



## **A COMPARATIVE MACRO ECONOMIC POLICIES OF SAARC COUNTRIES : AN EVALUATION**

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*Global economy is becoming very competitive. Under international product cycle hypothesis production of standard commodities are transferred to emerging countries. China and India have now potential of becoming the workshop for the world for such product under the current set of the WTO regulations. Increase in export earning in this way could be employed to expand production in various sectors of the economy thus creating more jobs for the young and talented individuals.*

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### **INTRODUCTION**

#### **Economic Policies**

Good economic policies inspire people to work hard and be innovative. Policies designed scientifically help to achieve micro and macro-economic objectives for growth and prosperity. While the industrial, manpower and employment, environmental or for research and development policies are designed for micro economic efficiency, fiscal, Financial and trade policies impact at the macro levels. In general, each of these policies aim at achieving the most efficient outcome possible within the resource constraints of the economy. Diamond approach that Rao and Seth (2009) applied to Bhutan could be adopted for analysis of fiscal issues in other countries too.

#### **Fiscal Policy**

Governments in modern welfare states need to provide not only the basic public services such as law, order and defence but also create economic and social infrastructure required for growth. Remaining under the guidance of the overall policies of the time, governments in South Asia implement budgets to achieve macroeconomic stability, better distribution of income and higher rates of investment in public and private sectors of the economy (GOI; Jetly: 2014). One part of these expenditure is for current expenditure to meet the administrative costs of those basic services but another part is for public investments. These are spent in construction of physical infrastructure such as roads, ports, canals, irrigation network, telecommunications and research and development. Then there are spending to provide for health and education and other services. Size of public spending as a ratio GDP increases with the public commitments like this. It was about 28 percent of GDP in India and Bhutan but around 20 percent in Nepal, Pakistan and Sri Lanka and slightly lower in Bangladesh.

Governments raise more revenue from the indirect taxes on goods and services and on international trade than the direct taxes on income and wealth in South Asian countries. Ratio of total revenue to the GDP collected in this way is a slightly lower than the ratio of public spending in these countries. Taxes increase prices of goods and services and put burden on both producers and consumers in the economy. These burdens increase proportionately with the rate of taxes. Higher taxes discourage business and growth of the private sector. Therefore, it is neither optimal nor desirable to raise tax ratio beyond a certain limit.

Governments borrow from the private sector and central banks when revenues are not enough to pay for the public spending. Crowding out occurs when government competes for funds from the private sector. Inflation spirals when government borrows from the central banks, which essentially means printing money to pay for the deficit. Larger deficit destabilises the economy as it also causes an accumulation of public debt over time. The debt GDP ratio was 50 percent in India in 2012. Countries which have higher public debt have very limited ability to engage in development activities as most of their revenues end up on serving the public debt. Privatisation of public enterprises may reduce debt but Ghosh and Sen (2012) argue for privatisation and liberalisation simultaneously otherwise it will be infeasible as it reduces wages and welfare of workers.

### **Monetary and Financial Sector Policies**

Money is required for exchange of goods and services and it is also used for deferred payments. Liquidity of the Financial system is essential for flow of credits in the private sector. Good Financial system encourages risk averse people to save. It motivates entrepreneurs to invest borrowing from the financial institutions. Large, medium and small-scale enterprises flourish and businesses expand when the financial system is more liquid and reliable. Excess liquidity, however, can cause spiraling inflation and negative real interest rate in the economy. India and its neighbors differ quite a lot in the degree of liquidity in the system.

Efficiency of the Financial system means smaller spread between the lending and borrowing rates, from 3 to 8.5 percents among SAARC countries. This raises the cost of capital and harms initiatives for investment.

Ratio of credits to the private to the GDP and market capitalisation ratios show the strength of economy to channel savings to the investment. Developing countries of South Asia are still far away from reaching the optimal ratio of the financial assets to GDP. While China had this ratio 1.34 but India has only 0.51. Further liberalisation of banking sector, strengthening of rules and regulations for contracts can create an environment for trust and creditworthiness of these economies. Despite this India has better market capitalization rate of listed companies than that of China; 68 percent compared to 45 percents.

### **Trade Policy**

Trade is considered an engine of growth. Asian tigers earlier and South Korea and China in recent years have achieved phenomenal growth rates by pursuing the export-oriented trade

policies. Reduction in tariffs and liberalisations in trade has significantly raised the rate of globalisation in the world. Based on Prowes database Goldberg et al. (2010) estimate about 31 percent of introduction of new products account for such reduction in tariffs in India. Kaushik, Arbenser and Klein (2008) used the error correction and cointegration to study relation between economic growth, export growth, export instability and gross fixed capital formation (investment) in India during the period 1971 - 2005.

It is possible to transform economies from a developing one to more advanced ones following trade promotion policies including the free trade area (FTA), South Asian Trade and Partnership Arrangement (SAPTA), Bay of Bengal initiative for Multi Sectoral Technical and Economic Cooperation (BIMSTEC) and power transformation agreement (PTA) and project development agreements (PDA). However, clarity is required in process of tariff reforms. Should they be unilateral, multilateral and customs union of South Asia (Neary 1998). Athukorala (2000) for simultaneous reforms of exports, imports and support mechanism. Dutta (2007) found workers in high tariff protected sectors received higher wages than sectors not protected by tariff; with liberalisation wage inequality increased as the wages declined in the protected sectors. Mottaleb and Sonobe (2011) found the education level of manufacturers and performance was higher in garment industry in Bangladesh and foreign owned companies did better than endogenous Firms.

Trade ratio has been growing remarkably in each of the country in South Asia. However, the deficit in the current account as a percent of GDP around 4 percent of GDP in India and above 5 percent in Sri Lanka means opening of economies for free trade also need to complemented by net inflows of foreign direct investment to avoid ever growing amount of outstanding international debt or depreciation of domestic currency with respect to reserve currencies. Running current account surplus each year China has accumulated about 2.5 trillion SDRs 13 times more than that of India.

According to findings reported in Bhattacharai (2011) India is not only the dominant country of the region but also the mostly diversified economy in terms of trading partners and range of commodities traded; Nepal and Bhutan are landlocked (India-locked) countries they trade mostly with India; remittance from exports of skilled and unskilled labour plays a very important role in filling the gap in the balance of payment for this region; among external trading partners EU is more integrated to the South Asia region on both exports and imports than the United States; despite a long shared border very little trade seems to occur between India and Pakistan; manufacturing products usually accounts for about 60 percent of exports and while agricultural products accounts between 10 to 20 percent except for Bhutan; fuels are significant components of imports, roughly half of the manufacturing imports tariff rates are around 15 percent for both agricultural and non-agricultural goods.

Countries engage also in investment abroad for various reasons. Getting the control of raw materials and resources or to extend the markets for its products. It might be easier to operate in subsidiary operation or partnership when investment occurs across the borders. India invests less about 0.5 percent of its GDP abroad; China was three times bigger in 2012. It was possible because China had above \$559 dollar in the current surplus.

One consequence of rising trade deficit is on the depreciation of the values of its own currency with respect to reserve currencies of the world. Indian currency has depreciated by 9 times against the SDR (from 10.1 Rs to 95.3 Rs per SDR) and 8 times against the US dollars (from 7.5 Rs to 58.6 Rs per SDR) in the last 33 years. This makes foreign goods more expensive to its citizens and some deterioration in the standard of livings in international comparison. Rate of depreciation of currencies were much higher in all other countries of South Asia than in India except Maldives.

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### **Education and Technology**

Producing quality products for the national and international markets requires skilled labour force. South Asian economies can achieve such skills by educating its children and young individuals properly. Good teachers are required to provide quality education. About 40 percent of adult population is still illiterate in South Asia now. These countries need to invest in adult and school education to raise their literacy rates. It is also important to ensure the quality of the literacy so that any literate person can follow instructions required in their employment to produce goods and services (Lohani et al. (2010)). This requires raising education expenditure to GDP ratios.

Share of the exports of high-tech goods in manufacturing have increased in both China and India in the last 25 years; to 26.3 percent in China and 6.6 percent in India. These can increase further with the sound education in the primary and secondary schools. It is difficult to achieve such standards when student teacher ratios (STR) are high; compare STR of 40 of India and Pakistan to 18 of China. China had 5.8 million primary teachers compared to 2.8 in India. Bloom and Williamson (1998) explain income as the main factor in reducing birth and death rates and demographic transition in India.

Good communication is essential for right ways of processing the information. Rapid expansions in the cell phones in the last 15 years have increased the awareness of people in South Asia. Cost of consumption and productions are significantly reduced because of these easy means of communication.

### **Poverty and Inequality**

High quality of living is the overall objective of the development process. Long life, good income and better education are dimensions of these qualities. Life expectancy has increased significantly in all South Asian countries from 50s in 1980 to mid 70s in 2012. It is also indicated by the growth rate in consumption as well as the proportions of people living in urban areas relative to those in rural areas. Poverty reduction strategies have succeeded to

some extent in reducing poverty (Panda and Ganesh-Kumar (2007), (Banerjee and Duflo (2007). Datta and Ravallion (2011) however suggests that poverty reduction strategies have reduced poverty but raised inequality.

Urban areas benefit from agglomeration economies; there are positive as well as negative externalities in cities. There are not only good means of transport and communications, good schools and better hospitals but also better recreational activities. It is easier to access public services there compared to those in rural areas. More than 90 percent of population lives in urban areas in advanced countries. Therefore, new cities need to be developed in South Asia for additional 60 percent of its population if the South Asia has to achieve the growth objectives. However, unplanned development also causes an increase in petty crimes including pick-pocketing and stealing; unacceptable ways of redistribution.

Ever since Kuznet (1995) propounded inverse U-shape hypothesis of income distribution there have been many studies to test this in real economies. Inequality starts rising as economies grow and is indicated by gini-coefficients. In South Asia such inequality has been rising slightly in the last two decades but can become alarming as indicated in case of China as these economies grow. While there is some trade-off between equity and efficiency tolerance to the greater inequality is harmful for economic growth in the long run. Traditionally land redistribution has been found to be associated with decentralisation and reducing poverty in India (Bardhan (2008) and Besley and Burgess(2000) and emergence of the middle class society (Banerjee and Duflo (2008)). Recent efforts by the Modi government to eliminate "Financial untouchability" by increasing access to financial assets to marginal income groups seems to be a better means of redistributing wealth.

Given above stylized facts on the major indicators and policy choices what are the models that could be used to analyse issues of sustainable growth and development properly. This issue is taken up in the next section.

## **CONCLUSION**

Momentum of economic growth in the South Asian economies is analysed based on stylized facts of these economies along with trends of their fiscal, monetary, trade, education and income distribution policies. Macroeconomic, general equilibrium, trade and game theoretic models have been identified that could be applied to analyse micro, macro and sectoral issues of economic growth. Achieving higher rates of economic growth requires more systematic and scientific analysis of potentials, existing strengths and comparative advantages of these economies so that they can march ahead in the growth competition in the global economy. Policies should be consistent and comprehensive to link various sectors, regions and nations in the path for long run growth. A strong pro-growth government in India with a good vision for the regional integration and development is instrumental in turning this region into another example of economic miracles in the global economy within the next few decades.

Several strategic points for growth emerge from the analysis of facts in this paper: 1) given its size of population this region should push for growth a global GDP up to 20 percent from

roughly 6.5 percent in 2014; 2) such growth requires increasing the ratio of saving and investment about 10 percent above the current averages around 35 percent; 3) process of structural transformation should continue till both the output and employment in the agriculture sector are less than 5 percent from around 17 and 50 percent; 4) such transformation will occur as this region moves towards urbanization so that about 90 percent of the population live in urban area with facilities leaving rural areas for meaningful economic uses; 5) it is important to reduce the student teacher ratios from 40 to around 16 to raise the cognitive skill of children to create human capital in science and technology; 6) the trade ratio should increase to around 100 percent from the 50 percent at this time; free trade enhances both the supply and demand sides of these economies; 7) the liquidity of the financial system need at least to treble to have a smooth flow of credits required for new and existing enterprises; 8) free convertibility of currency is essential to protect this region from international shocks; 9) a high 8 percent growth strategy is consistent with all above and requires firm commitment, efficient and strong public administration but the fruits of growth should be distributed more equally so that the gini-coefficient remain under 35 percent.?

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