



***SACEPS Task Force Report on  
South Asia Macro Economic Issues***

**Executive Summary**

**Prepared by  
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## Summary and Observations

### General Situation

- Economic**
- Beginning mid 90s, South Asian economies have been suffering from multiple constraints of growth- internal as well as external. Average annual growth has declined considerably in practically all the countries. World economic scenario, post September 11, has made the situation worse
  - Major highlights of the general economic situation include
    - significant changes in the composition of GDP in favour of services sector, especially at the cost of industrial sector
    - Agriculture has done well overall, but monsoon and other natural calamities continue to have heavy tolls
    - Industrial sector has been suffering from low and falling growth
  - On the structural side, the region suffers from low savings ratio. Most countries of the region, particularly the LDCs, depend heavily on foreign aids and concessional loans, as a result
  - Monetary and credit policies of the region are, by and large, growth oriented and favour domestic investment; while keeping control over rate of inflation and keeping money supply under control. Overall, prevailing interest rate is low and on the falling side
  - On the external side, there are serious balance of payments difficulties in all countries ( with the exception of India), accompanied by shortage of foreign exchange reserves
  - Trade performance has been relatively better in all the countries other than Pakistan. However, both export growth and tourist income have suffered considerably beginning 1997. But for suppressed import growth, this could have resulted in serious balance of trade and current account deficits

### Economic Reform and Its Impact

- To the extent economic reform is about liberalisation, progress has been substantial, especially with respect to the external sector liberalisation
- Problems are encountered in respect of structural adjustment programmes, in view of political obstacles and domestic economic constraints such as poverty and unemployment
- While external liberalisation has had some positive outcomes, it has increased vulnerabilities to the external

economic conditions

- Growth prospect of the region as a whole is now, to a great extent, dependent on world economic scenario and its volatilities. Internal liberalisation is yet to produce much positive impacts, even as it has rekindled entrepreneurship amongst the people by way of encouraging entrepreneurial initiatives.
- It was felt that economic liberalisation and structural adjustment programmes had failed to move in tandem and harmony, and in the process economic hardships such as income insecurities, unemployment, etc have increased
- Lack of good governance has also been a hurdle. Weak accountability at different levels of government, poor implementation, weak enforcement mechanism, ineffectiveness of public administrations, deplorable state of public utilities, etc are some aspects of government failure in the region.

### **Macro-Economic Issues and Structural Reforms**

- All the major economies suffer from large fiscal deficits. There are problems on the revenue side as well as expenditure side. While there are problems of increasing revenue buoyancy, there are constraints to expenditure control
- On the revenue side, the issues that need to be looked at are narrow tax base and poor compliance, among others
- Thanks to the measures initiated on fiscal restructuring, in most countries changes are taking place in composition of tax revenue in favour of direct taxes.
- So far as expenditure control is concerned, problems pertain to huge debt-servicing burden and growing government consumption expenditure, mainly in view of certain “difficult to contain” category of current expenditure such as subsidies, defense/ security expenditure and large size of government set up

### **Public Sector Reform**

- Performance of public sector, and its impact on the exchequer, is a major area of concern. Contribution of the public sector by way of internal generation has been declining steadily and often negative
- While privatisation can be an answer, progress on this front has been far from satisfactory
- Privatisation process has been hampered by factors such as
  - Lack of transparent policy framework
  - Inconsistencies in the policies

- Inadequate knowledge and understanding about the dynamics of market economy
- Lack of administrative will
- Lack of political will and commitment
- Absence of adequate number of competent private entrepreneurs, etc.

**Financial  
Sector Reforms**

- Banking sector suffers from serious structural weaknesses throughout the region
- Main problem is that of huge NPAs, resulting in poor profitability of the system
- There are other problems as well namely, high interest rate spread and existence of liquidity overhang
- The problem of NPAs are not often seen as a systemic problem and that adds to the difficulties in tackling the problem
- It is our view that mere focus on debt recovery, without a macro perspective, is likely to generate many other problems such as liquidity overhang, higher cost of capital, difficulty in accessing capital, inefficient allocation of credit etc. All these problems are already, very much evident in South Asia.
- Except in India, the NBFCs market is, by and large, undeveloped in South Asia
- Insurance sector reforms has been, by and large, a non-starter and almost a non-issue in large part of the region
- Again, except for India and Pakistan, South Asia has underdeveloped capital market. Good thing however is that all countries have introduced a number of measures for healthy development and regulation of capital market operations. What is also lacking is inadequate growth of supporting institutions such as NBFCs and mutual fund companies
- However, India and Pakistan have undergone distinct improvements, so far as development of capital market is concerned and there is now growing realisation in both the countries about the imperative of better corporate governance and development of equity culture, debt market, etc.
- Further, the focus has been now on enhancing the credibility of capital markets through emphasis on protection of interest of the investors, especially of the small investors

## **Issues in Infrastructure Development**

- Lack of infrastructure is a common problem of the region and pose major obstacles to higher growth. Shortage is both quantitative as well as qualitative
- There is need for extensive modernisation as well as creating additional facilities. Without massive investment from the private sector, there is little hope of adequate development
- Encouraging private sector investment is an important aspect of development policy in the entire region. However, actual private investment has been very limited and far from adequate so far, due mainly to lack of appropriate policy, procedural hurdles and Lack of adequate domestic enterprises.
- Political environment has been also holding progress in infrastructure reform
- Much of the difficulties have been in power sector reforms, particularly in India. Problem in power sector is compounded by the inefficiencies of the public sector units such as SEBs in India
- Typical problems in this context are: political interference, cross subsidisation, high T & D losses, poor billing and collection, etc.
- So far as, non-electrical energy is concerned changes have been relatively smooth, but adequate investments are not forthcoming and lack of cooperation is holding appropriate utilisation of resources available in the region e.g. natural gas.
- Significant developments are taking place in the field of telecommunication. But there is a huge challenge of modernisation and facilitating intra-regional connectivity. Here again, there is urgent need for regional cooperation. Further, the governments of the region will need to do a lot to encourage investments by the private sector and facilitate healthy competition.
- So far as roads are concerned, lot needs to be done to attract adequate investment, and there are several issues such as appropriate user charges, supporting policies, legal adjustments etc, that need to be addressed
- So far as railways are concerned, network is large but the system needs massive modernisation. Viability of the system is also a major issue
- Similarly region wise cooperation amongst the maritime nations in the region will go a long way in enhancing intra-regional trade, besides promoting tourism and opening up

many other development opportunities

- Civil aviation is poor and inefficient in the entire region and needs a regional policy

### **Issues in Real Sector**

- Current state of development in the region is a matter of concern in the sense that both agriculture and industrial sectors are in a state of crisis. The problems are many and complex.
- Growth outlook of the region depends on a lot on the state of the real sectors. Not only that, without appropriate development of the real sectors there is little hope of addressing many of the socio-economic issues, such as poverty and unemployment
- With respect to agriculture, that suffers from several structural constraints there are certain issues that need to be addressed individually as well as collectively. Some of the pressing issues in this context are
  - Low productivity
  - Rising cost of production
  - Decline in prices
  - Lack of adequate infrastructure
  - Lack of development in agro-processing, etc among others
- Further, there is also the challenge of protecting this sector from the vagaries of monsoon and natural calamities
- Industrial sector, particularly in India and Pakistan is at the crossroads in view of the changing policy paradigm. There is an atmosphere of uncertainty amongst a large section of domestic industry. For several reasons, for domestic enterprises liberalisation has been of little help. Domestic demand conditions have resulted in a situation of prolonged recession.
- In the Indian context, the factors that have contributed to the situation are
  - Inadequate growth in rural purchasing power
  - Decline in growth in employment in the organised sector
  - Slowdown, in industrial investment, in view of focus on restructuring and consolidation and excess capacity in several sectors
  - Inadequate investment in social and economic infrastructure
- Needless to say there is high incidence of industrial sickness, not only in India but also in other countries
- Overall, the manufacturing sector in South Asia is passing

through a difficult phase of transition

**Social  
Sector Development**

- Less said, the better. South Asia is a hub of poverty, underdevelopment and poor quality of life. Failure in India has been greatly responsible for this image
- However, basic problem of the region is not lack of programmes and policies but poor implementation. Resources are limited, but are spread thinly over numerous programmes, and are directed to meet several objectives, resulting in ineffectiveness of the programmes
- Income inequality has increased in several countries, such as Bangladesh, Pakistan and Sri Lanka. Besides there is high incidence of underemployment as high as 45 % in Nepal
- Unemployment is a region-wide problem. Even Maldives with a population of 3 lakhs, have 5 % unemployment rate, much of which is because of lack of growth opportunities
- Following economic reform, and in the face of large fiscal deficit, social sectors have been made to suffer the onus of expenditure control more heavily than other sectors. Further, growing non-plan expenditure of the government is also affecting efficient allocation of resources
- Last but not the least, large-scale corruption leading to leakage of available resources. Political interventions are also affecting progress in social sector. It may be mentioned that social sector programmes in most countries of the region are often political programmes

**External  
Sector Development**

- Even if less globalised, South Asian economies are greatly exposed to the impact of globalisation and external economic conditions
- Current developments in the global economy are matters of concern for South Asia in this context
- More so, as all South Asian economies are vigorously pursuing liberal trade regime, the challenges of WTO are also matters of concern
- With respect to trade performance, South Asia has done relatively well but has been facing major constraints since the last couple of years on account of adverse global economic and trading environment, resulting in large current account deficit in most countries and also Balance of Payments difficulties
- A matter of concern is that export baskets of most countries is highly concentrated in favour of a limited

number of items. Also of concern is the import structure of countries, which is not favourable to growth of industrialisation

- Difficulties in BOP situation (except in India), coupled with limited foreign exchange reserves has given rise to difficulties in the external economy, while the prospect of concessional loans and aids are not good enough
- To make matter worse the surge in global FDI flow has by passed the region. South Asia's share in global FDI declined from 1.03 % in 1997 to 0.54 % in 2001. Against per capita global average FDI flow of \$ 135 during 1997-2000, it was only \$3 for South Asia

### **Regional Co-operation in South Asia**

- The region has not been able to make any impressive progress on this score. Each country has been following their interests independent of each other
- There has been some encouraging progress on bilateral cooperation. But again what has been achieved is much less than potential
- Intra-SAARC trade, estimated at less than \$ 6 billion, is around 4 % of total trade of the region. Apart from lack of political commitment, there are some practical hurdles on the way, which are
  - Lack of connectivity
  - Lack of complementarity
  - Inadequate industrialisation
  - Absence of necessary infrastructure
- SAPTA and SAFTA are yet to take off the ground. Progress under SAPTA has been limited by apprehensions about the impact on bilateral trade balances, resulting in lack of confidence
- Needless to say, intra-regional investments are also meager and mostly from India to other countries. SAARC initiative needs a renewed thrust