Big Bang

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Abstract- *THE debate on the relative merits of "big bang" economic reforms vis-à-vis "gradual" reforms has preoccupied policymakers in many emerging nations since the collapse of the Soviet Union in the early 1990s.*

The proponents of "big bang" reforms argue that the latter will bring about a fundamental shift in people's expectations about the future by altering the existing structure of the economy. Detractors say that the resulting dislocation to the economy and uncertainty will do more harm than good. The capacity of the state to implement so many sectoral and micro-economic reforms simultaneously is limited and therefore the risks of failure are high. They point to the sale of state-owned assets at rock-bottom prices to a group of Russian oligarchs — a direct result of hasty, ill-prepared and opaque privatization. Faced with violence, Mexico, like Pakistan, is underperforming. The recent elections brought to power a reformer, President Enrique Pena Nieto, who is committed to unlocking Mexico's suppressed economic potential. He has decided to follow a "big bang" approach and is bringing about landmark reforms in sectors such as energy, tax, labour and education.

Keywords- Economy, Privatization, Kaizen, Planning.

I. INTRODUCTION

The announcement of this reform package has suddenly focused global investors' attention on Mexico. Oil majors such as Exxon, Mobil and Royal Dutch Shell are ready to invest billions of dollars in the energy sector. Economists believe that this reform package could transform Mexico into one of the most promising markets and increase the annual economic growth to six per cent. What lessons can we draw from this approach? Pakistan has demonstrated it can grow rapidly provided there is a conducive environment for firms, farms, small businesses, service providers, etc. The country has been underperforming for the last five years. Investor confidence, domestic and foreign, has hit rock bottom and the general mood here regarding the economy is that of depression and uncertainty.

The biggest deterrent to new investment is the current state of the depressed economy and an atmosphere of gloom and doom. Declining investment, in turn, has slowed growth reinforcing the population's despondency. To break out of this, an attempt has to be made to uplift the sentiments of both the market and the general population.

This is hardly possible under a Kaizen approach. But there is a big opportunity to turn things around. That opportunity is the successful transition from one democratically elected government to another for the first time in the country's history. Such a transition will soothe the nerves of those who always see a conspiracy by the military and America to deprive the country of its democratic rights. As a result of such a transition, political stability, a sine qua non for economic reforms, would be ushered in providing the basis for a favorable business and investment clime. It is most likely that a coalition government, led by one of the major political parties, will assume power.

Irrespective of whether it is the ruling party or the opposition parties that come to power this opportunity should not be missed and a "big bang" reform package should be introduced. Fortunately, much work has already been done by the government, the Economic Advisory Council, the Planning Commission, external donor agencies and the private sector including the Pakistan Business Council. Thanks to this effort, the contours, contents and projected consequences of various reforms are available.

Once elections take place and the transition is smooth the uncertainty regarding political survival will no longer loom large. The next government will be required to fine-tune various reforms, turning them into a coherent action plan. It must work out the modalities of implementation, assign responsibility and divide work between the federal and provincial governments, monitor progress regularly and take corrective actions when needed.

It is possible that this package of reforms could be launched with full vigor within the first year of the newly elected government. The benefits and results of this effort will start becoming visible by the time the next election cycle begins, giving enormous political advantage to the incumbents.

What should be the components of this comprehensive economic reform package? Top on the list

would be energy, tax and tariff, privatization and restructuring of public enterprises, education, technology, competition and the civil services.

Reforms are badly required to create jobs to absorb millions of new entrants into the labour force every year. Dependence on the IMF and other traditional economic partners in lieu of these reforms is no longer a viable option. If the next rulers commit the same mistake and rely on external assistance instead of putting their house in order, we will be in for a much greater shock. To create the "big bang" effect all these reforms must be carried out simultaneously as a comprehensive package. This effect will boost the confidence of investors and change the general mood of the country.

However, the above agenda cannot be executed unless we make a fundamental shift in our collective mindset. If the new government along with the judiciary, media and parliamentary committees decide on a witch-hunt against the outgoing government in the name of accountability, indulge in retribution, continue with insinuations and unverified allegations of wrongdoing, then we can forget about any beneficial impact resulting from these reforms.

Those entrusted with the implementation of these reforms will be constantly preparing their replies, appearing before court, the National Accountability Bureau, Public Accounts Committee, FBR, etc responding to news stories and defending their honor. They'd have very little time for anything else. Contrary to conventional wisdom the capacity to implement does exist but has been dissipated and diverted in pursuit of these unproductive activities. No doubt those found guilty of corruption and malfeasance should be punished after due process but others should be spared this agony and allowed to work diligently.

If this opportunity is missed, we will plunge deeper into a state of despair. This is a sure path to stagnation and decline in incomes, jobs and livelihoods. It is a threat to our existence.

We need a paradigm shift to boost investors' confidence regarding the economy. Economic markets work on sentiments and expectations – if they don't have confidence in the economy, they'll adopt a wait-and-see approach and there will be no investment or economic activity.

I used to think incremental changes would bring change and stability to the economy. But now I think we need a big bang approach: we need to handle the challenges facing the economy in a comprehensive, holistic manner so as to shift the mood and the confidence levels regarding the economy.

To this end, the government needs to carry out a few major reforms. Many of the studies and work required have already been done, which is why the next government can easily implement these in the next 60 to 90 days.

The top five challenges you see ahead

The **first** major challenge is conducting governance reforms. The previous government has done well by delegating constitutional authority and powers to the provincial governments and by giving 60 percent of national resources to the provinces. But there's no clarity as to how this money is to be used to the benefit of the common man. And that missing link between the provincial government and the common man is the local government. The next government needs to take [these improvements] to the next logical level by setting up local governments.

Most citizens come across the government functionaries because of land, water, health or education-related issues. Services need to be delivered at the grassroots level and the concentration of power at the provincial level is inimical to empowerment and the provision of access to basic services.

Second, there's the law and order situation: we can't pretend this is a 9/11 outcome. The poor security situation is creating disorder in our society; people who step out their homes for work fear they won't come back alive. This is creating indifference and apathy towards economic activities and investment and must be addressed on a war footing. Security agencies have to work together on this agenda because this is not just lawlessness: we can't seem to prevent crime, apprehend culprits, investigate the cases, prosecute them on the basis of that evidence and secure convictions from the courts. And then, taking it one step further, institute the prison reforms that will help rehabilitate criminals rather than produce more hardened breeds.

Third is the question of the management of our energy resources. I don't think in terms of 'shortages' or 'surpluses'; it's how you manage your resources; coal, power, or water. At present, there is too much posturing and innumerable turf wars among the 20-odd agencies. People keep talking about circular debt, about transmission and distribution losses and fuel oil – these are relevant but above all, we need a coherent and holistic management of our resources.

Fourth issue of fiscal management: our system of tax assessment and collection is both inefficient and inequitable. There are many studies now, which show that revenue collection can be improved by up to 50 percent by improving

the tax administration and by widening the tax net. And any government that comes in needs to fix this, otherwise we'll be back to double-digit inflation.

Fifth, the public sector enterprises (PSEs) need to be shed. The Rs400 billion spent on PSEs should be spent on education, health and targeted subsidies through the Benazir Income Support Programme; anything else is a waste of resources. [Our problem is that] development expenditure is allocated on political considerations, not economic. In fact, the only time the allocations were made on economic considerations was in the 1960s. But the Planning Commission seems to have lost the [vision] it used to have.

Finally, there's the issue of continuity of policies. Every government starts from square one, forsaking all previous projects and policies.

The critical factor for them to consider is whether in 2014, the political forest would look attractive enough that the people would vote them back to power. Leaving aside voters in some traditional rural areas, the youth--- who now form a considerable size of the electorate, will be the new element in the equation. The new census will show that the urban constituencies will form at least 40 percent of the total electorate.

The ruling parties can only keep the youth of today contended and happy if they are able to provide them jobs, essential food at affordable rates, clean drinking water, healthcare facilities and education to their families. Security of life and property and providing an expeditious and inexpensive justice system also remains a challenge and a must. To fulfill these aspirations, Pakistan needs a healthy forest and strong trees, which take their roots in good governance, sound economic policies and management.

But are the political parties trying to strengthen these trees?

The answer is a firm **"no."** On the contrary, the political parties are weakening the existing roots by creating jobs in the public sector for few of their loyal supporters and saddling the exchequer with financial burden, amplifying the fiscal deficit. For each job only one person is obliged by the politician, while 99 other potential or actual supporters, who do not get that job, are disappointed. The politicians end up with the worst of both the worlds. They not only alienate the majority for the sake of a few, but also unwittingly contribute to the problems of fiscal deficit, debt and inflation.

Economic trees such as growth, poverty reduction, employment creation, low inflation and investment gain strength if there is a positive market sentiment and a general upbeat mood among consumers and businesses. In other words, they have confidence in the foresight and capabilities of policy makers and the leadership. As a result of this confidence, investors will sense a positive return on their future investment and expand or build a new capacity for goods and services. This heightened economic activity will create jobs, reduce unemployment, add to purchasing power and thus raise aggregate demand. It will naturally boost growth rates and results in more taxes because of higher incomes, filling in the fiscal gap.

The salaries of public servants can be revised upwards and development spending on energy, transport, infrastructure, education and health can be accelerated as additional resources become available. Shortages and supply bottlenecks in the energy sector -- that cripple the economy and create disaffection among the people -- will be eased, lowering the costs of doing business, making Pakistani goods competitive in the international markets and cooling tempers of the households. Looking at the successes of the domestic investors, foreign investors will also bring in capital, know-how and technology. This scenario is not theoretical but has actually been played out in practice several times in this very country for extended periods of time.

There is a conflict between individual and collective interests and between short- and long-term goals. Policy makers must abandon the short-term and narrow goal of maximizing benefits for themselves and their loyalists. Little do they realize that when each politician extracts a large piece of pie for himself and loyal supporters, very little is left for the majority. And without the majority vote, their party cannot come back to power. Coalition politics is not stable. Our leaders must wake up to the reality that demographic changes with a large number of youth as voters, growing urbanization, rising middle classes and vibrant media, social networking through the internet are bringing about significant though not so visible changes in the political landscape even since 2008. Unless they shift their tactics and do not come out of the smugness of their past glory, they would be in for a big surprise in 2014.

The memories of June 1991, when the foreign exchange reserves fell to a level equal to barely a week's imports, are way behind us. Our journey from these problems to the position of comfort that we enjoy today has been exciting. The aftermath of the crisis of 1991 was to correct for the implicit anti-export bias built up during the first three and a half decades of planning and to reap the competitiveness and efficiency gains for the economy from a more open trade regime.

What were the major elements of the reforms?

First, arrangements were put in place for the move towards a market-determined exchange rate.

Second, since 1992 the trade policy imbibed a medium-term perspective.

Third, a key aspect of the trade reforms has been a substantial reduction in import tariff rates and a drastic rationalisation of the tariff structure, including their dispersion.

Fourth, concerted efforts have been made to dismantle the panoply of non-tariff barriers that was predicated upon the balance of payments reasons under the GATT.

Fifth, the Reserve Bank of India has undertaken several measures to ensure adequate and timely availability of bank credit for trade finance at competitive interest rates.

Sixth, there has been a policy thrust for creating appropriate institutional arrangements for supporting a vigorous export drive. These include export processing zones, special economic zones, overseas banking units and technology parks. These reforms in the trade policy regime have unlocked entrepreneurial energies. India's merchandise exports have been rising at a rate of over 20 per cent per annum, in US dollar terms, in recent years.

India has engaged herself constructively in multilateral trade negotiations under the WTO. Within its multilateral commitments, India has forcefully articulated its position which reflects the concerns of the developing countries. In tune with the worldwide spread of regional trading arrangements and our belief that such arrangements act as prelude to progressive multilateral trade liberalisation, India has entered into several preferential trade agreements.

These reforms in the trade policy regime have unlocked entrepreneurial energies. India's merchandise exports have been rising at a rate of over 20 per cent per annum, in US dollar terms, in recent years. As a result, the secular decline in India's share in world exports from two per cent in 1950 to 0.5 per cent in the 1980s has been halted. This share began rising in the 1990s and is currently at 0.8 per cent. The export strategy envisages a doubling of India's share in the world merchandise trade by 2008-09.

Services

Trade policy reforms undertaken since the 1990s have shed their traditional focus on merchandise trade and encompassed a wide range of tradable services, reflecting India's competitive advantage in business services, technical and professional services. The EXIM policies of recent years have selected services for special focus. India accepted the obligations under Article VIII of the IMF's Articles of Agreement and instituted current account convertibility in 1994. Besides, there has been a progressive liberalisation of the exchange control regime. Foreign direct investment (FDI) has been permitted in a host of services in order to take advantage of modern technology, with some restrictions on financial services, taking into account the current stage of development and openness. Further, increasing availability of speedier and cost-effective money transfer arrangements through the banking channels and post offices has resulted in significant increase in the use of formal channels for remittance transfers.

Exports of services have risen consistently by over 20 per cent per annum in recent years. Within services exports, software and IT-enabled services have been growing at an average rate of 46 per cent annually since the mid-1990s. Over the years, skill content of Indian labour has been rising and the traditional markets of the Middle East have given way to the US, Europe and other industrialised countries. For the external sector, this natural advantage has translated into significant inflows in the form of remittances from Indians working abroad. Workers' remittances are nearly four per cent of India's GDP now and have provided considerable and sustained support to India's balance of payments.

Reserve Management

The adequacy of foreign exchange reserves is a relevant consideration in the management of the capital account.

First, adequacy has to be viewed not only in terms of trade needs but also other short-term liabilities.

Second, it is not merely the long-term or short-term debt in terms of original maturity that is relevant for reserves, but the profile of external debt in terms of residual maturity. A trade-related debt which is in the nature of collateralised debt may be less severe on reserve requirements.

Third, any addition to portfolio flows may warrant comfort through some additions to reserves. In fact, there is merit in presuming that the flows are temporary till there is reason to judge them to be permanent.

Fourth, it is necessary to recognise that reserves provide cushion to manage real and external sector shocks like oil prices.

Fifth, there is usually an opportunity cost of maintaining foreign exchange reserves, but this must be weighed against the financial and non-financial costs associated with volatile and adverse exchange rate movements.

Finally, while the optimal level of reserves is difficult to quantify, attention to level of reserves as a means of self-insurance is essential. In the final analysis, the adequacy of reserves needs to be assessed in terms of a medium-term perspective taking into account the possible levels of the current account deficits, the composition of capital flows, the level of international confidence in the ability of the country's payment position and pace and quality of growth. Viewed from all these perspectives, the current level of reserves continues to be comfortable.

The essence of portfolio management of reserves by the RBI is to ensure safety, liquidity and optimisation of returns. The reserve management strategies are periodically reviewed by the RBI in consultation with the Government. In deploying reserves, attention is paid to the currency composition, duration and selection of instruments. While there is no set formula to meet all situations, the RBI applies sound portfolio management principles and risk management.

Exchange Rate Management

A major success in external sector management has been the transition from an administered exchange rate regime to a more flexible, market-based system. Under the new arrangements instituted in early 1993, the day-to-day movements in exchange rates are market determined. India's current exchange rate policy focuses on management of volatility without a fixed target, while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period, in an orderly way. To this end, the RBI monitors closely the developments in the financial markets at home and abroad, and takes such monetary, regulatory and other measures as considered necessary from time to time.

The conduct of exchange rate policy is guided by three major purposes: first, to reduce excessive volatility in exchange rates, while ensuring that the movements are orderly; second, to help maintain an adequate level of foreign exchange reserves and third, to help eliminate market constraints with a view to developing a deep and liquid foreign exchange market. The policy is aimed at preventing destabilising speculation in the market while facilitating foreign exchange transactions at market rates for all permissible purposes.

There is a wide consensus that India's exchange rate policy has stood the test of time, despite several domestic and external developments, including the severe currency crises which characterised the 1990s. Recent international research on viable exchange rate strategies in emerging markets has lent considerable support to the exchange rate policy followed by India.

Global Economy and India

The debate in India has customarily been on the contours of the public policy in the context of increasing global economic integration. More recently, however, a debate in the rest of the world has been in evidence on the challenges likely to be faced by the global economy on account of progressively increasing global integration of the Indian economy. Hence, there is merit in looking at, perhaps illustratively, some of the global challenges of our integration while we move forward in this regard.

Over the next half-century, the population of the world will age faster than during the past half-century as fertility rates decline and life expectancy rises. In Europe, the demographic profile is already tilted towards the higher age group and by 2050, this is projected to accelerate. Projections suggest a turning point between 2010 and 2030 when the European Union, North America and Japan will experience a substantial decline in savings rate relative to investment which may be reflected in large current account deficits. Most of the high performers of East Asia and China are in the second stage of the demographic cycle. Elderly dependency is expected to double in these countries by 2025. Their working age populations will increase modestly first and then shrink. These projections suggest that East Asia could increasingly become an important supplier of global savings up to 2025; however, rapid population ageing thereafter would reinforce rather than mitigate the inexorable decline of global savings. India is entering the second stage of demographic cycle and over the next half-century, a significant increase in both savings rate and share of working age population is expected. The share of the labour force in population in India is expected to overtake the rest of Asia, including China, by 2030. Looking ahead, the rest of the world may increasingly rely on China and India for supplies of both labour and capital and this could significantly influence the evolution of the global economy. It is evident that China and India will have to give high priority to generating employment and both are poised for substantial increases in productivity.

Financial Integration

On the path of integrating the Indian financial markets with the global financial system, we have chosen to proceed cautiously and in a gradual manner, calibrating the pace of capital account liberalisation with underlying macroeconomic developments, the state of readiness of the domestic financial system and the dynamics of international financial markets.

Unlike in the case of trade integration, where benefits to all countries are demonstrable, in case of financial integration, a "threshold" in terms of preparedness and resilience of the economy is important for a country to get full benefits. A judgmental view needs to be taken whether and when a country has reached the “threshold” and the financial integration should be approached cautiously, preferably within the framework of a plausible roadmap that is drawn up by embodying the country-specific context and institutional features. In India, we have been adhering to a cautious and sure-footed approach in our reforms so far and there is merit in doing so since it enables us to avoid policy reversals on the one hand and build on the past strengths on the other.

India has made significant progress in financial liberalisation since the institution of financial sector reforms in 1992 and this has been recognised internationally. External financial liberalisation, in particular, has expanded at a fairly rapid pace. At this stage, the optimism generated by impressive macroeconomic performance accompanied with stability has given rise to pressures for significantly accelerating the pace of external financial liberalisation. It is essential to take into account the risks associated with it while resetting an accelerated pace of a gradualist approach.

First, India’s public debt and fiscal deficit as a proportion of GDP is currently among the highest in the world, but it has been financed almost entirely from domestic savings. There is a commitment to fiscal consolidation in the medium term with the implementation of the Fiscal Responsibility and Budget Management Act, 2003. In the interim, however, before embarking on any faster pace of external financial liberalisation, the possible spill-over effects of fiscal deficits into external sector need to be carefully evaluated.

Second, it is widely recognised that financial instability can lead to high variability in real activity and, as the Asian financial crisis has tellingly demonstrated, even cause interruptions in the growth process. Financial distress has resulted in macroeconomic and welfare losses. Resilience and flexibility in the real sector of the economy are essential to deal with surges of capital flows, large reversals and associated fluctuations in financial prices that become inevitable with accelerated liberalisation of financial sector. At present, some inflexibilities in pricing policies and restrictions on domestic trade constrain the response of the real sector. In general, therefore, low level of system flexibility at the current juncture is a major constraint on economic agents and financial market participants in responding to highly accelerated financial liberalisation and dealing with its downside risks.

Third, the adequacy of foreign exchange reserves is often cited as a consideration for significantly accelerating the pace of financial liberalisation. Foreign exchange reserves are, in the final analysis, a cushion to withstand both cyclical and unanticipated shocks. Therefore, reserve adequacy may be a necessary condition but not a sufficient one for speeding up financial liberalisation. There is a clearer recognition today that the net benefits from financial liberalisation in respect of any developing country would be enhanced only if complementary policies in non-financial sectors are followed.

Finally, the existing international financial architecture is not adequate to prevent or mitigate the domestic and external effects of financial crisis in large economies like India. The impact of instability in times of crisis appears largely to be borne by the home or domestic public sector rather than the global private sector. The issue of setting the pace of financial liberalisation revisits the issue of trade-off between sustained growth and a growth rate that could potentially turn volatile and unstable.

Thus, the recent experience in many countries shows that periods of impressive macroeconomic performance generate pressures for speedier financial liberalisation since everyone appears to be a gainer from further liberalisation, but the costs of instability that may get generated are borne by the country, the government and the poorer sections. Avoiding crises is ultimately a national responsibility. The approach to managing the external sector, the choice of instruments and the timing and sequencing of policies are matters of informed judgment, given the imponderables.

II. CONCLUSION

Over the years, India’s commercial and financial linkages with the rest of the world have been increasing with trade liberalisation and openness on the capital account. This is reflected in the transmission of international impulses to the real sector and domestic financial markets. Trends in international prices have now significant influence on domestic prices. Indian corporates and institutions are increasingly accessing international markets with consequent

diversification benefits. While this process has provided important opportunities, it has also brought in new challenges and risks, necessitating fine-tuning of macro policies in a much broader canvass and context. India is, thus, moving from a focus on managing external sector to implementing an optimal integration of domestic and external sectors, with the global economy.

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