Indira Gandhi National Open University
School of Social Sciences

BECE-016
ECONOMIC DEVELOPMENT:
COMPARATIVE ANALYSIS AND
CONTEMPORARY ISSUES

Emerging Global Economic Order

4

''शिक्षा मानव को बन्धनों से मुक्त करती है और आज के युग में तो यह लोकतंत्र की भावना का आधार भी है। जन्म तथा अन्य कारणों से उत्पन्न जाति एवं वर्गगत विषमताओं को दूर करते हुए मनुष्य को इन सबसे ऊपर उठाती है।''

— इन्दिरा गांधी

"Education is a liberating force, and in our age it is also a democratising force, cutting across the barriers of caste and class, smoothing out inequalities imposed by birth and other circumstances."

— Indira Gandhi

Indira Gandhi
National Open University
School of Social Sciences

BECE-016
Economic Development: Comparative Analysis and Contemporary Issues

Block

4

EMERGING GLOBAL ECONOMIC ORDER

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August, 2010

ISBN-978-81-266-4853-5

Further information about the School of Social Sciences and the Indira Gandhi National Open University courses may be obtained from the University's office at Maidan Garhi, New Delhi-110068.

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi, by Director, School of Social Sciences.

Laser typeset by Mctronics Printographics, 27/3 Ward No. 1, Opp. Mother Dairy, Mehrauli, New Delhi-30

Printed at : Vijayalakshmi Printing Works Pvt. Ltd., B-117, Sector-5, Noida-201301

BLOCK 4 EMERGING GLOBAL ECONOMIC ORDER

Globalisation is the extraordinary explosion of both technology and information, in ways that have considerably reduced the twin concepts of time and space. It refers to global economic integration of many national economies into one global economy, mainly through free trade and free capital mobility propelled by Information and Communication Technology. It follows that in order to be competitive the productive plant of each country would be torn out of their national context (disintegrated) and re-integrated into the new whole, the globalised economy.

Paul Streen pints out to two important faces that have emerged of globalisation are:

a) Growing legal and institutional framework within which the regimes of contemporary international trade, finance and investment are being conducted. The emergence of World Trade Organisation is the one of the most important example of this kind of trend.

b) Emergence of powerful communities and groups around issues which are essentially global in their reach, such as the environmental issues, women's and anti-nuclear movements, human rights struggles and like. Groups like Amnesty International, Green Dot, WWF, Consumer bodies have become phenomenally powerful and are challenging national governments.

This block titled Emerging Global Economic Order deals with World Trading System, emerging financial system, emerging information technology and emergence of world economic reform.

Unit 14 deals with the emergence of global trading system with reference to WTO for developing countries and future direction for structural reform.

Unit 15 explains the development of world financial system, principles of IMF and suggestion for New World Monetary System.

Unit 16 discusses the development of information technology and its role of information technology in economic development.

Unit 17 deals with the emergence of world economic reform in different sectors in general and India in particular.

UNIT 14 EMERGING TRADING SYSTEM

Structure

14.0 OBJECTIVES

After going through this unit, you should be able to:

- narrate the emergence of global trading system;
- discuss the relevance of WTO for developing countries regarding the problems of GATT; and
- forecast for trade promotion and future directions for structural reforms.

14.1 INTRODUCTION

At the end of the Second World War, the United States and Europe have led the world's march towards progressively free trade. Eight multilateral rounds of trade liberalisation were successfully concluded under the auspices of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organisation (WTO). Since the mid 1980s, multilateral pacts have been complemented by numerous bilateral and regional free trade agreements (FTAs). Due both to progressive policy liberalisation and dramatically falling transportation and communication costs, international trade has propelled world economic growth for the past 50 years. The period between 1950 and 2000 was the best half-century in recorded economic history: world GDP grew on average by four percent annually, and world trade systematically expanded faster by around two to four percent per year.

14.2 ABOUT TRADE

Trade is not an end in itself. But trade can enhance a country's access to a wider range of goods, services, technologies and knowledge. It stimulates the entrepreneurial activities of the private sector. It creates jobs. It attracts private capital. It increases foreign exchange earnings. Above all, it contributes to generating resources for sustainable development and alleviation of poverty.

14.3 WHAT IS WORLD TRADING SYSTEM?

A global trading, financial, and migration system largely free of national, policy-created barriers functioned well for nearly half a century until the outbreak of the First World War. Lord Keynes bemoaned its collapse with the words, "What an extraordinary episode in the economic progress of man, that age was which came to an end in August 1914" and described it in vivid detail, albeit from the perspective of an upper-class Englishman. During the Second World War, sensing their impending victory over the Axis powers, the Allied powers thought ahead to the design of a world economic system that would prevent a recurrence of the disastrous economic experiences of the inter-war period: global economic depression, competitive devaluation of national currencies, and raising of tariff walls.

The first concrete move towards establishing a framework for the world trading system was taken by the United States, with its Proposals for the Expansion of World Trade and Employment. These were published on December 6, 1945, and forwarded to all other countries in the world. At the same time, the US extended an invitation to 15 countries, including Brazil, China, Cuba, and pre-partition India (which then comprised contemporary Bangladesh, India, and Pakistan), to take part in negotiations for the reduction of tariffs and other barriers to trade. All these countries, with the notable exception of the Soviet Union, accepted the invitation.

14.4 HISTORY OF WORLD TRADING SYSTEM OR INTRODUCING GATT

At the end of the Second World War the interwar period was still fresh in memory. When the victorious countries (especially Britain and the United States) started to plan for new, more viable relations in the international economy, they were determined to avoid the mistakes of the past. The Bretton Woods conference (named after the meeting place, Bretton Woods in New Hampshire, U.S.) held in 1944 was the starting-point for a new order. The world economy would be organised around three cornerstones: the International Monetary Fund (I.M.F.), the International Trade Organisation (I.T.O.), and the International Bank for Reconstruction and Development (I.B.R.D.).

The I.M.F. was designed to take care of short-term problems in connection with international liquidity. It would help to smooth out and solve difficulties that the respective countries would perhaps have with their balances of payments in fixed exchange rate regime.

The I.B.R.D. would help to channel international investments along desired lines. It would especially help the countries most in need of capital, the less developed countries, to get capital from the more developed, industrial countries.

The I.T.O., on the other hand, would deal with the 'real' side of trading relations. It would help to create a liberal system of regulations governing world trade; it would, in the long run, be the vehicle that carried the world toward a system of free trade.

The International Trade Organisation was the least successful of the above-mentioned three organisations; it never actually came into existence. A conference in Havana in 1947-48 established a charter for the I.T.O. This charter, however, was never ratified by the U.S. Senate. Nor did any other country ratify it; thus the I.T.O. was never established. Instead, GATT came into being. GATT was a less ambitious organisation with headquarters in Geneva. It would serve as a sort of clearing house between nations. Instead of bargaining on a bilateral basis, the member countries of GATT would meet in Geneva and negotiate jointly at the same time on matters of trade policy. Thereby, it was hoped, a more orderly and just result could be achieved.

There are today more than 150 countries that are contracting parties to GATT, and an additional twenty-four belong to GATT on a 'provisional' basis. The Soviet Union and China are notable absentees, though Czechoslovakia, Hungary, Poland, Romania and Yugoslavia are all full members. The clause of most-favoured nation in principle Lies out any preferential treatment among nations as far as trade policy is concerned.

14.5 GATT AND DEVELOPING COUNTRIES (PROBLEMS OF GATT)

Under GATT's auspices, eight successful rounds of multilateral negotiations for reducing barriers to trade were concluded. The liberalisation of trade barriers under successive rounds resulted in remarkably rapid growth in trade, at nearly 8 percent a year on average, in the volume of world trade between 1950 and the first oil shock in 1973. In the roughly two decades thereafter (1973-90), which included the second oil shock of 1979 and the debt crises of the 1980s, average trade growth slowed to around 4 percent a year. During 1990-2002, it recovered to an average of slightly less than 6 percent a year. In all these periods, trade grew faster than output, so that the share of trade in output increased substantially.

Despite success in reducing trade barriers and accelerating growth of world export volume, many countries did not participate in GATT due to some significant reasons, such as:

1) Trade barriers in commodities of export interest to developing countries were not reduced to the same extent as trade barriers in commodities mostly traded among developed countries.

2) Agriculture, a sector of great interest to developing countries largely remained outside the GATT framework until the Uruguay Round.

3) GATT only promoted the interests of developed and industrialised countries. In sum, the GATT was unfriendly, if not actively hostile, to the interests of developing countries.

14.6 ROUNDS OF GATT

Major issues

Rounds	Year	Place	Major issues
First round	April 1947	Geneva	a) abolition of tarrifs & preferences
Second round	1949	Annecy (France)	a) 147 bilateral negotiations for around 500 items

Rounds	Year	Place	Major issues
Third round	1950-51	Torquay (England)	a) Out of 400 bilateral negotiations only 147 were completed
Fourth round	1955-56	Geneva	a) 900 million $ concessions were given on imports and 400 million dollar on exports by USA
Fifth round	1960-61	Geneva	a) Most of LDCs expected unilateral tarrifs conscious from developed countries
Sixth round (Kennedy Round)	1963-67	Geneva	a) USA, EEC, Japan & Canada reduced 55% tarrif
Seventh round (Tokyo Round)	1973-79	Tokyo	a) Reduction in tarrifs b) abolition of non-tarrif restriction liberalisation in agricultural trade etc.
Eighth round (Uruguay Round)	Sep 1986	Punta del Este Uruguay	a) Tarrifs reduction b) non-tarrif barries c) trade in services d) intellectual property rights (TRIPS) e) Foreign Investments f) Agriculture g) Textiles h) Settlement of disputes

Check Your Progress 1

1) What is Global Trading System?

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2) Differentiate between GATT and WTO.

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14.7 THE URUGUAY ROUND

Within three years of the conclusion of the Tokyo Round, the US wanted to use the 1982 GATT ministerial meeting to initiate another round of multilateral trade negotiations. The meeting had been called to examine the functioning of the multilateral trading system. The US was interested in extending the traditional negotiating agenda to include service and intellectual property rights. A group of developing countries led by Brazil and India strongly opposed this, on the grounds that developing countries were not ready to negotiate on services trade on an equal footing with developed countries, and that, besides, the latter had not lived up to their obligations in the case of trade in textiles and agricultural products. They demanded commitments from developed countries not to introduce any new GATT-inconsistent measures (the "stand-still" demand) and to remove any such measures in existence (the "roll-back" demand).

The US did not succeed in launching a new round but it enunciated a two-year work programme for the GATT that involved 17 topics, including services. Even before the work programme was completed, the Japanese Prime Minister had initiated a discussion on a new round and persuaded the G-7 industrialised countries to consult their trading partners about the objectives and timing of a new round. Eventually, the opposition of Brazil and India was worn down, and a committee was established to prepare recommendations for adoption at the GATT ministers' in September 1986 in the meeting at Punta del Este, Uruguay.

The course of negotiations of the Uruguay Round was tortuous; from the start in September 1986 to the approval of the Final Act in December 1993, the process was as just as full of conflicts and periodic breakdowns as the pre-negotiations that led to its launch. The negotiations were to take place in Geneva, with a mid-term review in Montreal at a ministerial meeting in December 1988, and to be concluded in December 1990. In fact, by the time of the ministerial meeting in Brussels in December 1990, final agreements had been reached on almost none of the topics. Serious negotiations did not begin until 1988, and when the ministers met in December for the interim review, only six of the fifteen negotiating groups had clear texts for approval by the ministers. The US sent a powerful signal that it would aggressively pursue unilateral actions without necessarily first exhausting its options under the GATT or awaiting the outcome of negotiations on others. The interim review meeting ended inconclusively with agreement in a few areas such as tropical products, interim reforms of the GATT dispute-settlement procedures, commitments to reduce tariffs on average by a third, and the provisional introduction of a new trade-policy review mechanism (Schott 1994: 8). But on agriculture, textiles, trade-related aspects of intellectual property rights, and safeguards, the ministers could not agree.

Thus, several factors along with the appointment of a very active new Director-General of the GATT, namely Peter Sutherland, led to intensive negotiations in the second half of 1993 and culminated in the Final Act of the Uruguay Round, agreed in December 1993.

14.8 ROAD TO THE DOHA ROUND

The Uruguay Round Agreement as a single undertaking includes agreement on traditional GATT issues such as reductions of tariffs and tariff bindings; a not completely successful attempt to bring agricultural trade under multilateral disciplines a major revamping and strengthening of the Dispute Settlement Mechanism; phasing out of the Multi-fiber Arrangement; agreements on Trade-related Investment Measures (TRIMs) and Trade-related Aspects of Intellectual Property Rights (TRIPs); and a new General Agreement on Trade in Services

(GATTS). Since the conclusion of the Round as envisaged, multilateral agreements on Financial Services and Telecommunications have been concluded as part of the GATT.

The chairman of the Doha meeting, Qatari Minister of Finance Youssef Hussain Kamal, structured the discussion around six topics: agriculture, implementation, environment, WTO rules, the so-called Singapore issues (trade and investment, trade and competition policy, transparency in government procurement, and trade facilitation), and intellectual property. Informal discussions took place on each topic, with any delegation that wished to participate being invited to do so. A "friend of the chair" led the discussions and reported their progress regularly to the full heads of delegation. This process, of holding informal discussions on each topic simultaneously with formal meetings at which ministers made their conference statements, avoided much of the unhappiness associated with the "Green Room" process of earlier ministerial meetings.

14.9 CANCUN MEETING

The Cancun meeting opened with a draft ministerial declaration prepared by Carlos Perez del Castillo of the General Council and Director-General Supachai Panitchpakdi of the WTO. In their covering letter to ministers, they stressed that while the draft declaration had not been agreed "in any part" and did not include many of the member governments' proposals, in their best judgment it constituted a workable framework for action by ministers at Cancun. The draft in particular included a version of the US-EU joint proposal on agriculture.

14.10 A BOLD FORECAST

Taking all this together, it is forecasted a six-month extension of the Trade Promotion Authority, until December 2007, so that the Doha Development Round can be brought to a conclusion. With an extension of TPA, it is expected shallow results will be achieved in the DDR during the rest of 2009, with many of the negative consequences described in the first scenario. To keep the WTO in the game and to keep hope alive, it can be predicted that, at the end of DDR negotiations,WTO ministers will announce a series of plurilateral talks for particular sectors- e.g., zero-for-zero tariffs for selected manufactured goods, continued talks on Mode 2 for selected service sectors, and additional coverage of the government procurement code.

It is also expected the launch of exploratory talks on big regional deals – FTAAP, Western Hemisphere, Transatlantic, East Asia, and South Asia. But we do not expect regional talks to lead to concrete results within the next five years. The "real action" will be in bilateral FTAs, with the choice of partner selection determined as much by foreign policy considerations as economic interests. However, we are thinking that the United States is likely to sit out the game until late 2009 or 2010, for lack of presidential negotiating authority. Enlightened countries will follow the Chilean and New Zealand models, by unilaterally reducing barriers and adopting complementary domestic reforms, without waiting for bilateral or regional negotiations.

In the meantime, driven by information technology and innovative developments in transportation, we foresee that global trade and investment will grow rapidly. If a combination of bilateral FTAs and transportation/ communications technology serves to keep world trade and investment brisk, ten years from now multilateral negotiations under WTO auspices may seem less urgent than they do in 2007.

14.11 FUTURE DIRECTIONS

GATT, the World Bank, IMF, the UN, and other intergovernmental agencies were created in the 1940s, and it is often suggested that their design reflected the need to address the pressing problems of the period. The problems of the 21st century are not the problems of the 1940s, and it is argued that for this reason alone, structural reforms of these institutions are urgent and new institutions must be created as needed. Some commentators go even further to argue that globalisation inevitably erodes national sovereignty in many areas of policy making and shifts it to intergovernmental agencies, and that this in turn calls for supra-national agencies for policing competition (global anti-trust) and regulating financial intermediaries and migration. Some argue for global taxation, to address cross-national externalities of various kinds, including environmental externalities and those relating to the volatility of short-term capital flows and redistribution.

Check Your Progress 2

1) What is Uruguay Round?

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2) Discuss main provisions of cancun meeting.

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14.12 SUMMARY

In this unit there is a short overview of the world trading system since the Second World War, emphasising the contribution and problems of GATT, it seemed that trade liberalisation makes to world growth. Next, it is dealt with Doha Round and other meetings. This is followed by and examination of different scenarios for the future of the world trading system, highlighting risks and opportunities associated with each and concluded with bold predictions and future directions.

14.13 KEY WORDS

Integration : Merger

Entrepreneurial Activities : Activities performed by entrepreneur such as supply of capital, organisation of production, buying inputs, bearing the risk etc.

Global Economic Depression : That state of world economy in which men and machinery remain unemployed persistently as compared with a recession during which unemployment is of short duration.

Devaluation	:	The reduction of the official rate at which one currency is exchanged for another.
Non-discrimination	:	Considering at per.
Most Favoured Nation Clause	:	The clause in an international trade treaty under which the signatories promise to extend to each other any favourable trading terms offered in subsequent agreements to third parties.
Tariffs	:	Taxes imposed on commodity imports.
GATT	:	General Agreement on Tariffs and Trade – An international trade organisation for the expansion of multilateral trade with the minimum of barriers to trade and the abolition of preferential trade agreements among member countries. It is renamed as WTO (World Trade Organisation) in 1995.
IMF	:	International Monetary Fund was set up by the Bretton Woods Agreement of 1944. The fund was established to encourage international cooperation in the monetary field and removal of foreign exchange restrictions.
IBRD	:	International Bank for Reconstruction and Development popularly known as World Bank was established in 1944 to encourage capital investment for the reconstruction and development of its member countries.
G-7	:	Group of seven industrial and developed countries namely – Canada France, Germany, Italy, Japan, United Kingdom, and United States.

14.14 EXERCISES

1) Discuss the emergence of World Trading System.
2) Explain the objectives of GATT.
3) Discuss the objectives and working of WTO.
4) Keeping the developing countries in mind, indicate how far the objectives of WTO have been fulfilled?
5) Indicate the problems of GATT with special reference to developing countries.
6) Discuss the relevance of WTO for developing countries.
7) Keeping the changing scenario of global trading system in mind, suggest some new measures for future trading.

14.15 SOME USEFUL BOOKS

1) GATT, The Role of GATT in Relation to Trade and Development.

2) GATT, International Trade.

3) Balassa B., Trade Liberalisation among Industrial Countries, New York, McGraw-Hill, 1967.

4) Mortan K. and Tulloch P., Trade and Developing Countries, London, Croom Helm, 1977, P 228.

5) Green R.H. and Singer H.W., 'Towards a Rational and Equitable New International Economic Order : A case for Negotiated Structural Changes', World Development No. 6, 1975.

6) Tyler W.G., Issues and Prospects for the New International Economic Order (Lexington Books, 1978).

7) Panchmukhi V.R. et. al., Economic cooperation in the SAARC region {New Delhi, Research and information system for the New-aligned and other Developing countries, 1990}.

8) Singh Sudama, International Economics, Fourth Edition.

UNIT 15 EMERGING FINANCIAL SYSTEM

Structure

15.0 OBJECTIVES

After going through this unit, you should be able to:

- describe the financial system and its functions;
- explain the development of world monetary system and establishment of IMF;
- to explain the objectives and criticism of IMF;
- describe the evaluation of world bank and its affiliates ;IDA, IFC;
- description of ADB;
- delineate the characteristics of SDR;
- suggest the world monetary basket;
- explain the reasons for the breakdown of the Bretton Woods System;
- suggest to reform the present monetary system; and
- analyse the present and future monetary system.

15.1 FINANCIAL SYSTEM AND ITS FUNCTIONS

The financial system comprises a variety of intermediaries, markets, and instruments that are related in the manner which provides the principal means by which savings are transformed into investments.

The financial system performs the following interrelated functions that are essential to a modern economy:

- It provides a payment system for the exchange of goods and services.
- It enables the pooling of funds for undertaking large-scale enterprises.
- It provides a mechanism for spatial and temporal transfer of resources.
- It provides a way for managing uncertainty and controlling risk.
- It generates information that helps in coordinating decentralised decision-making.
- It helps in dealing with the incentive problem when one party has an informational advantage.

15.2 DEVELOPMENT OF WORLD MONETARY SYSTEM AND IMF

The depression of the 1930s affected both the industrial and the primary producing countries. Production and trade fell. The dollar price of primary products decreased by 50 percent from 1929 to 1932, and this makes of exports fell even more. The G.N.P. of the United States fell by one-third in the period 1929-33.

The Great Depression also created havoc in the international monetary system. Several primary-producing countries devalued their currencies in 1929 and 1930 in an attempt to counteract the decline of their export earnings. Instead of leading to any lasting improvement, an epidemic of exchange depreciations broke out. It gathered momentum in 1931 with the depreciations by Great Britain and countries belonging to the British Commonwealth. Confusion reigned in the world economy. A considerable number of statesmen and economic observers still believed in a return to the gold standard. The final blow to the old system came during 1933-4 when the United States devalued and when an economic conference in London of leading governments failed to organise any early return to the gold standard or to supplant it with any orderly new system.

Plans for an international institution that would organise the international monetary system circulated among the Allied powers during the Second World War. During a conference in 1944 of forty-four nations at Bretton Woods, New Hampshire, in the United States, these plans took a more definite shape. In July of that year the International Monetary Fund was created.

Towards the end of Second World War, the idea of the International Monetary Fund (IMF) was mooted. The English economist, J. M. Keynes, hoped that various nations would have deposits at an international institution, drafts on which could be used for purposes of international settlement; but the Americans would not agree to this. They insisted that deposits at the IMF should be gold convertible. A period of over about 35 years is a long enough time to test the strength and vitality of any organisation. The IMF, established on 27th December, 1945, following discussions at Bretton Woods, USA, actually started operations in March 1947. A backward glance at the work of the Fund over its past years and a forward look at the tasks before it in the immediate future might, therefore, be a useful exercise.

The IMF in spite of the drastic changes on account of the force of circumstances during the last decade particularly, continues to hold a commanding position in two spheres – in the sphere of exchange stability and in the sphere of facilitating international payments or providing International liquidity.

15.3 OBJECTIVES OF IMF

To promote international monetary co-operation, to facilitate the expansion and balanced growth of international trade, to promote exchange stability, to help in the establishment of a multilateral system of payments, to make available Fund's resources to correct maladjustments in the balance of payments, to lessen the degree of disequilibrium in the international balance of payments position of the members. These objectives continue to be the main concern of the Fund or any other international monetary system, even after the lapse of over almost 35 years. It is to be noted that the world monetary and currency situation has moved far away from its Bretton Woods moorings.

15.4 CRITICISM OF IMF

1) Criticism from the outset, the I.M.F. played a conservative role. The Fund feared that its resources would be used for reconstruction purposes and not for solving short-term balance of payments problems.

2) IMF playing quite a passive role during the 1950s. In the late 1940s it stressed the necessity for adjustment in exchange rates and took a positive view of the devaluations by Britain and most other Western European countries in 1949.

3) Fund did not try to work for any systematic use of exchange-rate changes during the 1950s and the 1960s. Exchange-rate changes among industrial countries were looked upon with disapproval. They tended to be delayed and were resorted to only when all other means of adjustment had been tried.

4) The I.M.F. was also built on the principle of promoting a multilateral credit system. Developments during the 1950s and the 1960s tended, however, to bypass the I.M.F. in this area. In times of crisis the central banks were inclined to cooperate directly, outside the auspices of the I.M.F. So-called 'swap' arrangements between the Federal Reserve System of the United States and the central banks of some Western European countries and Japan became important. The 'swaps' consist of an exchange of currencies between countries.

Recent experiences have shown that the I.M.F. can play an important role in reforming the system's structure. An important step toward revitalising the Fund was taken in 1967 at the I.M.F. meeting in Rio de Janeiro when Special Drawing Rights were introduced. From relative obscurity the Fund has emerged, at least potentially, as an important supplier of international liquidity and the most important international forum for discussions on international monetary matters.

The institutional architecture should be completed with the reforms of another institution already in existence, the World Bank and the creation of two new organisations: an institute to manage risk and a control commission. The World Bank would be a specialised Agency of the IMF (and throng it of the UN) for the financing of projects directed to promote security, human development and environmental and social sustainability of the globalised economy. The bank would thus become the principal financial support for human development and could justify a change of name of Human Development Bank.

Check Your Progress 1

1) What is financial system?

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2) What are the objectives of IMF?

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15.5 EVALUTION OF WORLD BANK

The International Bank for Reconstruction and Development, popularly known as the World Bank, owes its birth to the deliberations of the United Nations Monetary and Financial Conference which met at Bretton Woods, New Hampshire, to prepare the final text of the Articles of Agreement of the International Monetary Fund and the International Bank for Reconstruction and Development from July 1 to July 22, 1944. The World Bank was established on December 25, 1944 when the Articles of Agreement were ratified by the requisite number of member governments. The global war had completely dislocated the multilateral trade and had caused massive destruction of life and property. The economics of England and other countries in Europe has been completely shattered. While the need for promptly reconstructing the war-damaged economics of European countries was recognised, it was also recognised that stable world peace was threatened from the presence of great disparities in incomes and wealth manifested in the wide differences in the standard of living between the developed and the underdeveloped countries. Consequently, the problem of raising the standard of living of the vast masses of people of underdeveloped countries brought to fore the need to develop the economics of these countries. Thus, the Bretton Woods Conference was also responsible for establishing the International Bank for Reconstruction and Development

15.6 FUNCTIONS OF WORLD BANK

The World Bank is an international corporate institution whose capital stock is owned by its members. The principal functions of the Bank are:

i) to assist in reconstruction and development of the territories of its member governments by facilitating investment of capital for productive purposes,

ii) to promote foreign private investment by guarantees of or through participation in loans and other investments of capital for productive purposes,

iii) where private capital is not available on reasonable terms, to make loans for productive purposes out of its own resources or out of the funds borrowed by it, and

iv) to promote the long-range growth of international trade and the maintenance of equilibrium in the balance of payments of members by encouraging international investment for the development of the productive resources of members.

Bank's loans are directed to help the members to build foundation of sound economic growth. Loans made or guaranteed by the Bank are, except in special circumstances, for the purpose of specific projects of reconstruction or development. The Bank ensures that the proceeds of any loan are used only for the purpose for which the loan is granted. About 28 per cent of World Bank's loans have been made for development of power, another 30 per cent for development of transportation, 12 per cent for development of agriculture, forestry and fishing, and the balance 30 per cent for development of industry, technical assistance, population planning, education, telecommunications, tourism, urbanisation, water supply and sewerage.

Although the World Bank may have belied the expectations of some nations, in appraising the Bank's role we should not forget the limitations within which the Bank works. The Bank has been largely instrumental in accelerating the pace of economic development in different countries of the world. Although the Bank has failed to finance all the development projects, it has financed a large number of them which have proved a remarkable success.

In future, the Bank will be in a stronger position to render financial assistance to the member countries with its increased capital resources and the active co-operation of its affiliates – International Development Association and the International Finance Corporation.

Check Your Progress 2

1) When was the IBRD established?

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2) Write a note on functions of IBRD.

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3) Who are the two affiliates of World Bank?

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15.7 INTERNATIONAL DEVELOPMENT ASSOCIATION

The World Bank unanimously adopted a proposal on October 1, 1959 for setting up in principle the International Development Association. It was "resolved that with respect to the question of creating an international development association as an affiliate to the Bank, the executive directors, having regard to the views expressed by the governors and considering the broad principles on which such an association should be established and all other aspects of the matter, are requested to formulate articles of agreement of such an association for submission to the member-Governments of the Bank".

The idea to establish an international institution to give loans on liberal terms to underdeveloped countries was first mooted by Senator Monroney which was later approved by President Eisenhower. In August 1959, President Dwight Eisenhower publicly supported the idea of the IDA. He included it as one of the three proposals for raising international liquidity and directed the Administration to study the feasibility of implementing it in co-operation with the International Monetary Fund and the World Bank. Thus, the credit for taking initiative for the establishment of the IDA goes to the United States of America and the World Bank which felt that the burden of development assistance should be more widely shared by the more industrialised countries of the world. The IDA, nicknamed as the 'soft loan window' at which the underdeveloped countries can borrow in hard currencies without worry to repay in the same currencies, formally commenced its operations on November 8, 1960. The IDA grants development credits more generously to the developing countries and its loans are more flexible than World Bank loans, being for 15 years at least. The IDA finances a certain percentage of the cost of a project that is meant not only for meeting the foreign exchange component of the project but also a part of the cost of local currency. Many countries which could not borrow from the Bank for projects because they are not regarded creditworthy by the Bank are able to secure credit from IDA. The credits granted by the IDA bear a lower interest rate than is charged by the World Bank on her loans and where conditions warrant there is no interest but only an administrative charge is levied on IDA loans. The IDA has financed wider range of projects than the World Bank has been able to finance. The only criterion for IDA to grant credit for a project is that the project to be financed should be of a 'high development priority'. The other salient feature of the IDA credits is that these credits can also be repaid in local currencies of the borrowing countries. Consequently, borrowers have not to worry about finding the scarce foreign exchange at the time of repayment of credits. In short, IDA provides loans on terms which do not bear heavily on the external balance of payments position of the borrower member country. The IDA also gives loans to individual industrial undertakings without government guarantee.

15.8 INTERNATIONAL FINANCE CORPORATION AND ITS PURPOSE

Established in 1956, the International Finance Corporation which the next affiliate of World Bank derives its status and powers from the Articles of Agreement to which its member countries have subscribed and through which it came into being. The membership of IFC is open to all countries which are members of the World Bank. As on June 30, 1982, the total membership of IFC stood at 122.

The essential function of IFC is to assist the economic development of its less developed member countries by promoting the growth of the private sector of their economies. The Corporation helps to mobilise domestic and foreign capital for this purpose. Article one of IFC's Articles of Agreement states the purpose of setting up IFC in the following words:

The purpose of the Corporation is to further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas, thus supplementing the activities of the International Bank for Reconstruction and Development. In carrying out this purpose the Corporation shall:

i) in association with private investors, assist in financing the establishment, improvement and expansion of productive private enterprises which would contribute to the development of its member countries by making investments, without guarantee of repayment by the member government concerned, in cases where sufficient private capital is not available on reasonable terms;

ii) seek to bring together investment opportunities, domestic and foreign private capital, and experienced management, and

iii) Seek to stimulate, and to help create conditions conducive to the flow of private capital, domestic and foreign, into productive investments in member countries. The Corporation shall be guided in all its decisions by the provision of these Articles.

15.9 ASIAN DEVELOPMENT BANK

In this regard the Asian Development Bank, popularly known as the ADB, is a multinational regional development bank established for the purpose of lending funds, promoting investment, and providing technical assistance to the developing member countries, and generally for fostering the economic growth and co-operation in the Asian region. The Charter of the Bank was ratified by the majority of the Signatory countries in early 1966 and it started its operations in Manila in December 1966. The Bank operates under the aegis of ECAFE. Since the idea of the ADB was first proposed by the ECAFE in 1963, the speed with which it has been established represents good achievement by its architects and sponsors. The ADB has two significant features. Firstly, it is an Asian Bank, conceived by the United Nations Economic Commission for Asia and the Far East (ECAFE). Its headquarters are located in the ECAFE region in Manila in Philippines. More than 60 percent of the ADB's capital is subscribed by its 31 regional members. The President and seven of the ten directors also come from the region. Secondly, unlike certain regional financial institutions, the membership of the Bank extends beyond the region. Consequently, many countries outside Asia have contributed to the capital of the Bank and are represented on the Board of Directors and professional staff of the Bank. Such members numbering 15 are designed as non-regional members.

15.10 RATIONALE OF BANK AND ITS FUNCTIONS

The justification for the establishment of the ADB is firmly based on the hypothesis that accelerated economic growth in poor countries is functionally related to the rate of capital formation in these countries. Since a high rate of capital formation in the low per capita income countries of Asian region is not possible through the low levels of domestic saving, financial resources from outside sources must be made available to these poor countries. The idea to establish a regional development bank for Asia emerged from the discussions at ECAFE's First Ministerial Conference on Asian Economic Co-operation held in Manila in December 1963. This initiative was taken up by a working group of experts whose findings were submitted to the ECAFE session in Wellington in March 1965, which in turn led to the formation of a Consultative Committee. The Committee drafted the Agreement establishing the Asian Development Bank, which was subsequently adopted at the Second Ministerial Conference on Asian Economic Cooperation held in Manila in November-December, 1965.

The Charter of the Bank was formally signed on December 4, 1965. It was, however, left open for additional signatures until January 31, 1966 when 31 countries had signed the document. The Charter became effective on August 22, 1966 with the ratification by 15 of the 31 signatories and by September 30, 1966, 30 nations had satisfied conditions for membership and had remitted the first instalment of their paid-in capital subscription. Preliminary arrangements for the Bank's establishment were made by a Preparatory Committee formed in December 1965 and the Inaugural Meeting of the Bank's Board of Governors was held in Tokyo on November 24-26, 1966. The Bank formally commenced business on December 19, 1966.

Functions

The ADB has the following functions and objectives:

1) To promote investment in the ECAFE region of public and private capital for development purposes;
2) To utilise the available resources for financing development, giving priority to those regional and sub-regional as well as national projects and programmes which will contribute most effectively to the harmonious economic growth of the region as a whole, and having special regard to the needs of the smaller or less developed member countries in the region;
3) To meet requests from members in the region to assist them in co-ordination of their development policies and plans with a view to achieving better utilisation of their resources making their economies more complementary, and promoting the orderly expansion of their foreign trade, in particular, intra-regional trade;
4) To provide technical assistance for preparation, financing and execution of development projects and programmes, including the formulation of specific proposals;
5) To co-operate with the United Nations and its organs and subsidiary bodies, including, in particular, ECAFE and with public international organisations and other international institutions, as well as national entities whether public or private, and to interest such institutions and entities in new opportunities for investment and assistance; and
6) To undertake such other activities and to provide such other services as may advance its purpose.

15.11 SPECIAL DRAWING RIGHTS (SDR) AND ITS FEATURES

Gold has been replaced by a new international reserve asset called Special Drawing Rights (SDRs). It will perform all the functions of gold or gold standard without facing the limitation of' the same. It was the result of a slow and gradual evolution of the discussion of many master minds in the field of international monetary economics. It was also called 'paper gold'. It was approved in principle at the Fund's annual meeting at Rio de Janeiro in September 1967. The SDRs scheme, however, came into actual operation only from January 1970. The scheme, as adopted by the IMF is the integrated development of the ideas of Keynes, vision of Triffin, Bernstein and others in the fifties and the long drawn official discussions of the sixties which eventually gave birth to the new reserve asset called SDRs.

The mains features are as follows:

Features:

i) SDRs – a form of paper gold-will supplement gold itself and the two existing reserve currencies-the dollar and sterling. The idea is essentially based on the Keynesian plan of Bancor currency.

ii) The scheme confers on the members of the IMF new special drawing rights (SDRs) in proportion to their quotas. In other words, the allocation of SDRs will be made to a member country on the basis of their quotas.

iii) These rights are designed to meet the need as and when it arises for the settlement of international balances. Their use in the beginning is confined to those countries which are suffering from the balance of payments difficulties.

iv) The creation of SDRs is essentially similar to the concept of credit creation by the central banks within the country. The main features of the new plan are the principle for the conscious creation of man made reserves to supplement gold. SDRs do not accrue to the Fund in the first instance, but these are, deliberately created by the Fund on behalf of the participants according to the needs.

v) All the decisions regarding the creation of SDRs will require an 85 percent majority of the voting power of the participants. The SDRs will be issued for a basic period of five years in regulated amount each year. The basic period may also be an empty period when no allocations are made. Not all the members of IMF need be participants; there is liberal scope for opting in and opting out. Members can opt in during the operation of a basic period and receive allocation.

vi) The scheme is general, universal and non-discriminatory in character because it confers same benefits on all.

vii) There is no compulsion to repay earlier borrowings from the IMF while drawing on SDRs. Repayments or reconstitution of the reserves (SDRs) which have been used will be necessary only in the case of the use beyond 70 percent of the average allocation over the preceding five years. To this extent, the unconditional character of the new facility is confirmed. In other words, every country is obliged to keep on an average at least 30 percent of its SDRs in its own reserves. If in a year it spends more, it must spend less in the following year. This obligation to maintain a minimum average balance of SDRs was reduced to 15 percent from 30 percent as a result of Second Amendment to Articles of Fund in 1978.

viii) SDRs are expected to be used to meet the balance of payments needs and not for the sole purpose of changing the composition between SDRs and gold or foreign exchange or reserve positions in the Fund. Although SDRs will figure in the published reserves of a country alongwith gold, foreign exchange and the gold tranche of its quota in the Fund (where it has not already been drawn), these reserves of SDRs cannot be spent directly in goods and services under the rules, a country can normally use its SDRs if it is in balance of payments difficulties.

ix) With the introduction of SDR scheme, there will be two accounts in the IMF– (a) the general account, (b) the special drawing rights – account. The general account deals with ordinary drawing rights already existing and ordinary transactions of the IMF relating to quotas, drawings, subscription, interest charges etc. The SDR account will deal with SDRs. The best way to understand the scheme is to think of the rights as pieces of papers which other countries will accept in payment of debt – that is paper gold. In other words, these rights are just like coupons which can be exchanged for currencies required by the holder of SDRs for making international payments However, they are not pieces of paper like bank notes or treasury bills, they are simply entries in the SDR account of IMF. Initially, at least the Fund will not itself possess any of the new assets.

x) The basic obligation of a member is to provide its own currency when requested to the Fund, up to a total of three times its own allocation of SDRs. A modest rate of interest will be paid in SDR on holdings of such drawing rights by the Fund, which will charge it from countries using SDRs.

xi) According to the SDR scheme, it will be a sort of gold paper. The value of SDR was originally fixed in gold The value of the SDR being fixed had to be maintained by the member countries one SDR=one US dollar worth of gold at the then official rate of 35 an ounce or 0.888671 grams fine gold. But since February 1973, 1 SDR=1.2 US dollar. At present in 1982 onwards it is equal to 150 US dollar. Now its value depends on the standard basket of 5 currencies dollar, mark, franc, yen and pound sterling.

15.12 NEW BRETTON WOODS

The gradual acceptance of baskets, such as the *ecu*, the predecessor of the *euro*; the coupling to a basket of currencies fundamental for world stability, such as the *yuan*; the parallel failure of other attempts to couple only to a single currency of the hegemonic power; all these phenomena indicate the road already begun, that of multilateralisation, to bring the international monetary system up to date with an economy in course of globalisation, multipolar and interdependent.

The intellectual thread for a "new Bretton Woods" is something which unites the bancor of Keynes, the special drawing rights of Triffin/Ossola, the European monetary unification and the pressing criticism made by Stiglitz of the catastrophes provoked by the rigid application of the Washington Consensus in situations such as those in South-East Asia, Russia, Argentina (where the dollarisation of the peso finished with a serious default of the country and damage to savers throughout the world). However, it is necessary also to take account of the fact that we face, in many ways, a new situation, both because of the extraordinary weight of the problems caused by the unilateral management of the global economy, and because of the complexity and linkage of the challenges for a peaceful and sustainable future. A new Bretton Woods ought thus to propose a solution together for the two orders of problem:

To consolidate/get over/use the immense foreign debt of the United States and of other debtor countries and introduce a discipline to impede the repetition of fundamental permanent and cumulative disequilibria, like that of the US current account deficit, financed with the savings of the rest of the world; 2) to guarantee the financing of the supply of the necessary public goods for the functioning of a globalised economy, to bring back under control the "World Risk Society". For that, in using the ideas, concepts, architectures and instruments in which the thread of Keynes-Triffin-Stiglitz is rich, and referring to the European experience from 1969 to the creation of the euro and its stable and valuable functioning, we must have in mind a global vision, systemic and not only mechanical, ecological and not only economic, insurance and not only banking.

This time the problem cannot be resolved by passing the baton from one hegemonic power to another. We are talking about substituting an ordered system for a disordered order, a multilateral system (a system of systems) for a unilateral order, a cooperative system for a hegemonic order, a global system for a circumscribed order, and an equitable system for an unequal order.

15.13 A MOVE TO WORLD MONETARY BASKET

It is now necessary to move to a world monetary standard: not a gold standard nor a gold-exchange standard, not a dollar standard and not even a euro standard, but simply a world standard. The objective is the creation of a world currency, but one can start with a unit of account based on a basket of currencies, a world currency unit (WCU). The weight of the various currencies in the basket would have to be set out in the agreements according to a valuation of each, based on economic fundamentals which also include elements which are not today counted as economic, such as human development, ecological sustainability, the concentration / diffusion of assets and incomes, the demographic composition of the population and their tendencies. Since the measurement of these values is today still rough and can lead to discussions, a procedure would have to be designed to revise the agreement to modify the weights. In future, when reliable and shared measurements are available, the revisions could become automatic. The WCU has no need for coupling. It expresses a productive potential socially and ecologically compatible and a promise of payment in terms of goods and services which constitute world wealth redefined as above.

Check Your Progress 3

1) What is SDR?

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2) How is SDR concerned with international payment problem?

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3) What is the currency of Europe?

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15.14 THE BREAKDOWN OF THE BRETTON WOODS SYSTEM

From 1950s to mid 1960s the Bretton Woods System worked smoothly. During this period world output increased and with the reduction of tariffs under the GATT, world trade also rose. But the Bretton Woods System broke down after that.

The principal causes and sequences for the breakdown of the Bretton Woods system are as follows:

Built-in Volatility: The Bretton Woods System had a built-in volatility that ultimately led to its breakdown. It was an adjustable peg system within plus or minus 1 percent of the par value of $ 35. In case of fundamental disequilibrium, a country could devalue its currency with the approval of the IMF. But countries were reluctant to devalue their currencies because they had to export more goods in order to pay for dearer imports from other countries. This led countries to rely on deflation in order to cure BOP deficits through expenditure-reducing monetary-fiscal policies. The UK often restored to deflation such as in 1949, 1957 and 1967.

The Triffin Dilemma: Since the dollar acted as a medium of exchange, a unit of account and a store of value of the IMF system, every country wanted to increase its reserves of dollar which led to dollar holdings to a greater extent than needed. As a result, the US gold stock continued to turn down and the US balance of payments continued to depreciate. Robert Triffin warned in 1960 that the demand for world liquidity was growing faster than the supply of gold was increasing little. Since the dollar was convertible into gold, the supply of US dollars would be insufficient in relation to the liquidity requirements of countries. This would force the US to discard its commitment to convert dollars into gold. This is this Triffin Dilemma which actually led to the collapse of the Bretton Woods System in August 1971.

Lack of International Liquidity: There was a growing lack of international liquidity due to increasing demand for the dollar in world monetary markets. With the development of world trade, BOP deficits (and surpluses) of countries increased. This necessitated the supply of gold and of the dollar. But the production of gold in Africa was increasing very little. This led to larger demand and holdings of the dollar. Countries also wanted to have more dollar holdings because they earned interest. As the supply of dollars was inadequate in relation to the liquidity needs of countries, the US printed more dollars to pay for its deficits which other countries accepted as reserves.

Mistakes in US Policies: The BOP deficits of the US became steadily worse in the 1960s. To overcome them, the policies adopted by the US government ultimately led to the world crises. Rising US government expenditure in the Vietnam War, the financing of US space programme and the establishment of "Great Society" (social welfare) programme in the 1960s led to large outflow of dollar from the US. But the US monetary authority (FED) did not devalue the dollar. Rather, it adopted monetary and fiscal measures to cut its BOP deficit.

Destabilising Speculation: Since countries with "fundamental disequilibrium" in BOP were reluctant to devalue their currencies and also took time to get the approval the IMF, it provided speculators an opportunity to resort to speculation in dollars. When devaluations were actually made, there were larger doses of devaluation than originally anticipated. This was due to destabilising speculation which made controls over capital flows even through monetary-fiscal measures ineffective. This was the immediate reason for the UK to devalue the pound in 1967.

Crisis of Confidence and Collapse: The immediate cause of the collapse of the Bretton Woods System was the eruption of a crisis of confidence in the US dollar. The pound has been devalued in November 1967. There was no control over the world gold market with the appearance of a separate price in the open market. The immediate cause for the collapse of the Bretton Woods System was the rumour in March 1971 that the US would devalue the dollar. This led to a huge outflow of capital from the US. On 15 August 1971 that the US suspended the conversions of dollar into gold when some small European central banks wanted to convert their dollar reserves into gold at the US. It refused to intervene in the foreign exchange markets to maintain exchange rate stability and imposed a 10% import surcharge. Thus the main cause of breakdown of the Bretton Woods System was the problems of liquidity, adjustment and confidence. The increase in liquidity (international reserves) was in the form of dollars arising from BOP deficits of the US. But as the US was unable to adjust its deficits and excessive dollar accumulated in foreign countries, there was a crisis of confidence in the dollar and the Bretton Wood System brokedown.

Between 15 August 1971 and the Smithsonian Agreement of 18 December 1971, 48 countries including the United States, Japan and a large number of European countries abandoned fixed exchange rates. The 'Group of Ten' industrial countries met at the Smithsonian Institution in Washington on 18-19 December, 1971 and agreed to a new system of stable exchange rate with wider bands. As a first step towards realignment of major currencies, the US, devalued dollar by 8 percent, the Japanese revalued the yen by 17 percent and the Germans their mark by 14 percent. The Smithsonian Agreement widened the margin of fluctuations of the exchange rates to 22.5 percent above or below the new parities of central rates. It officially devalued the dollar against gold from $ 35 to $ 38 per ounce. In 1973, the band was widened to 4.5 percent. The Smithsonian Agreement broke down following the devaluations of the US dollar by 10% in February, 1973.

Another progress took place in Europe when the EEC countries decide to limit the fluctuation of their currencies relative to each other to a smaller band. This came to be known as "the snake in the tunnel". Under this arrangement, the EEC currencies were tied together and could fluctuate within narrow limits in relation to one another but could fluctuate in relation to other currencies within the limits set by the band proposals.

15.15 THE PRESENT INTERNATIONAL MONETARY SYSTEM

At the beginning of March 1973 India, Canada, Japan, Switzerland, the UK and several smaller countries had floating exchange rates. However, the "joint float" of the EEC countries continued even after March 1973 and was now called the "snake in the lake", as there was no band within which the EEC currencies could fluctuate relative to other currencies. In March, 1979 the European Monetary System (EMS) was formed which created the European Currency Unit (ECU) which is a "basket" currency of a unit of account consisting of the major European currencies. The EMS limits the internal exchange rate movement of the member countries to not more than 2.25 percent from the "central rates" with the exception of Italy whose lira can fluctuate up to 6 percent. In the meantime, the Jamaica Agreement of January 1976 (ratified in April 1978) formalised the regime of floating exchange rates under the auspices of the IMF. A number of factors forced the majority of member countries of the IMF to float their currencies. There were large short-term capital movements and central banks failed to stop speculation in currencies during the regime of adjustable pegs. The oil crisis in 1973 and the increase in oil prices in 1974 led to the great recession of 1974-75 in the industrial countries of the world. As a result "the dollar went into a rapid decline, which, by late 1978, had such alarming proportions that the United States government finally decided on a policy of massive intervention in order to prevent a further fall in the value of the dollar".

At last, the system of managed floating exchange rates had come to stay by 1978. By the Second Amendment of the IMF Charter in 1978, the member countries are not expected to maintain and establish par values with gold or dollar. The Fund has no control over the exchange rate adjustment policies of the member countries. But it exercise international "surveillance" of exchange rate policies of its members.

The second Amendment has reduced the position of gold in the global monetary system in the following way by: (a) abolishing the official price of gold; (b) delinking it with the dollar in exchange arrangements; (c) eliminating the obligations of the Fund and its members to transfer or receive gold; and (d) selling a part of Fund's gold holdings.

The Second Amendment has also made SDRs as the chief reserve assets of the global monetary system whose Value is expressed in currencies and not in gold. It is now a unit of account, a currency peg and medium of transactions.

The present international monetary system of floating exchange rates is not one of free flexible exchange rates but of "managed floating". It has rarely operated without government intervention. Periodic intervention by governments has led the system to be called a "managed" or "dirty" floating system. In 197, when the intervention was heavy, it was characterised as a "filthy" float. When Governments do not intervene, it is a "clean" float. But the possibilities of a clean float are very remote. Thus a system of managed floating exchange rate is evolving where the central banks are trying to control fluctuation of exchange rates around some "normal" rates even though the Second Amendment of the Fund makes no mention of normal rates.

The present international monetary system has evolved in a number of important ways, including new allocation of SDRs, increased nations' quota in the IMF, renewal of the General Agreements to Borrow (GAB), the abolishment of the official gold price, and the formation of the European Monetary system (EMS) and the Euro Currency.

The US is the major country which has been influencing the global monetary system. It has permitted the dollar to float in relation to other currencies with occasional interventions when the dollar has reached extreme highs or lows. When the dollar was extremely high (appreciating), the g-5 (US, UK, Germany, Japan and France) agreed to intervene to bring the dollar down by the Plaza Accord in September 1985. Subsequently, the dollar depreciated substantially i.e. by more than 50% relative to the yen. By early 1987, the dollar had become undervalued and by the Louvre Accord, the G-7 countries (G-5 plus Canada and Italy) agreed to co-operative in keeping their exchange rates around their current levels at that time.

"The Lourve Accord was successful in stabilising exchange rates for the rest of the year. Since then there seems to have been a consensus that exchange rates should be broadly stabilised, but there is little overt co-operation among countries".

Problems:

The present international monetary system is faced with excessive fluctuations and large disequilibria in exchange rates. Often countries, both developed and developing, have faced with either excessive appreciation or depreciation of their currencies in relation to the dollar which continues to dominate the world monetary system. Even the newly created Euro of the EU which was supposed to be a strong currency has been depreciating considerably since its inception against the dollar. This has adversely affected the world trade.

Check Your Progress 4

1) What are the problems of the present international monetary system?

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2) What is Triffin Dilemma?

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3) Discuss any two reasons for the breakdown of the Bretton Woods System.

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15.16 SUGGESTIONS TO REFORM THE PRESENT MONETARY SYSTEM

Economists have suggested a number of measures in order to avoid the excessive fluctuations and large disequilibria in exchange rates for reforming the present world monetary system.

1) **Harmonization and collaboration of Policies:** A few economists and McKinnon in particular, suggested international co-operation and co-ordination of policies among the leading developed countries for exchange rate stability. According to McKinnon, the US, Germany and Japan should have the optimal degree of exchange rate stability by fixing the exchange rates among their currencies at the equilibrium level based on the purchasing power parity. Thus they would co-ordinate their monetary policies for exchange rate stability.

2) **Establishing Target Zones:** Williamsons called for the establishment of target zones within which fluctuations in exchange rates of major currencies may be permitted. According to him, the forces of demand and supply should determine the equilibrium exchange rate. There should be an upper target zone of 10% below equilibrium exchange rate. The exchange rate should not be allowed to move outside the two target zones by official intervention. In February 1987 the leading five developed countries agreed under the Louvre Agreement to have some sort of target zones for the stability of exchange rates among their currencies. Despite official intervention by these countries, the exchange rates continued to fluctuate within wide margins than agreed upon at Louvre. Thus Williamson's proposal has been discarded being impracticable.

3) **Improving Global Liquidity:** The reform package of the present world monetary system should improve global liquidity. As a first step, both BOP deficit and surplus countries should take steps to reduce a persistent imbalance through exchange rates via internal policy measures. Second, they should also co-operate in curbing large flows of "hot money" that destabilises their currencies. Third, they should be willing to settle their BOP imbalances through SDRs rather than through gold or dollar as reserve assets. Fourth, there should be increasing flow of reserves to the developing countries.

4) **Leaning against the Wind:** To reduce the fluctuations in exchange rates, the IMF Guidelines for the Management of Floating Exchange Rates, 1974 suggested the idea of leaning against the wind. It means that the central banks should intervene to reduce short-term fluctuations in exchange rates but leave the long-term fluctuations to be adjusted by the market forces.

5) Richard Cooper suggests a global central bank with a global currency which would be a global lender of last resort.

6) Jaffrey Sachs proposes the creation of an international bankruptcy court which should deal with countries.

7) George Soros opines that the IMF should set ceilings for external finance for each country beyond which access to private capital need not be insured. But there should mandatory insurance by an international credit insurance corporation.

8) Paul Krugman suggests reintroduction of capital controls as a "least bad response" to an international crisis.

9) **Objective Indicators:** To iron out exchange rate fluctuations, the IMF Interim Committee suggested the adoption of such objective indicators as inflation-unemployment, growth of money supply, growth of GNP, fiscal balance, balance of trade and international reserves. The variations in these indicators require the adoption of restrictive monetary-fiscal measures to bring stability in exchange rates.

The various suggestions to reform the present monetary system are closely inter-linked. But there is lack of unanimity over the various proposals among the nations. Given the differences of opinion between the developing and developed countries themselves, there is no hope that any concrete proposal to reform the global monetary system would be acceptable to nations. So the present system of managed floating exchange rate is likely to stay on.

15.17 THE FUTURE OF THE MONETARY SYSTEM

By the end of the Second World War, the United States was the overriding economic power of the free world, and it is therefore little surprise that the international financial system adopted at Bretton Woods in July 1944 was in large measure the US plan, with the US dollar playing a central role. As would be predicted by an application of game theory in situations involving an overwhelmingly dominant player, solutions invariably unravel according to the dominant player's preferences. The "golden rule" is that "he who has the gold makes the rules," and in 1944 the United States held the majority of the free world's official gold reserves, approximately 75 percent of the total. Therefore, the United States was the only country in a position to fix its currency to gold.

The economic supremacy enjoyed by the United States at the end of the Second World War has been battered by the phenomenal economic preference of South East Asian countries, most particularly the People's Republic of China, Japan, and the "four tigers" Hong Kong, Singapore, Taiwan, and South Korea, and also by the growing strength of an increasingly integrated Europe. The European Union with its 25 members between the Baltic and the Mediterranean, and Aegean and Atlantic, is noticeably larger than the United States in combined GDP and population. The change in the balance of economic power is clear from the fact that today there is a much more even sharing of economic power between the United States, Europe, and Japan. This means that we can no longer predict important economic changes, such as in the organisation of the international financial system, simply by studying the preferences of any one country. In any situation linking three players who can form coalitions, outcomes are difficult to forecast. This is because by forming an alliance with either larger economic unit, the small country holds the balance of power.

One clear outcome of the new balance of power is a need for each party to consult with the others. No single power can take the chance of triggering actions by the other two. This acknowledgment of the need to co-operate has manifested itself in G-7 summits, in the co-operative exchange-rate intervention policy of the Plaza Agreement and Lourve accord, in the frequent meetings of leading central bankers under the support of the bank for international settlements in the renewed attention paid to tariff negotiations, and in numerous matters involving taxation, interest rates, and other policies. It seems likely that with increasing financial and economic interdependence, the evolving international financial system will involve even closer co-operation.

The other consequence is the potential emergence of the three trading bloc currencies, a dollar bloc based on the Americas, a yen or perhaps a Yuan bloc centered on Japanese or Chinese trade, and a euro bloc centered on the European Union. The pattern of international trade shows increasing regionalism with associated risks of increased protectionism. Indeed, the larger of trading blocs become the greater is the danger of rising trade protectionism. This is because the blocs believe there is less to lose from trde restriction, and because in larger trading areas, more industrial constituencies are represented which have an interest in keeping competition for their own products more restricted.

Check Your Progress 5

1) What are Jaffrey Sachs and George Soros suggestions to reform present monetary system?

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2) Briefly explain Target Zones.

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15.18 SUMMARY

In this unit the whole monetary systems as well as institutions are presented and the new Bretton Wood System is discussed in various aspects. The problems and suggestions for a better international financial system is also analysed and its future is also discussed. It is needed to configure a real and proper World Monetary System's Organisation operating as a system of systems for the regional currencies and as a supplementary system for the currencies not yet participating in the regional systems. Naturally, the IMF will have to be reformed to represent as democratically as possible the major regional monetary areas. It will have to be governed, co-operatively, by qualified majority, voting based on the weight of the participants and present annual report to the UN General Assembly, in the context as a more general democratic strengthening of the UN itself.

15.19 KEY WORDS

Globalised Economy	:	Economy integrated with the world economy.
SDR	:	Special Drawing Right is the instrument for financing information trade. It is issued by IMF to its member countries which are also known as paper gold.
IMF	:	International Monetary Fund — an international institution for encouraging international co-operation in the monetary field.
Dollarisation of World Economy	:	Predominance of American currency Dollar in the world economy.
Exchange Rate	:	The rate at which one currency is exchanged with another currency.
Swap Arrangement	:	Exchange of currencies between countries.
World Monetary Basket	:	Creation of a world currency.
Bretton Woods	:	An international conference was held at Bretton Woods, new Hampshire in the US in July 1944 which led to the establishment of IMF and IBRD.
FED	:	US Monetary Authority
EMS	:	European Monetary system
GAB	:	General Agreement to Borrow

15.20 EXERCISES

1) Discuss the emergence of world financial system.
2) Explain the purpose of the IMF. How far has the IMF been successful in achieving these purposes?
3) Discuss the role of the international monetary fund as a source of supply of international liquidity.
4) Explain the World Bank and its functions.
5) What ADB stands for?
6) What is SDR?
7) In the light of the present financial crisis is a new Bretton Wood needed?
8) Discuss in detail the reasons for the breakdown of the Bretton Woods System.
9) Analyse the present and future of the international financial system.

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UNIT 16 EMERGING INFORMATION AND TECHNOLOGY ORDER

Structure

16.0 OBJECTIVES

After reading this unit, you should be able to:

- explain the development of information technology;
- explain the role of information technology in enhancing the growth and overall economic performances.

16.1 INTRODUCTION

The then chairman of NASSCOM, Late Mr. Dewang Mehta, had once given a slogan "Roti Kapda Makan Aur Bantwidth". A man of vision could realise that apart from the three basic necessities, a good communication infrastructure is essential for the development of any country in the modern perspective. In the current Information Technology scenario, various organisations and companies all over the world are relying heavily on access to information in the electronic medium. The Internet is the major source of information in knowledge based societies. There has been a major thrust in both the developed and developing countries to establish a robust and sufficient communication infrastructure. The early lead in infrastructure development by the different government, organisations has witnessed considerable economic growth. In a noteworthy statement, the Prime Minister of Malaysia said: "it can be no accident that there is today no wealthy developed country that is information poor, and no information rich country that is poor and underdeveloped".

No wonder that among the Asian countries, Malaysia was among the pioneers to reap the maximum benefit of Information Technology revolution and it is among the few countries along with India to have passed an information Technology Act. Trading through the electronic medium in this country has become a reality. More and more people are taking advantage of IT. In any knowledge based society, early access to relevant information is the key to success. Information explosion through Internet has been tapped well by western countries and they have profitably utilised the Information Technology in different sectors like Banking, Agriculture, Transportation, Environment, Business and Entertainment and Education etc. After penetrating the western countries, the Information Technology has started making an impact in India also.

16.2 APPLICATIONS OF INFORMATION TECHNOLOGY

1) Multimedia Applications

Multimedia is the term used to denote the combination of multiple mediums. The term Multi indicates many and Media indicates the means adopted for communication. We can define a multimedia system as a computer controlled environment which is used to process individual images, sound and text. Multimedia includes the combination of text, audio, video, graphics and animation. It has become a popular technology in the last decade and widely used in advertisement, cinematography and fashion design. Multimedia is closely related with interactive videos that produce information represented as animation, audio, video, graphics text etc. on demand. It is a powerful media to provide effective interaction between the users and information. Interactive multimedia is finding application in geographical information system, business and corporate presentations, education and training. Several software products for manipulating and editing the information represented in audio, video, graphics and animation have already arrived in the market. Some of these are Corel Draw, Sound Blaster, Macromedia Flash and MS Office tools. A typical multimedia presentation comprises an effective use of textual matter, images, digital audio and digital videos etc.

The combination of all these mediums can be profitably used in entertainment business communication and knowledge transfer. It also finds a valuable application in the medical field with the use of communication technology. Telemedicine is the area where doctors can be consulted by patients located in remote places. The patient can submit his diagnosis reports online to the doctor in the form of images, sound and videos. This technique uses video conferencing sessions where both doctor and patient can consult each other. Various components of multimedia are discussed below.

a) Textual Contents

Text, in its most simple form, is the collection of alphabets, numerals and special characters. Text may be composed using alphabets, numerals and special characters like, @ # $ etc. Text is considered to be the most dominating component in any Multimedia Presentation.

b) Audio

Audio or sound is produced by vibration of waves and it is a physical characteristic of matter or substance. Its outcome is the waveform produced through oscillation. Audio may be analysed in terms of parameters like amplitude, frequency, bass etc. Several methods have been developed for storage and retrieval of sound using the digital computer. There are several software programmes which may be used to store, produce and process the information contained in the audio. Audio editing, which is modifying the sound quality by changing the parameters through the software, is quite common now-a-days. The quality of audio can be interpreted by hearing only. Audio serves as an important data type and it helps various experts in taking decisions. The audio may be stored in a database in the form of files and audio data may be processed by the digital computer. For example, mixing of sound or modifying the sound parameters like frequency, pitch, amplitude, bass etc. is done frequently to enhance the impact of presentations. The inclusion of sound or audio makes any multimedia presentation much more effective.

c) Images and Graphics

Image is the spatial representation of an object or entity. It contains lot of information value in the sense that many times an image itself is sufficient to trigger a decision making process. There are several ways to represent an image in the digital medium. Bit Map Images are the basic mechanism to store any image in digital form. The image parameters like colour, intensity, hue etc. are stored in the form of numbers and the same may be used to generate the images. GIF, JPEG , TIFF are other formats used to represent images on digital computers. Using images in multimedia presentation, adds enormous value to the effectiveness of the presentation.

d) **Digital Video**

Video is the collection of synchronized images and sounds. When several continuous images are produced before the eye at a regular interval with sound the effect of motion is produced. Video is also sometimes called Motion Video. Since a video contains many images and sound, it requires a huge space for storage. MPEG is the group accredited by ISO for the production and representation of video. The video camera may be used to capture the video and it may be stored in the digital computer. There are several software programmes by which the video may be played and even edited. The video is perhaps the most powerful medium to detail out any event.

Interactive Multimedia is being used in many domains like advertisement, fashion design, textile design, corporate training, education, games etc.

2) **Office Applications and Desk Top Publishing**

Computers are also finding applications in solving day-to-day office problems. In any office, be it government or private organisation, the processing of several types of documents e.g. reports, orders, contract, form, letters etc. is required. The computers can be used to create, store and retrieve as well as, edit and print the document. An electronic office uses computers for procurements of files, office communication, assisting in decision making and administrative work. Several software products are available for assisting office and secretarial work. These are word processing tools like MS Word, Word Star, Chi Writer etc, spread sheets using Lotus 123, Excel etc and for database application, FoxPro, Fox Base etc. are used. MS Access is also used in offices for day-to-day database application. Computers are being used for Desk Top Publishing. The DTP work includes the production of documents with text, images and graphics. Ordinary word processors like Word, Chi may not take up the job of desk top publishing. There are several softwares dedicated for desk top publishing like Page Maker, Ventura etc. DTP software uses a page layout and allows the user to enter the text and place the images and other graphic objects on to it. All these objects can be adjusted by modifying the size and other parameter to fit on to the page. These software programmes are being used in the publishing industry for the production of newspaper, books and magazines.

3) **Education**

Information technology has proved to be extremely useful for education and research. It is not too far from now, when people used to collect the relevant information in the library journals and books. A lot of time used to be wasted in finding the relevant information source. With the popularity of the World Wide Web and easy accessibility to the Internet, it now takes a few seconds to find any desired information. Information Technology is considered as the convergence of several fields of science, technology and communication. It can be profitably used in education as it supports the thinking process by providing a set of examples to solve a problem with the use of Instructional Software. The Instructional Software has a complete range, starting from school kids to professionals. It is not uncommon to keep important lectures and presentations in digital forms like CDs. In several schools / institutions, computers are being used as teaching aids. Computer Assisted

Instruction (CAI) softwares are being written by professionals for school children. This software presents the problems and solutions in a systematic manner which helps the students to logically understand the subject. In colleges and universities, the lecture series of various professors are recorded and may be referred later on. Virtual Classrooms and teaching are gaining momentum day by day.

Computers may be used for individual and collaborative learning in schools. There are several softwares, which explain the concepts of mathematics, logical reasoning, and basic science by repetitive presentations. A student may keep interacting with the problems and these problems are designed in such a way that the student gets thorough understanding of the subject. Computers may be used for classroom teaching and instruction by providing a full and effective multimedia presentation on the topics. Collaborative software for education is used where groups of students take up the problem collectively and this provides ample scope for group learning.

4) **Banking and Financial Institutions**

Information technology has helped the banking and financial institutions to automate their business process and minimise the transactional delays. In the banking and financial institutions, the performance is measured in terms of processing speed and customer satisfaction. With the application of computers, it has become possible to clear the recurring dues like payment for electricity, telephone bill, shopping bill by instructing the bank for payment from customers account. Telebanking is a good example of this. After the introduction of computer in banks, online funds transfer from one account to another has also become possible. The customer may instruct the bank's computer for payment to a third party, account transfer after providing the authentication detail. Authentication of credit card, debit card and other electronic payment instrument by the bank has also facilitated shopping, purchasing and minimised the transaction delays. Internet banking offers both bank and customers a huge opportunity by convenience. With the introduction of ATM (Automatic Teller Machine), it has become possible for customers to withdraw cash from the bank round the hour. Now it is not necessary for the customer to move down to the bank premises for collecting the cash. The ATMs are installed or are being installed at several places in most towns.

5) **Weather Forecasting**

Weather Forecasting is one of the important areas of application of information technology. Traditional weather forecasting methods were based upon the analysis and prediction through experiences. It was a combination of both science and art. In modern days, after utilising the enormous processing capabilities of digital computers, several scientific methods for weather forecasting have been developed. These methods employ numerous factors such as availability of data, previous experiences and the level of difficulty that the forecast situation presents. In the modern and scientific techniques, it is possible to read the weather maps in digital medium and these maps may be processed in such a way, that a pattern for the next few days is obtained. Based on the forecaster experience and projected weather maps, the forecasting is done. Use of computer has facilitated the job of data processing related with weather. The size of data used for weather forecasting is normally huge; therefore use of computers for processing these data is essential. Following are the techniques used in weather forecasting:

a) **Conventional Weather Forecasting**

Conventional methods of weather forecasting used the simplest method of prediction based on yesterday's weather and the experience of the forecaster. This method is called Persistence method. It is perhaps the most simple way of weather forecasting. In this method, the weather forecaster uses the present day weather as a basis for declaration of the next day's weather. It is assumed that the weather conditions do not normally change drastically. The persistence method works for the geographical region where the weather conditions do not change very fast and the weather maps are changed slowly. For the geographical regions where the weather conditions change very frequently, these forecasting methods do not work.

Another important technique for making a forecast is through weather maps. The weather forecasting methods which employ the prediction based on the weather maps and experience of the forecaster are called Trend Methods. These methods involve determining the speed and direction of the movement of elements air masses, fronts, pressure systems, and areas of clouds and precipitation. Using this information, the forecaster can predict the location of these elements in the future. Differences in latitude, possible acceleration/deceleration of storm systems, local effects such as topography, bodies of water etc. are some of the important parameters used for weather forecasting using trend methods.

b) **Analog Methods for Weather Forecasting**

The Analog Method works on a very simple principle. This method compares the weather condition of the day with the weather condition in the past when the weather scenario looked very similar. Based on the past record, the weather for the coming days is predicted. It is assumed that the previous effects on the weather will continue because similar causes have similar effects once again. This approach works well for the region where the climatic variables do not change dramatically. A similar weather conditions can he examined from the past weather data for that particular area and depending upon the past experiences or data, a forecasting may be done. The use of analog method is difficult and complex because it is very difficult to find a perfect match of similar weather conditions in the past. Various weather features rarely line up in the same location and in the same manner as they did on the previous occasion. Even small differences between the current time data and the comparing past data can lead to very different results.

c) **Computer based Numerical Methods for Weather Forecasting**

The numerical methods for weather forecasting use the processing capability of digital computers. Numerical Weather Prediction is another technique based on numerical methods, where data are processed by a digital computer according to forecasting algorithms. The weather maps in digitized form take huge space and multiple maps for different conditions are processed in order to predict the weather of tomorrow. Several Forecast Models have been developed for weather forecasting and are executed on the super computers. They provide predictions based on many atmospheric variables such as temperature, pressure, wind speed, direction and rainfall. A forecaster examines how the features predicted by the computer will interact to produce the day's weather. The numerical weather prediction methods are also not accurate because of the complex nature of atmospheric conditions; therefore, the equations used by these models to simulate the atmosphere are not always correct. Despite these shortcomings, the numerical weather forecasting methods are still considered as the most accurate forecasting methods.

There is another similar method for Weather Forecasting through Textual Examinations.

This technique uses the data providing a clear picture of the weather in the previous days and the current data is analysed for the weather prediction based on previous data. For example, a previous day climatic data is analysed which gives the precipitation, temperatures, humidity and other parameters. Maps are then plotted at regular intervals to get the trend of weather changes. These maps are analysed and weather for future is predicted.

Computers are very much required to develop weather forecasting models. Weather forecasting requires enormous data to be processed, therefore usage of computer for this application not only saves time but also a high degree of precision in the forecasting is obtained.

6) **Graphics and Image Processing**

Image processing and publishing is being used in almost all areas of life. Processing an image without a computer is a complex and tedious job. It takes many hours to conceptualize the image and edit it conventionally. With the introduction of computers, processing an image has become quite simple. There are areas like Geographic Information System, Path Finder etc. which are based on image processing. Image processing is being used in weather forecasting where the images captured by satellites are analysed and processed to study the environmental changes.

Graphics is a powerful medium which may replace a thousands of words. Now-a-days, with the introduction of information technology editing and processing of images has found new dimensions. All the publication media like newspapers, hooks, magazines, film production, television use information technology concepts for processing, editing, reproducing, storage and retrieval of images and graphics. There are several software products available for these jobs. It has also become possible to minimise the cost of processing the images in digital formats and communicate the images to other users instantly. The images broadly may be classified into two categories called Vector Images and Raster images.

Vector images are described by their geometric parameters. An image containing several objects having similarities to lines, circles, square, cube, parallelogram or may be captured using their geometric parameters like radius, length, thickness etc. and location. The colors are also captured by their parameter like combination, hue and saturation. A vector image is resolution independent. A Vector image may be scaled to any size and printed on any output device at any resolution. This process does not allow the image to sacrifice its details and clarity. The vector image is a good option for storing and representing small sized images where the object may be scaled to any size.

Raster images are captured by a grid of small points called pixel. The collection of pixels constitute the raster image. Every pixel denotes a position and colour contents. The position of pixel and colour values for every pixel are used to represent a raster image.

7) **Science, Technology Problems and Industry Automation**

Scientific and industrial design requires the solution of several complex problems. These problems generally involve bulk of data to be processed. Use of digital computers to solve the most intricate scientific and industrial problems is increasing day by day because of their fast computational speed and time saving. Design of electrical appliance, transformers, simulations of power generation and distributions, mechanical and nuclear reactor designs, civil structures, beams, building and bridge design need complex computations. Several software for handling these complex and specialised applications are available. Computer Aided Design (CAD) tools are examples of this. Computers are also being used intensively for the Process Control in an automated plant. Microprocessor based controllers in the process plant are programmable, and once programmed they perform specialised tasks effectively and accurately. On several occasions, the humans are not employed in hazardous working conditions such as gas chambers, working under high temperatures, or in high current zones etc. In these areas, computers are being deployed. The computers are also playing a very important role in military communications. Radar system employs computers for processing the image data and computer controlled radar system predicts the speed and direction of the flying objects. Several customised 1software have been developed and deployed for specialised application areas.

16.3 INFORMATION TECHNOLOGY CAN HELP PRODUCTIVITY GROWTH AND OVERALL ECONOMIC PERFORMANCE

In this lesson it is analysed the channels through which the internet and information technology can help boost productivity growth and overall economic performance in the emerging nations in general, and in India in particular. It is argued that in order to take full advantage of this new technology, the countries will have to make major investments in "complementary" areas, including research and development, education and infrastructure. Moreover, it can be argued that unless the countries in the region are able to implement major institutional and economic reforms, investment in information technology will have a small effect on growth. The reason for this is simple: information technology is a "general purpose technology," and its impact on growth depends not only on its own level, but also of other complementary factors.

For a number of years economists were skeptical regarding the effects of computer technology on aggregate productivity and economic growth. The statement attributed to Nobel Prize winner Robert Solow, "you can see computers everywhere, except in productivity figures," captures quite vividly this perspective.

Investments in technology do not have a large direct effect their on productivity. Its impact is indirect, and is mostly related to changes in other aspects of the productive process. Investment in information technology plays the role of a "facilitator" that allows other innovations to take place.

"Investment in information technology complements the changes in other aspects of the organisation. To be successful, firms typically need to adopt computers as part of a "system" or "cluster" of mutually reinforcing organisational changes."

Most of the study indicates that the rate of return to investment in information technology exceed by a wide margin the rental rate of computer capital of information technology investment:

- The new microeconomic research has identified a number of factors and "organisational changes" that determine the success.
- In order to be fully productive, IT has to be accompanied with investments in human capital, especially at the technical level.
- The productivity impact of IT investment is higher in industries with high expenditure in R & D.
- IT investment has a greater impact in decentralised settings.
- Effective IT investments take place where there is less vertical integration.
- Some of the most successful implementation of IT projects have taken place in new companies.
- IT investment thrives in organisations that introduce greater flexibility to labour relations.

But, at the macro level, it is seen that productivity growth in the developed States accelerated after 1995, and much of this is accounted for by sectors which used or produced IT intensively. Authors John Van Reenen and Raffaella Sadun, of the London School of Economics, see a contrast between the developed and developing countries where, despite the acceleration in productivity in sectors which produce IT (e.g., semiconductors, computers), there was no comparable acceleration in the sectors that used IT intensively (such as retail, wholesale, and finance).At the micro level, recent statistical research on large samples of firms has shown that information technology significantly increases productivity, but that there is wide variation in the size of this effect. The organisational structure of some major fims-greater decentralisation or better management practices - enables them to obtain much higher returns from their IT investments than other firms in the same sectors with similar levels of employment and capital investment. The authors show that the higher productivity of US multinationals located in Europe - as compared to other multinationals - appears to be linked to their better use of IT. They argue that this is likely to be due to the superior internal organisation of such firms, such as stronger worker incentives, smarter targets, leaner manufacturing, etc. This effect is particularly strong in the IT-using sectors, where the developed countries experienced a productivity burst, whereas developing countries did not. This difference in the use of IT may explain the absence of developed style productivity acceleration in developing over the last decade.

Check Your Progress 1

1) Name the three areas related to Information Technology which are significant for industrial growth in India?

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2) What is ernet and nicnet?

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16.4 AN EMERGING OPPORTUNITY FOR INDIA: THE PRODUCTIVITY OF INTERACTIONS

India being the one of the largest nations in the world, with a rich heritage of education and training, possesses tremendous potential for economic growth through information technology. This is evident from the phenomenal growth of IT companies in India. The IT industry in the past decade has shown an exponential growth. In comparison to other developing countries, India has shown a significant growth in the utilisation of information technologies and in managing information. One study shows that the sales of Personal Computers in India have been growing at more than 20% per year. A contributing factor in this growth was the intense competition between various hardware companies which led to a sharp decline in the prices of PCs, networking equipment and other peripherals. There are three areas related to Information Technology which are significant for industrial growth. These are (i) a National Information Technology Policy, (ii) guidelines for establishing a communication and information infrastructure and focus on education and, (iii) training in IT. National information policy is required to facilitate the commercial activities on the internet. India has already passed and implemented an Information Technology Bill, which has formed a basis for Electronic Governance. Various tasks like lodging an FIR by E-mails, communication and meeting on the Internet, seeking the desired information on the internet about government organization can now be done. Similarly, payments by the customers on the net have a legal status. A national policy is very much required to remove the legal and administrative hassles by adopting novel ways to strengthen the business using Information Technology. National information policy in developing countries is concentrated on trade, international relations, national security and technology. The regulatory framework in developed countries is enforced to protect investment, intellectual property and individual privacy in the information market. The legal framework addresses the private sector involvement, skilled human resources, standards and implementation aspects. In most developing countries, a regulatory framework hardly exists for the information work in the country. This is urgently required as the rapid growth of information technology is changing the mode of business. The virtual corporation, electronic market and Electronic Business, customer relationship, product assessment activities have changed the modes of business considerably after adopting the innovative applications of Information Technology. While the information technology including telecommunication has penetrated every market in the developed world, the developing countries still largely view information technology as only a means to support MIS, finance and accounting facilities and data processing.

The work force in developing countries is changing from the labour-intensive to knowledge-based activities. In developed countries, surveys have shown that the usage of Internet is closely associated with higher education. The same concept applies to a developing nation like India. An Education and Training policy is required to improve the literacy rate. There is a difference between computer literacy and conventional literacy. A computer literate person is one who possesses the experience of handling personal computers, is capable of preparing the documents, writing the E-mail etc. It is the responsibility of the government departments to work together to increase literacy in developing countries. Only through this, can people in the country better themselves and compete globally to access and disseminate information using the Internet. In this context, the training of information professionals should be given priority. The trained information professionals would be able to utilise the Internet more efficiently and will be more effective in acquiring, organising and disseminating information.

The Central and State Governments have taken several initiatives for a wide propagation and utilisation of Information Technology. The last decade in India has witnessed a major Information Technology revolution. An example is the growing use of Internet. In a very short span of time, the use of computers at offices and homes has become a reality. Use of Internet at office and home is increasing day by day at an exponential rate. Inspite of this studies show that out of the total population of Internet Users. USA contributes more than 50%, followed by the European countries. The Asian countries contribute merely 10-16%. Thus, there is a lot of scope for improvement and growth. The government in India has started several projects in this regard. ERNET and NICNET are good examples of these project.

Educational and Research Network (Ernet)

The Educational and Research Network (ERNET) was initiated in 1987 by the Department of Electronics (DoE) to provide computer communication for the academic and research community in India. ERNET is a joint project of the department of Electronics (DoE), Government of India and United Nations Development Programme (UNDP).It is India's first TCP/IP network set up for fostering educational and research activities in the premier institution and research laboratories. The main focus of ERNET project was to provide the Internet access to software developers, students, research scholars and academician at the premier research institutes and laboratories. Full fletled Internet connectivity was started few years later by another government agency VSNL (Videsh Sanchar Nigam

Limited). It is an organisation which has opened India's long distance communication services to the public. It is providing services such as E-mail, file transfer, remote login and database access. Another government agency, the National Informatics Center (NIC) was set up in the late 1980s to provide computer support to the government and public sector undertakings. It also provides limited Internet access to exporters and educational and research institutions.

ERNET involved the participation of eight educational and research institutions in the country. The five Indian Institutes of Technology at Mumbai, Kharagpur, Kanpur, Chennai and New Delhi, the Indian Institute of Science, Bangalore, and the National Center for Software Technology, Mumbai and the Department of Electronics (DE) New Delhi are serving as nodal centers for the ERNEF project. The main objectives of this project are given below:

1) To establish a countrywide computer network involving premier educational and research institutions in the country in order to foster academic and industrial research. One of the objectives of this network is to provide connectivity to the educational and research Institutions abroad.

2) To develop Informatics infrastructure in the country.

3) Human resource development by providing education and training to increase the awareness of information resources available through the Internet.

4) To open the gateway to the world to provide an information base to the servers located abroad.

ERNET uses the network infrastructure in two folds. It uses at terrestrial wide area network that interconnects the backbone nodes as well as a VSAT based link that interconnects the backbone nodes and other remote VSAT sites. There are few other service providers that have also started providing the Internet services under the government setup. These are 'SOFTNET' by Software Technology Park of India, NICNET by National Information Center and Gateway Internet Access Services (GIAS) by the Department of Telecommunication and VSNL.

National Informatics Center Network (Nicnet)

The establishment and growth of a good network infrastructure has been relatively slow in India due to its poor telecommunications infrastructure. National Informatics Center (NIC) was set up in the late 1980s to provide computer support to the government and public sector undertakings. NICNET (National Informatics Center Network) is one of the most important networks connecting several government departments and organisations in the country. The objective of this project is to provide the network and communication infrastructure for fast information storage and data transfer across various government organisations. This network provides both ways data communication for government agencies. It is also serving as a backbone for fostering the development planning and administrative monitoring by the government. NICNET is a satellite-based communication network using approximately five hundred earth stations and connecting government agencies at the central, state and district levels. The NIC is also developing the software for facilitating the government activities, project monitoring and economic planning. Although a government agency, the NIC is increasingly functioning like a commercial entity by distributing a variety of third party software products as well as its own applications.

NICNET is now-a-days is providing limit d V-SAT and dial-up Internet access to Government departments and Software Export Groups. It started its shell access initially at 2 Kbps, at 2400 bps and now-a-days it is providing high speed TCP-IP access through 64 Kbps V-SAT links.

ERNET and NICNET are considered as India's first ISPs that have provided internet access. However, several other government agencies like Department of Telecom (DoT) and VSNL (Videsh Sanchar Nigam Limited) are offering Internet services to a variety of subscribers on commercial basis. Several private organisations have also been given permission to provide internet services. Some of the important Internet service providers in the private sector are Satyam, BPL, and HCL Avadh on Line etc.

Other Important Dedicated Networks

CMC Ltd (Formerly Computer Maintenance Corporation), a government company has established it own network called INDONET for the computer users community in the country. The network provides distributed data processing facilities on an all-India basis to large organisations using CMC's computers for their data processing operations. CMC has also taken up large software projects for the automation of Railways and other government departments. Other important networks already under operation under the aegis of the government are SIRNET (Scientific and Industrial Network), BTISNET (Biotechnology Information System Network), and SOFTNET by Software Technology Park. All these networks are self sufficient and are being used for file transfers, E-mails, video telephony and other Internet services.

Thus the reality is that everyone needs to use technological, engineering and scientific innovations one way or another. Another reality is that, these technologies, scientific discoveries and inventions come with numerous challenges and some of the challenges are life threatening. And yet another reality is that not everyone is able to contribute towards the development of innovations due to economic reasons and yet everyone is affected one way or another by the consequences of these innovations. It is therefore, necessary to ensure that all categories of stakeholders are involved in any innovation we introduce.

Check Your Progress 2

1) What is IT (Information Technology)?

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2) What is VSNL?

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3) Where is the Nodal centers of ERNET?

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16.5 SUMMARY

So, in this onit it can be said that in the real world, economic and social relations are seldom one way. This means that while an effective adaptation of information technology requires a cultural revolution, information technology can itself help catalyse cultural and institutional change. Information technology can help increase transparency and reduce corruption. This is the case, for instance, in countries where government procurement has gone on line. Also, by reducing the costs of communications, information technology can reduce "economic distance" across countries. "Closeness," in turn, increases international trade and helps blur cultural differences. Leamer and Storper (2001) have recently argued that, although the internet will not replace the basic mechanisms through which "trust-based" business relations are established, it will reduce the maintenance costs of this relation. This is likely to reduce transaction costs and will make economic relations more effective and productive.

16.6 KEY WORDS

Innovation	:	The introduction of new products or production processes.
Technology	:	The sum of knowledge of the means and methods of producing goods and services.
Infrastructure	:	The underlying capital of a society embodied in roads and other transportation and communications systems, as well as water supplies, electric power and other public services.
Decentralisation	:	Scattered.
Productivity Growth	:	Annual increase in output.
Investment	:	Expenditure on real capital goods.
Sustainable Development	:	Development which is ever lasting and contributes to the quality of life through improvements in natural environments.
IT	:	It means Information Technology is an area in which the computers has made a significant impact on all dimensions of our day to day like e.g. reservation of air and railway tickets, buying and selling items on internet, electronic market, bank transaction on net, entertainment, education, communication, hotel reservation and so on.
Complementary areas	:	The areas conducive to development.
DTP	:	Desk Top Publishing, Internet.

16.7 EXERCISES

1) Explain the Emerging trend in Information Technology.

2) Discuss the role if Information Technology in the development of developing countries.

3) How can IT helps in productivity growth?

4) Give the applications of IT.

5) What are the important networks in India?

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UNIT 17 ECONOMIC REFORMS AND THEIR IMPLICATIONS

Structure

17.0 OBJECTIVES

After going through this unit, you should be able to comprehend the:

- emergence of world economic reform in general;
- impact of reform on different sectors in general;
- study of India's economic reform in particular; and
- impact of India's economic reforms on different sectors in particular.

17.1 INTRODUCTION

Emergence of world economic reforms is seen in the form of worldwide expansion of productive and service activities, growth of international trade, diminishing importance of national frontiers, and intensive exchange of information and knowledge throughout the world. But they coexist with a concentration of "global" activities in certain countries, regions, even neighbourhoods, and certain firms and corporations. In this connection India's recent progress towards economic growth stems from reforms undertaken after the 1991 fiscal crisis, which lifted India from decades of slow growth under socialist rule and offered an opportunity to improve living conditions in the immensely, poor country. And the recent growth has been impressive among the highest growth rates in the world. A great portion of the world's poor live in India and will depend on its future growth to overcome poverty. The stabilisation efforts of India in 1991 successfully warded off financial collapse and demonstrated that the governments could be trusted to develop and implement sound economic policy. Appealing to the Indian aspiration of self sufficiency, controversial reforms in areas like taxation, financial services, trade, labour, agriculture and public sector management were developed and approved by Indian committees rather than by external bodies like the World Bank or IMF.

17.2 EMERGENCE OF WORLD ECONOMIC REFORMS IN GENERAL

The 1980s' turn to economic liberalisation generally undermined state capacities by reducing public sector economic activities and reducing fiscal capacities. In the realm of ideas, this had been preceded by what John Toye (1987) called the 'counter revolution' against development economics. The early 1980s' sovereign debt crises led to stabilisation programmes under the auspices of the IMF and structural adjustment programmes (SAPs) managed by the World Bank. Together, they quickly obliterated and reversed the McNamara-Chenery heritage at the World Bank.

The case for trade liberalisation has been undermined by growing evidence of widespread 'jobless growth', the ambiguous evidence of the employment effects of trade liberalisation and the misleading claims of earlier advocates of trade liberalisation (Rodriguez and Rodrik). Even Paul Samuelson, the doyen of mainstream international trade theory, has acknowledged what most critics, especially from the South, have long argued. They argued that trade liberalisation does not necessarily ensure welfare gains for all, even in the medium term, but that outcomes instead depend very much on 'initial conditions' (resource endowments), the short and long term dynamic consequences of the new international economic specialisation as well as economic capacities to take advantage of the new opportunities thus offered.

In the period since the greatest sources of global inequality have been international, rather than national. We have to look at the consequences of international economic liberalisation or globalisation much more carefully and critically. In this regard, it is relevant to look at five issues: International trade, finance, agriculture, Land and labour.

17.3 IMPACT OF REFORM ON TRADE

The conclusion of the Uruguay Round of trade negotiations saw the World Trade Organisation (WTO) replace the General Agreement on Tariffs and Trade (GATT) with considerably enhanced powers and a significantly broadened scope of ostensibly trade related matters. Perhaps most importantly, membership of the WTO involves a 'single undertaking' requiring compliance with all WTO agreements unlike the previous option under GATT of signing up on an agreement by agreement basis. The WTO has also created and strengthened processes and mechanisms for dispute settlement, that have tended to favour corporate interests and rich country's government who can better afford the legal and lobbying resources to pursue and advance their interests.

17.4 IMPACT OF REFORM ON FINANCE

In an unliberalised financial system, the government plays a large role in determining who gives and receives credit and at what price. Governments may offer various rationales for maintaining such a system, including, for example, preserving financial stability or channeling resources to support government industrial policy, give priority sectors access to low-cost credit, or finance a budget deficit.

Proponents of liberalisation point out that financial development is strongly associated with economic growth. They argue that the allocation of capital is more efficient in a competitive financial system and that higher real interest rates stimulate saving, thereby increasing the funds available to finance investment. Moreover, government allocated credit tends to be characterised by poor lending decisions, weak repayment discipline, and government corruption, since those grant access to capital (usually at low rates) may buy influence to protect their favored positions.

While liberalisation is not without its critics who question the link between liberalisation and higher saving rates and suggest that it may make some countries more vulnerable to crisis. Financial sector reform was high on the agenda of policymakers during the last quarter of the twentieth century. Countries around the world, developed and developing alike, liberalised their financial systems allowing markets to set interest rates, eliminating controls so that capital could flow freely across borders, and opening their doors to foreign financial firms.

But there were significant differences in the pace and scale of reform. Reforms were swift in some countries, sluggish in others; some countries merely tweaked their financial sectors, while others overhauled them. A large and technically sophisticated literature has examined the consequences of financial sector liberalisation, but the factors triggering reform have received less attention. Although there have been case studies supporting various economic and political theories about the forces driving reform, little statistical testing has been done.

Financial Reform: What Shakes It? What Shapes It?

Given the difficulties inherent in undertaking any kind of reform, including financial sector reform, it is not surprising that inertia often sets in. The uncertainty over who will win and who will lose, the opposition of elite or special interest groups-these are just two of the issues facing policymakers considering reform. And yet many countries did reform their financial sectors during the last quarter of the twentieth century. What enabled or forced them to challenge the *status quo*?

Various studies have identified three possible triggers for reform: discrete events, or shocks; a learning process that grew out of new information or success with initial reform measures; and a government's political ideology, institutions, or structure. The lack of cross-country data on financial liberalisation has made it difficult, however, to analyse the timing, direction, and size of policy changes in a way that allows patterns to emerge. Moreover, financial liberalisation consists of both discrete changes that are easy to identify and gradual changes that become visible only over time, while existing measures of liberalisation refer either to a one-time change in the rules or to continuous proxies, such as the level of financial development.

17.5 IMPACT OF REFORM ON AGRICULTURE

The WTO trade agenda has broadened from GATT's focus on manufactures to include services while giving renewed attention to agriculture. Undoubtedly, many developing countries with strong agricultural productive capacities will benefit from less protected markets in the North for their exports. Historically, however, there has been a great deal of hypocrisy and self-interest in the rhetoric and practice of trade liberalisation. For example, many critics note that the European countries declared trade liberalisation objective of **'everything but arms'** has, in practice, involved **'everything but farms'**. In any case, the gains from agricultural trade liberalisation will mainly benefit a few successful agriculture exporting countries, including those in North America and Australia, rather than, say, Africa where many gain from subsidised European food prices.

17.6 IMPACT OF REFORM ON LAND

Land reforms throughout the world (also agrarian reform, though that can have a broader meaning) is an often-controversial alteration in the societal arrangements whereby government administers possession and use of land. Land reform may consist of a government initiated or government backed real estate property redistribution, generally of agricultural land, or is part of an even more revolutionary programme that may include forcible removal of an existing government that is seen to oppose such reforms.

Throughout history, popular discontent with land-related institutions has been one of the most common factors in provoking revolutionary movements and other social upheavals. To those who labour upon the land, the landowner's privilege of appropriating a substantial portion - in some cases half or even more of production without making a commensurate contribution to production may seem a rank injustice. Consequently, land reform most often refers to transfer from ownership by a relatively small number of wealthy (or noble) owners with extensive land holdings (e.g. plantations, large ranches, or agribusiness plots) to individual ownership by those who work upon the land. Such transfer of ownership may be with or without consent or compensation; compensation may vary from token amounts to the full value of the land.

In various times and places, land reform have encompassed the transfer of land from ownership even peasant ownership in smallholdings to government-owned collective farms; it has also, in other times and places, referred to the exact opposite: division of government-owned collective farms into smallholdings. The common characteristic of all land reforms is modification or replacement of existing institutional arrangements governing possession and use of land.

17.7 IMPACT OF REFORM ON LABOUR

The government has plans of amending the Contractual Labour (Regulation and Abolition) Act of 1970 and replacing it with the Contract Labour (Regulation of Employment and Conditions of Service) Act. In making organised labour markets flexible, the two prime candidates for change are the Contract Labour Act and Industrial Disputes Act. Hence, the change in nomenclature from abolition to regulation is welcome. However, the concerned Group of Ministers (GoM) and Cabinet continue to be divided about how flexible the law should become, a division that will no doubt also be mirrored when the Bill is placed before Parliament. Actual legislative change will therefore take some time coming. Clearly, policy makers, and this includes the Union labour minister, are reluctant to give up the control mindset. First, there is Section 10 of the 1970 legislation which allows the government to prohibit contract labour in select occupations. In the public sector, courts have sometimes interpreted this optional prohibition as mandatory, although some recent judgements have reversed this trend. While some members of Cabinet want Section 10 to go, others want it scrapped for specific occupations. This identification of 12 such occupations by the labour ministry is completely arbitrary and will continue to impart rigidity to non-identified sectors. It is better to repeal Section 10 in its entirety, having ensured that legislative vacuum doesn't lead the judiciary to interpret prohibition of contract labour in a mandatory sense.

Second, the labour ministry seems adamant upon linking flexibility to social security. While the latter is indeed desirable, making it a precondition for changing the Contract Labour Act seems strange. Third, the Bill rightly passes on the business of maintaining registers, introducing insurance and compensating workers for retrenchment to the contractor. But defying logic, the labour ministry is insistent that the principal employer should be responsible. Since the principal employer is often the government or its agencies, the labour ministry's attempts will continue to constrain the public sector. Most remarkable of all, the labour minister wants a mandatory 25 percent representation of workers on boards of companies and mandatory profit sharing.

Check Your Progress 1

1) What is Land reform?

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2) Define Labour reform.

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3) What is WTO trade agenda for agriculture?

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17.8 EMERGENCE OF INDIA'S ECONOMIC REFORMS

Economic reforms were introduced initially on a moderate scale and controls on industrials were substantially reduced by 1985 industrial policy. This set the trend for more innovative economic reforms and they got boost with the announcement of the landmark economic reforms in 1991. After over four decades of insulation from world markets, state controls and slow growth, India in 1991 embarked on an accelerated process of liberalisation. The 1991 reforms ensured that the way for India to progress will be through globalisation, privatisation, and liberalisation. Economic reforms include liberalisation, privatisation and globalisation. Liberalisation implies deregulation of the economy, privatisation signifies transfer of ownership from public to private while globalisation is the integration of domestic economy to the World Economy.

Indian economy was in deep crisis in July 1991, when foreign currency reserves has plummeted to almost $1 billion, inflation has roared to an annual rate of 17%, fiscal deficit was very high and bad become unsustainable, foreign investors and NRIs had lost confidence in Indian economy. Along with these bottlenecks at home, many unforeseeable changes swept the economy of the nation. So, the Indian economy needed a complete overhauling in our economic policies and programmes. Major measure initiated as a part of the liberalisation, globalisation as well as privatisation strategy in the early nineties. These LPG mantras are necessary because of the backward/poor economic structure of the nation. Indian industry lacks in its marketing skills and efficiency of timely suppliers and dynamism of expanding suppliers parallel to global demand. Enormous investments which the technological upgradation of industry requires, can be met only by foreign collaboration. Top level managerial and marketing skill has to be obtained by commercial treaties. Indian economy has enormous potentialities and trade advantages like low labour costs and huge skilled manpower, therefore it was deemed rise to shift LPG trade regime in later 1990s. Liberalisation necessitated privatisation and these two in turn could work effectively for globalisation of Indian economy.

So, the 1991 Balance of Payments [BOP] crisis forced India to procure a $1.8 billion IMF loan and acted as a "tipping point" in India's economic history. The IMF bailout wounded the pride of a country that had strove above all for self-sufficiency through its post independence socialist policies. The bailout announced to Indian policymakers and the world the country's policy failures.

Check Your Progress 2

1) Explain Economic reform.

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2) What is Liberalisation?

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3) Define Privatisation.

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4) What is Globalisation?

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17.9 IMPACT OF REFORM ON TRADE AND INVESTMENT (WHAT'S BEEN DONE AND THE WAY FORWARD)

India's trade policy prior to the 1991 reforms was characterised by high tariffs and import restrictions. Foreign-manufactured consumer goods were entirely banned, and capital goods, raw materials, and intermediate goods for which domestic substitutes existed were importable only through a bureaucratic licensing process.

Although foreign ownership in some Indian companies was permitted, investors faced complications that included a subjective licensing process, high regulation upon approval, and equity-holding caps. In fact, until recently Indians had only one television program and had to settle for locally-produced Thumbs Up instead of Coca-Cola.

India has come a long way towards opening its borders to trade exports and imports and both Congress and the BJP have been committed to increasing free trade. India has and should continue to take advantage of the WTO as a cover against domestic backlash to further tariff reductions. Concessions like temporary subsidies may be necessary to placate short-term losers in non-competitive industries. Investment has increased throughout the past decade and a number of important industries like aviation and construction have raised or eliminated caps on foreign investment.

What's been done

Recent trade and investment policy reforms:

- Eliminated import licenses and reduced import duties from rates that had been the world's highest;
- Liberalised trade in service and technology industries;
- Improved recognition of international intellectual property rights;
- Allowed 100% ownership in firms in a large majority of industries (excluding banks, insurance, telecommunications, and airlines);

The way forward

To improve its trade and investment environment, India should:

- Further reduce import duties and restrictions;
- Reduce costly procedures for exporting finished or intermediate goods;
- Attract foreign investment to meet demand for infrastructure projects;
- Reduce foreign investment barriers within the retail sector;
- Invest in infrastructure and education, as a recent survey of global CEOs cited infrastructure and poor skill level as the two leading deterrents;
- Pursue free trade agreements in the spirit of creating a greater global balance and to advance India's economic interests.

17.10 IMPACT OF REFORM ON FINANCIAL SECTOR (WHAT'S BEEN DONE AND THE WAY FORWARD)

In order to liberalise the financial sector, our P.M. Narsimha Rao established committees in year 1991 to research and make recommendations regarding financial system modernisation, deregulation, and lending improvements. The committee-based approach reflected Rao's strategy of building consensus through Indian-led and designed plans.

Before the 1990's, regulations limited the ability of the Indian financial sector to efficiently allocate resources. Regulations required heavy investment in government debt, while lending was restricted to specific sectors Bank nationalisation left management of most financial institutions to political forces.

Efforts to privatise and introduce competition were approached cautiously, due to the political sensitivity of these reforms and resulted in more limited change than did deregulation. Changes did not impact the banking workforce or management structure; banks remain overstaffed and poorly managed. Trade unions persist as a formidable enemy of future reforms aimed at reducing operating expenses. The large and mobilised workforce, associated with the Communist parties, has gone on strike in the past, holding the entire banking system hostage.

What's been done

India has implemented reforms that have led to relatively well-functioning capital markets.

These reforms:

- Liberalised interest rates;
- Abolished cumbersome approval requirements for financial transactions;
- Liberalised capital markets through the abolition of the Controller of Capital Issues, which controlled all funding activities of large manufacturing corporations;
- Allowed companies to more easily sell stock.

The way forward

In order to continue supporting the most dynamic sectors of the economy, India should:

- Design strategies to increase venture capital;
- Allow investment in securities as an alternative to domestic saving in order to reduce reliance on foreign inflows in capital markets;
- Allow pension funds to invest in stocks;
- Improve and deepen debt markets for larger corporations;
- Increase competition from commercial and foreign banks in the financial sector.

17.11 INDUSTRIAL SECTOR REFORMS (WHAT'S BEEN DONE AND THE WAY FORWARD)

India's industrial policy was one of the areas most changed by the economic liberalisation of the 1990s. The early reforms crystallised a trend that had been building since the national government moved towards a pro-business approach to industrial policy during the 1980s. During the following decade, India transitioned from a centrally planned and operated economy to a market-driven economy, reflecting a global trend toward less regulated economies. Most government-operated industries in India are now privatised, though some political contention still exists over the removal of reservation schemes.

What's been done

Industrial sector reforms:

- Opened up the economy broadly to competition; and
- Reduced reservations for some small-scale industries.

The way forward

To build on its success in industrial policy reform, India should:

- Further reduce reservations for small businesses; and
- Formalise special economic zones (SEZs), where normal investment and trade restrictions do not apply, to help leverage further reform.

Though small in comparison to China's vaunted SEZs, such efforts may hail a more drastic sea change in industrial policy as new ideas for further reforms become more prevalent in Delhi's circles of power. Milind Deora, a young and rising member of India's parliament, sees such a shift occurring today, suggesting that "the old guard is leaving."

17.12 AGRICULTURAL SECTOR REFORMS (WHAT'S BEEN DONE AND THE WAY FORWARD)

India must improve conditions for farmers and invest more in education and health care to reach its goal of 8% growth. It should to be aimed to modernise agriculture and increase manufacturing by expanding agribusiness and food processing.' Yet any change to the agricultural sector faces intense political opposition. Despite the fact that it contributes only 20% of India's GDP, the agricultural sector has always been politically influential. Interest group politics often hinder government attempts to cut costs in its agricultural spending. For example, Prime Minister Singh recently attempted to decrease government fertiliser subsidies but was stopped by a farmers' lobbying group from wealthy agricultural states.

What's been done

Agriculture has been largely ignored in the reforms of the last 17 years due to entrenched interest groups.

The way forward

Substantial deregulation of the agricultural sector is necessary in order to increase India's competitiveness in world markets. To achieve this, the government should:

- Eliminate subsidies that have largely benefited interest groups rather than poor farmers, in order to align incentives and liberate resources from state budgets;
- Reallocate these freed-up resources toward urgent public interventions, such as building roads, irrigation channels, and refrigeration facilities.
- Eliminate artificial price supports for food goods to reduce corruption and distortionary farming incentives.

17.13 LABOUR REFORMS (WHAT'S BEEN DONE AND THE WAY FORWARD)

While less than 10% of the 500 million-person labour force is "organized" or has regular contractual employment, labour regulations have made unions a powerful force in Indian politics. The tide is beginning to change, however. There are fewer labour strikes today, labour agreements now generally include clauses on productivity, and court judgments are no longer reflexively in favour of labour.

What's been done

Labour markets remain one of the most regulated sectors of the Indian economy as labour reform was not addressed in the early 1990s.

The way forward

A more flexible labor policy will support business development and enhance India's growth. In particular, policies should be designed to:

- Remove restrictions on laying-off workers;
- Moderate benefits obtained by unions;
- Deregulate wage practices.

Labor reforms should be coupled with the creation of a stronger social safety net to support affected employees.

17.14 LAND REFORMS (WHAT'S BEEN DONE AND THE WAY FORWARD)

Due the taxation and regulation under the British Raj, at the time of independence, India inherited a semi-feudal agrarian system, with ownership of land concentrated with a few individual landlords (Zamindars). Since independence, there has been voluntary and state initiated/mediated land reforms in several states. The most notable and successful examples of land reforms are in the states of West Bengal and Kerala. After promising land reforms and elected to power in West Bengal in 1977, the Communist Party of India (Marxist) [CPI(M)] kept their word and initiated gradual land reforms, such as Operation Barga. The result was a more equitable distribution of land among the landless farmers, and enumeration of landless farmers. This has ensured an almost life long loyalty from the farmers and the communists have been in power ever since. In Kerala, the only other large state where the CPI(M) came to power, state administrations have actually carried out the most extensive land, tenancy and agrarian labour wage reforms in the non-socialist late-industrialising world. Another successful land reform programme was launched in Jammu and Kashmir after 1947. However, this success was not replicated in other areas like the states of Andhra and Madhya Pradesh, where the more radical Communist Party of India (Maoist) or Naxalites resorted to violence as it failed to secure power. Even in West Bengal, the economy suffered for a long time as a result of the communist economic policies that did little to encourage heavy industries. In the state of Bihar, tensions between land owners militia, villagers and Maoists have resulted in numerous massacres. All in all, land reforms have been successful only in pockets of the country, as people have often found loopholes in the laws setting limits on the maximum area of land held by any one person.

17.15 SUMMARY

In this unit various aspects of reforms has been discussed in general and in particular too. Certainly, great steps have been taken towards reform on trade, finance, industry, agriculture, land and labour etc. there are substantial progress has been made in reducing poverty, and India has a growing and thriving middle class. However much remains to be done, the government intrudes where it need not, in everything from coal mines to discos, but fails to manage the basic services that should like decent roads, a stable power distribution infrastructure, and quality primary education.

17.16 KEY WORDS

Structural Adjustment Programmes: The programmes to overcome the economic crisis, gripping the nation as revealed in fiscal, revenue, budget, BOP, agricultural, industrial imbalances.

Economic Reforms : Economic reforms ensure the way for progress in economy through liberalisation, privatisation and globalisation.

Liberalisation : Deregulation of the economy.

Privatisation : Transfer of ownership from public to private.

Globalisation : Integration of domestic economy to the world economy.

Jobless Growth : Increase in production without employment generation.

SEZ : The zone where export oriented industries are established.

17.17 EXERCISES

1) Discuss the emergence of world economic reform in different sectors.
2) Explain the impact of economic reform on trade and investment in India.
3) Examine the impact of economic reform on agriculture in India.
4) What has been done for labour reform in India?
5) How far industrial sector reform has been satisfactory?
6) Discuss the financial reform in India.

17.18 SOME USEFUL BOOKS

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NOTES

SOSS/IGNOU/P.O.3T/August-2010

ISBN-978-81-266-4853-5