054072 (0.43078)	0.0768		
CF	0.6403876 (0.14738)	0.001*		
CINF	-1.83157 (0.82757)	0.05**		
*Significant at 1%,				

Source: World Development Indicators 2017.

Interpretation

Even afterwards, the effects of investments are managed; both outflows and inflows of capital have a big impact. The significance of the investment declines to below the straight significance level when the current account balance variable, which is nearby significant and has a 0.485 significance level, is included. It is obvious that the productivity channel is at work in this situation when examining the routes via which capital inflows effect growth. Overall capital inflows seem to have an impact on productivity that is 0.05 percent of the growth process. Nonetheless, while capital flow variables are significant (0.001) in growth regressions, some of them become negligible when the investment ratio is included (0.067). When the capital flow variable is present, the significance of investment also decreases, suggesting that there is some collinearity between the capital inflows and investment ratio. The outcomes of all the regressions imply that the capital inflow measures are statistically significant. This tends to imply that the economies of South Asia saw an increase in investments as a result of better openness.

Conclusion

The estimated results demonstrate that South Asian country financial integration is negatively and significantly impacted by fiscal performance. In order to reach a higher level of financial integration, it is suggested that developing countries should reduce the amount of government engagement in economic and financial operations. Economic hardship has a beneficial and significant impact on the financial integration of a limited group of South Asian nations, which pushes them to rely on outside assistance to achieve financial integration. Hence, emerging countries might lessen their level of economic hardship by achieving financial integration on an equitable footing.

This is the first comprehensive study of the relationship between global financial integration and economic growth in the eight South Asian countries between 1980 and 2015 conducted elsewhere in the globe. This study's use of a wide range of measures of global financial integration to analyze how IFI affects South Asia's economic growth is another one of its distinctive features. Additionally, it looked at the impact of various capital inflows as a substitute for IFI on growth. Also, it looked at how capital inflows could spur growth. The purpose of this study is to investigate the relationship between global financial integration and economic growth using GMM and random effect model analysis. Real per capita, investment, inflation, current account balance, and other macro variables were adjusted for during the modeling process. Some useful conclusions from this investigation were founded. Except for Afghanistan, Bangladesh, and the Maldives, the study found that the economies of South Asia were less open to the outside world than those of Bhutan and India. Yet, there was an increasing trend in South Asian nations' integration of external finance. Moreover, indicators of the South Asian economies' financial fragility have improved over time. Policymakers are thinking about participating in the capital account transition for India in particular because it has one of the world's fastest expanding economies.

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