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GLOBALIZING INDIA: A CRITIQUE OF AN
AGENDA FOR FINANCIERS AND SPECULATORS

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Globalizing India : a critique of an agenda for financiers and speculators

1. Globalization as process and as policy

The word 'globalization' has been tortured and made to assume many different meanings since the time it was invented. At the risk of adding to the fragmentation in its connotation we can distinguish between two different generic classes of meanings attributed to it. One is the spread of human civilization, artefacts, institutions, patterns of living, information and knowledge to span the planet earth (and the stratosphere surrounding it). The other is a policy deliberately aimed at spreading certain institutions, modes of doing business, producing and trading commodities, services and information across all the states of the world. An analyst can trace the process of globalization in the various senses of the first generic class without accepting the agenda implicit in the second class.

Following the usage of other analysts, we can distinguish the following subclasses included in 'globalization' in its analytical sense. First, there is a spread of international trade in goods and 'commodities' in the Marxian sense (the latter are distinguished by the fact that they are produced with the help of inputs traded in the market and are destined primarily for sale). Secondly, people migrate from one country or region to another, temporarily or permanently. Thirdly, money or means of payment are exchanged on an increasing scale between different countries or regions (when different regions within the same country have different media of exchange, as happened in India under British rule until the eve of the first World War). Fourthly, capital flows from one country to another to help produce goods and services. Fifthly, finance - not necessarily linked to the production of goods and services - flows between different countries. Sixthly, transnational companies arise which increasingly engage in the activities listed so far. Seventhly,

technology is traded as between different countries. Increasingly, with the spread of the patent regimes governed by the Paris Convention as modified by the provisions of the World Trade Organization, frontier technologies take an increasingly proprietary form. The eighth aspect of globalization is the spread of print and electronic media. The ninth aspect is the growth in international trade and production of services of all kinds - shipping, insurance, banking, healthcare and, of course, finance. As is clear from this list, the categories sometimes overlap, but if we do not list them separately we are likely to miss out on the multifaceted nature of globalization as a process.

As in the case of other aspects of capitalist development globalization also displays many features of combined and unequal development. The growth of international trade may be said to be the earliest feature of the process of commercial internalization. It has, however, often been associated with an exchange of money at a fast pace, and also with migration of people. For example, in the three centuries after the Europeans' discovery of navigable routes from Europe to the western hemisphere and around Africa to Asia, commodities travelled mainly from Asia to Europe, silver from the Americas to Europe and thence to Asia, and enslaved Africans were subjected to forced migration from Africa to the Americas. Within Europe itself, before the Netherlands became industrialized enough to attain the status of a leading commodity-producing nation, it became the financier of European wars and the economic progress of competing nations, especially of England, and thereby helped hasten its own economic and political decline. We can produce a chronology of stages of globalization, from increasing commercialization of a basically self-sufficient economy through its increasing involvement in international trade flows and attendant specialization in particular branches of production, to its

involvement in flows of portfolio and direct investment, to its integration in international production structures through an increasing tempo of exchange of inputs as between firms (often affiliates of the same firms), to the increasing domination of its production, exchange and banking structure by transnational non-financial corporations and transnational banks, and finally to its entanglement in seemingly uncontrollable flows of finance across its borders (Bagchi, 1994). But this evolutionary sequence is neither linear nor inevitable nor irreversible. In the case of India and the international economy as a whole the flow of international trade had accelerated from the 1870s to 1913 and had decelerated from the middle of the 1920s (Bagchi, 1993). In India's case, however, the ratio of foreign trade to national income tended also to decline over the period from the 1950s to the early 1970s, but it increased slowly again from the late 1970s.

The ebbs and flows in the components of different aspects of involvement of a national economy in international trade, production and finance are influenced strongly by broad developments in the international economy as well by domestic policies. For example, foreign trade was used from the beginning of British rule as the chief conveyor belt for the remittance of the tribute extracted from the Indian empire to Britain. But its importance as the transmission mechanism for the extracted tribute grew in the period of the spread of the gold standard to the major industrializing economies of the North Atlantic and the acceleration in the rates of growth of their national income and resulting demand for industrial inputs and primary commodities. Contrariwise, the worldwide depression in trade in agricultural products which set in from 1926 (i.e., some years before the Great Depression starting in 1929) badly affected Indian exports. Again, the rise in the ratio of Indian foreign trade to national income in the late 1970s was much less induced by policy

than by developments in the world economy and especially by the growth of demand for Indian exports in West Asia and some other oil-exporting regions. However, global recession in the early 1980s brought down the share again. In 1985-86, the share of India's exports to India's GDP was 4.7 per cent. The corresponding figure rose to 6.8 per cent on the eve of the spate of liberalization measures adopted in June-July 1991. The share of exports to GDP rose to 10.3 per cent in 1996-97, but has stagnated at around that level in the last two years, with a slowdown in the growth of both exports and national income.

What then are the policies which have promoted the globalization of the Indian economy in its various aspects in recent years ? Virtually all the elements of the policy of economic liberalization which started in an attenuated form in 1985 but was adopted as an official policy stance from 1991 have promoted globalization of Indian capitalism in all its aspects. We devote the next section to a rapid sketch of these policy measures.

2. A brief sketch of the so-called economic reforms in India since the 1980s and some of its results

In India, partly as a legacy from the days of the second World War and partly as the outcome of moves to ration scarce resources and direct them to planned uses and to curb the power and the socially damaging behaviour of foreign capital and monopoly houses, a number of regulations sought to delimit the fields of operation of the private and the public sectors, allocate investment and finance, and control the inflow and outflow of foreign funds. From the late 1970s, however, some of these regulations were

relaxed and the foreign exchange value of the rupee was allowed to drift downward on a crawling-peg basis. In 1981 India obtained an Extended Funding Facility credit of SDR 5 billion from the IMF, but did not draw the last instalment of the loan and no major changes took place in the array of policies pursued by the government. However, in 1985 began a series of moves which essentially amounted to an expansive, debt-dependent fiscal policy directed at stimulating the growth of the economy (for a description of the policy changes see Datta, 1992; Bagchi, 1995, Section 5 and Nayyar, 1996, chapters 2 and 3). The changes effected in 1985 covered all the major fields of regulation except the capital market. The rigour of the Monopolies and Restrictive Trade Practices Act (1969) was considerably reduced, making it virtually irrelevant as far as the expansion of monopoly houses was concerned. The government encouraged foreign investment into many areas which had earlier been barred to the latter. It considerably liberalized the imports of capital goods and materials, especially of those needed for large projects in electricity generation, and in industries utilising natural gas and oil. Along with these moves, the burden of taxation on high-income and propertied groups was considerably lessened. The government resorted to higher and higher doses of deficit financing to defray its expenditures and this led to a rapid accumulation of internal, and even more ominously, external, debt. By the beginning of 1991, India was faced with the prospect of defaulting on her debt obligations and accordingly being unable to secure even short-term loans except on very onerous terms. In June-July 1991, in order to restore confidence among India's debtors and in the rupee, the government entered into an agreement with the IMF for a standby first-tranche credit of SDR551.93 million (about US \$754 million) and drawings under the compensatory and contingency financing facility totalling the equivalent of SDR 1352

million (about US\$1847 million). Later in the year, the IMF granted another standby credit authorizing drawings upto the equivalent of SDR1656 million (about US\$2262 million) (International Monetary Fund, Press Release No.91/64, 31 October 1991). In accordance with the memorandum of understanding reached with the IMF, the government of India carried out a series of policy reforms. The rupee was devalued by about 24 per cent. Initially a dual exchange rate was introduced, a lower rate being obtainable by exporters for their requirements. By the beginning of 1993, the currency was made convertible for current account transactions and the two rates were unified. Quantitative restrictions on imports were moderated or removed altogether, and import tariffs were brought down across the board. Earlier restrictions on foreign investment were done away with and a Foreign Investment Promotion Board was set up in order to attract foreign capital.

Internal deregulation accompanied these changes in the foreign trade and payments regime. Many of the industrial sectors which had been earlier reserved for public enterprises were now thrown open to the private sector as well. The government sold off large proportions of shares in public enterprises to private purchasers, including mutual funds and foreign financial institutions. The system under which firms had to seek permission of the government for establishing new enterprises above a certain size or investment above a certain limit was abolished, except for a specified group of industries. The provision under the Monopolies and Restrictive Practices Act imposing restrictions on investment and production on firms of groups with assets above Rs. one billion was abolished.

A degree of financial liberalization seeking to unify capital and money markets was also effected. Control over new capital issues was abolished. Banks were allowed to deal in shares by

setting up mutual funds. Foreign financial institutions were allowed to enter the stock market and buy up shares of Indian companies, subject to some mild restrictions. Banks were permitted to set their own rates for accepting deposits and lending money, but the central bank, of course, still has control over minimum cash reserves or rediscounting facilities and thus can influence the supply of base money and terms of lending. Lending to 'priority sectors' at preferential rates has been continued but de-emphasized in actual transactions by banks. The government has also tried, though not very successfully so far, to bring down subsidies to agriculture, by raising water rates for public irrigation facilities, electricity tariffs, and fertiliser prices. Subsidisation of phosphatic fertilisers has been discontinued with a strongly negative effect on their use.

3. The Indian experience compared with that of other countries of South Asia

We have so far discussed the Indian situation in isolation from the other countries of South Asia. However, because of a long historical legacy, and continual interchange among the peoples of these countries, they share many characteristics, including policy-induced but fragmented globalization. Among the South Asian countries the first serious policy package aimed at globalization was introduced in 1977 in Sri Lanka under the presidency of Junius Jayawardena. But several halting attempts at liberalization of the trade and investment regime were also made in Pakistan, attempts that were often stymied by unsustainable macroeconomic imbalances. In Bangladesh a more thorough going liberalization programme was introduced in the 1980s under the military regime and were continued by the democratic regimes that succeeded it.

Given the background, it is useful to examine some country-

specific indices of aspects of globalization mentioned earlier.

The first set of such indices relates to the shares of exports and imports to GDP (Table 1). In many of the countries of South Asia these ratios were going up before the onset of the formal policy of globalisation as Tables 1 and 2 reveal. Sri Lanka, had historically a high ratio of foreign trade to its GDP, because of the importance of plantation crops such as tea, coffee and rubber in its economy. The ratio of exports and imports to GDP in South Asian economies remains much lower than in typical East and Southeast Asian economies. Moreover, except for the case of exports from Bangladesh, Pakistan and Nepal there is no strong time trend in foreign trade flows in these economies. In most of the cases, imports of merchandise were higher than exports to start with, and the absolute increases in imports have generally been higher than those in exports so that balance of payments deficits have continued to trouble them even after the process of liberalisation has proceeded for some time. The gap between exports and imports has been generally bridged by remittances from migrant workers, and foreign aid including foreign loans, supplemented in the case of Sri Lanka and India, by some inflows of foreign portfolio and direct investment.

Not only is the overall share of trade in GDP lower and increasing more slowly than in the fast-growing economies of East and Southeast Asia. The share of developing Asia (countries east of Iran) as a whole in Asian trade also is generally lower than the share of East and South-Eastern Asia in that trade. In 1994, whereas the share of total exports of East and Southeast Asia, barring Japan, going to Japan and developing Asia (as defined above) was 54.6 per cent, that of total exports of south Asia going to the same group of countries was only 27.7 per cent. Correspondingly, while the share of developing Asia and Japan in the imports of East and Southeast

Asia was 58.4 per cent, the share of imports of South Asia coming from the same region was 33.4 per cent. (ADB, 1996, pp.186-7). Moreover, intra-South Asian trade was also rather meagre in value : the share of exports of countries of South Asia going to one another was only 4.2 per cent in 1994, and the share the same countries had in the (Ibid.). thus south Asia did not gain much either from the dynamism of East and South-East Asian economies or from a thriving trade with one another.

Coming to another index of an active globalisation process, viz., inflows and outflows of FDI, we note that these were also rather feeble in the South Asian region. Table 3 reproduces the figures of FDI inflows as given in UNCTAD, 1995.

We have not reproduced the figures of FDI outflows because they are quite insignificant. It is difficult to discern any real time trend of FDI inflows into any economy except perhaps for India and Sri Lanka. But in their case also, they pale into insignificance compared with the inflows into say, Indonesia, Malaysia, Singapore or Thailand.

Table 1 Bangladesh, India, Pakistan and Sri Lanka : annual averages of exports and imports as percentages of GDP, 1970-1994

Country	Exports					Imports				
	1971	1980	1985	1990	1994	1971	1980	1985	1990	1994
Bangladesh	5.4	6.8	7.6	8.8	10.3	13.4	18.9	17.4	17.3	18.2
India	5.8	6.3	6.8	8.7	8.6	6.7	9.2	9.5	10.3	9.2
Pakistan	10.6	11.9	13.8	16.3	18.0	19.1	22.9	22.2	23.3	22.0
Sri Lanka	28.4	28.3	25.9	28.9	28.0	34.7	43.2	36.2	37.8	41.7

Source : Muqadda and Basu, 1994, Table 3.2; and WDR, 1996.

Table 2 Nepal : annual averages of percentages of exports and imports to GDP, 1977-1995

	1979-80 to 1983-84	1984-85 to 1988-89	1990-91 to 1994-95
Exports	4.7	5.2	9.0
Imports	16.4	18.1	24.8

Source : Guru-Gharana and Shrestha, 1996, Table 4.1.

**Table 3 FDI inflows into South Asia,
1983-1994**

(Figures in US\$ million)

	Average annual inflow						
	1983-1988	1989	1990	1991	1992	1993	1994
Bangladesh	1	3	1	4	14	6	
India	92	252	236	155	261	586	947
Nepal	1	-	6	2	-	-	1
Pakistan	106	210	244	257	335	346	313
Sri Lanka	39	20	43	48	123	195	122

Source : UNCTAD, 1995, pp.394-395.

We now come to another aspect of globalization that we have examined earlier, viz., labour migration out of and into the South Asian countries. Internationally comparable, reliable figures of movements of labour within the subcontinent, for example, from Nepal and Bangladesh into India (or any reverse movement) are not available. Nor are the figures of total migration outside the subcontinent for recent years (the latest internationally comparable figures are available up to 1985 or 1986, as given in the studies assembled in Amjad, 1989). However, a substitute is available in the form of figures of workers' remittances for Bangladesh, India, Pakistan and Sri Lanka. (WB, 1995, gives zero as the figure of workers' remittances for Nepal, which must be factually untrue : this means that these figures are not officially collected). In Table 4 are tabulated the ratios of workers' remittances to the GDPs and exports of the South Asian countries. The Philippines, the country with perhaps the largest share of migrants in the labour force is also included. The figures indicate that in Bangladesh and Pakistan workers' remittances play an even bigger role in generating income and acting as supplements to export earnings than in the case of the Philippines, another major labour-exporting country of Asia. The character of migration from all the countries is not the same. Among the migrants, there is a considerably larger percentage of women going out of Sri Lanka than out of the other South Asian countries. From the Philippines also there is a large out-migration of women. In both cases this is partly a reflection of the higher level of education of women than in most of the other labour-exporting lands but partly also the result of high levels of unemployment of women in both countries (see Table 5). Pakistan also has a high level of unemployment of women, but there the percentage of women in paid employment is rather low compared with the two other countries.

Table 4 : Workers' remittances (WR) as percentages of GDP and exports, South Asia and the Philippines, 1980-1993

Country	Year	WR as a percent- age of GDP	WR as a percent- age of merchandise exports
Philippines	1980	1.9	10.6
	1985	2.6	17.4
	1990	3.3	17.8
	1993	4.7	22.3
Bangladesh	1980	2.2	36.1
	1985	4.0	50.2
	1990	3.7	46.6
	1993	4.2	44.1
India	1980	1.6	32.7
	1985	1.1	25.6
	1990	0.7	12.4
	1993	1.2	13.4
Pakistan	1980	8.9	82.1
	1985	8.7	97.2
	1990	5.5	40.4
	1993	3.3	23.7
Sri Lanka	1980	3.5	13.1
	1985	3.9	17.7
	1990	4.6	19.9
	1993	5.4	19.3

Source: ADB, 1996, p.207; and World Tables, 1995 (for estimates of the figures for India in 1993).

Table 5 Genderwise distribution of unemployment in Pakistan, Philippines and Sri Lanka 1990-1994 (as percentages of the labour force and of the labour force of the respective gender)

	1990			1991			1992		
	Total	Men	Women	Total	Men	Women	Total	Men	Women
Pakistan	3.1	3.4	8.9	6.3	4.5	6.8	5.9	4.3	14.2
Philippines	8.1	7.1	9.8	9.0	8.1	10.5	8.6	7.9	9.8
Sri Lanka	14.4	9.1	23.5	14.1	10.0	21.2	14.1	10.6	21.0

	1993			1994		
	Total	Men	Women	Total	Men	Women
Pakistan	4.7	3.8	10.3	4.7	3.8	0.3
Philippines	8.9	8.2	10.0	8.4	7.9	9.4
Sri Lanka	14.7	9.1	25.2	13.6	9.9	20.8

Source : ILO, 1995.

Note : The 1990 figures for Pakistan are not comparable with the figures for other years because of a difference in the method of computation.

These figures of high unemployment among women, co-existing with the reported feminisation of labour, especially in labour-intensive export-oriented industries such as garments in Fiji, Bangladesh, Sri Lanka and Nepal reveal the contradictory impact of globalization on gender equity at low levels of economic development. On the one hand, the rapid penetration of market forces into rural areas and small towns often leads to the displacement of women engaged in subsistence activities in agriculture and in artisanal work such as handloom-weaving or other craft-work. On the other hand, if globalization is spearheaded by the growth of labour-intensive manufactures, then entrepreneurs bent on maximizing profits engage low-skilled, low-wage women's labour. This leads not only to the feminization but in the presence of grinding poverty, the juvenization of labourer. In this situation, where education and cultural practices allow them to join the stream of migrants, migration overseas can provide a way of escape and a path to higher incomes for women.

4. Towards financial liberalization in India : the illusion of security through securitization

In India, up to 1991, the banking system was closely regulated by the Reserve Bank of India (the central bank) and the Ministry of Finance, and the money and capital markets were segregated. Banks were not allowed to hold shares of private firms as part of their statutory holding of liquid assets against their liabilities. The Reserve Bank of India laid down two aggregate constraints on the operations of commercial banks. The first was the cash minimum ratio of cash to liabilities, (CRR), and the second was a legally stipulated minimum ratio of the value of approved securities

to the total liabilities of banks - the second liquidity ratio (SLR). There was also a distinction between the so-called term-lending institutions such as the Industrial Finance Corporation of India (IFCI), the Industrial Development Bank of India (IDBI) and the Industrial Credit and Investment Corporation of India (ICICI) and the commercial banks, who were supposed to extend mainly short-term credit. The rates of interest paid by banks on various classes of deposit and the rates of interest charged by them on different categories of loans were also specified. There was also a regulation that at least 40 per cent of the credit extended by the commercial banks would be given to the so-called priority sectors such as agriculture, small scale industry, transport operators and so on, at rates of interest which were lower than those charged to other borrowers.

Issues of new capital through the stock market were also regulated by an official Controller of Capital Issues. Banks could act as underwriters of capital issues but would not hold equities as major assets : in any case that would tend to infringe the requirement of keeping a minimum SLR as officially stipulated. Foreign investors were not usually allowed to hold more than a small percentage of equity of an Indian company.

In moves to deregulate the Indian economy most of the regulations, controls and devices of segregation between the money and capital markets, and between Indian and foreign investors were eased if not removed altogether. Banks were allowed to set their deposit rates and their lending rates within certain limits, the requirement of setting aside 40 per cent of the credit for priority sectors was eased, and because of the perception that reducing the fiscal deficit of the government would lead to lower borrowing requirements of the public sector, by 1997 the SLR was brought down from 38 to 25 per cent (RBI, 1997). The CRR was also

brought down to 10 per cent in a move to increase the liquidity of the banks in a regime of generally high interest rates. From May 1992, foreign institutional investors were allowed to participate directly in the Indian stock market. Already in 1987, public sector banks (which means the major part of the banking sector since all major banks had been nationalized) had been allowed to set up mutual funds for subscribing to bonds and equities. Non-banking companies were allowed to mobilise funds through deposits and other schemes, and other non-banking financial companies (NBFCs) were permitted to operate in the capital and money markets. Banks and NBFCs were allowed to raise money through certificates of deposit in India and abroad (by means of the so-called global deposit receipts or GDRs). Under the neoliberal regime, money market mutual funds, - not necessarily linked to banks, - were allowed to be set up in the private sector as well. In order to allow companies to tap new sources of funds and potential investors everywhere access to profit-making opportunities, many new stock exchanges were set up, covering all major cities and regions.

4.1 The logic of financial liberalization

The rationale behind all these moves was partly allocation-oriented and partly oriented towards promotion of entrepreneurship and thrift. It was supposed that higher rates of interest on deposits with banks and other financial intermediaries would encourage people to save more. At the same time freedom to set rates of interest on the parts of banks and NBFCs would encourage competition and better allocation of the savings mobilized as between the capital and money market agents. The unification of capital and money markets was also aimed at on the same grounds of better allocation of resources and faster growth. Finally, the government of India had already

been offering attractive rates of interest to foreign and non-resident Indian depositors on foreign currency deposits. Their privileges were further strengthened, and in a bid to attract both foreign direct and portfolio investment, foreign investors were allowed to enter many sectors of the economy which had earlier on been closed to them, and they were allowed to hold progressively larger shares of equity in such firms. The current BJP-led central government has allowed foreigners to hold 100 per cent equity stake in most sectors of industry and services, including infrastructural facilities. A programme of progressive privatization of major public sector corporations such as the State Bank of India, Indian Oil Corporation, Oil and Natural Gas Corporation, Bharat Heavy Electricals was set in train. From 1992 foreign institutional investors were allowed to buy and sell shares in the market, and their permitted stakes have been hiked progressively over the years. In the USA and Britain, the unification of the money and capital markets already occurred in the 1980s. Large transnational clearing banks, merchant banks, and mutual funds had got used to operating in both money and capital markets on their own behalf and on behalf of their clients. It was supposed by policymakers that these banks and fund managers would find investing in the Indian money and stock markets if they were allowed to have the same freedom of operation in India as they enjoyed abroad. (In fact, the origins of the so-called 'bank scam' of 1991-92 can be traced back to 1987, from when some of the transnational banks abused the new facility extended to them of the right to manage portfolios of stocks and bonds for their assets, and the Reserve Bank of India authorities turned a blind eye to these abuses in order not to offend the potential foreign investors).

4.2 Reaping the harvest of badly regulated financial liberalization in India

When the government of India adopted the step of abolishing official regulation of capital issues by companies, and indicated that further measures liberalizing industrial and financial regulation were in the offing, it started a boom in the stock market, and the share prices of many companies doubled and trebled within a few months. This share market boom collapsed around May 1992. It was revealed soon after that the boom had been fuelled by a small group of bull operators who had been financed mainly by a few foreign banks such as the Citibank, ANZ Grindlays Bank, Bank of America and major public sector banks such as the National Housing Bank and the Bank of Baroda, often in violation of the central bank regulations and prudential norms. A sum of at least Rs.5000 crores (Rs.50 billion) lent by the banks to brokers in the stock market remains unaccounted for even now. It is symptomatic that M.J. Pherwani, the then Chairman of the National Housing Bank, who had been a key player in the extension of the jurisdiction of the stock market (having recently chaired two high-powered committees relating to it, appointed by the Reserve Bank of India : Misra, 1997, p.353) died under suspicious circumstances as soon as the so-called 'bank scam' came into public view. The lesson of this bit of history is that if government regulation breeds corruption, so does the operation of private interests. Only an official watchdog with sufficiently strong penal powers can check the worst abuses committed by unscrupulous dealers and bankers.

After the revelation of the 'bank scam', the Government of India decided to endow the Securities and Exchange Board of India,

which had been established in 1988, with some real powers of monitoring and regulation of stock markets. The history of the operation of the Indian stock market has nevertheless been dotted with brokers often unable to meet their commitments, allegations and proved instances of insider trading, and deliberate manipulation of stock prices by bears and bulls. Stock prices have gone through several incidents of booms and troughs, the biggest boom having occurred between 1993-94 and 1994-95. (Table 6) But since then, with some fluctuations from time to time, the share prices have been on a downgrade, and 1998 has witnessed new troughs reached by the share market.

The value of primary capital issues in the stock market has also followed a zigzag course, as revealed by Table 7. From 1991 to the middle of 1993, India passed through an industrial recession, and then industrial growth picked up from 1993 to 1996, but from 1996 industrial growth rates declined again. Some of the acceleration of industrial growth from 1993 was a reaction to recession and inventory depletion in the earlier two years, but some was caused by the continued tariff protection afforded to major consumer durables and transport industries, such as cars and motor cycles, trucks, and so on; some growth was also caused by the rapid diffusion of information technology users among the affluent sections of the middle class. A larger inflow of foreign funds and a good monsoons sustaining agricultural production both boosted growth during those three years and helped moderate inflation. There was also a higher rate of growth of exports, helped by the devaluation of the Indian rupee and a strong growth in world trade. However, once these factors were exhausted, growth faltered, and from 1997 India entered into a renewed phase of slowdown in industrial growth, which has turned into a recession in 1998. These developments have been exacerbated by the Asian economic crisis

starting in Thailand in July-August 1997, and spreading to South Korea, Indonesia and Malaysia later. The latest major victim of the global slump and turmoil in foreign exchange markets has been Russia which in effect suspended the servicing of its foreign debt in September 1998.

4.3 The international turmoil in stock markets and the irony of external debt burdens

All these developments have had their impact on stock markets across the world and in India. The market for primary security floatation has virtually collapsed in India as Table 7 indicates clearly. The prices of stocks all across the world have been hammered. According to the *Economist*, 5 September 1998, almost US\$ 4 trillion had been wiped off the total value of share prices across the world in the preceding two months - a sum equivalent to the GDP of Japan, the second largest economy of the world. According to estimates published in HDR, 1998 (Table 20), the total value of the external debt of the developing countries in 1995 was US\$1,583 billions.

Table 6 Index numbers of prices of industrial securities, averages of weeks ended Saturday, India, 1990-91 to 1996-97 (Bose : 1981-82 = 100)

**Bombay Stock Exchange
Sensitive index (Senssex)**

	<u>Index numbers</u>	<u>of ordinary share prices</u>
1990-91	500.3	
1991-92	776.2	
1992-93	1142.3	
1993-94	1051.3	
1994-95	1537.3	
1995-96	1189.6	
1996-97	1146.8	3469
1997-98	1061.0	3813
June 1997	1069.1	4001
March 1998	N.A.	3817
13 October 1998	N.A.	2832.03

Sources: Reserve Bank of India : **Reports on Currency Finance** from 1991-92 to 1996-97 (Mumbai); Reserve Bank of India, **Annual Report 1997-98** (Mumbai, 1998); **Business Standard** (Calcutta), 14 October 1998.

Table 7 New capital issues by non-government public limited companies in India 1991-98

	No. of issues	Amount (Rs. billion)
1991-92	514	61.93
1992-93	1040	198.03
1993-94	1133	193.30
1994-95	1678	264.17
1995-96	1677	161.72
1996-97	851	104.57
1997-98	102	31.38

Sources: Reserve Bank of India; **Report on Currency and Finance, 1996-97**, Vol. II (Mumbai, 1997), Statement 127; Reserve Bank of India : **Annual Report 1997-98** (Mumbai, 1998), Appendix Table V.8.

According to the same **Report** (Table 37), the total external debt of Eastern Europe and the CIS was US\$263.861 billion in 1995, of which the debt of the Russian Federation was US\$120.461 billion. According to press reports, the latter figure had gone up to \$150 billion on the eve of the suspension of the debt servicing by Russia in 1998. Assuming a similar rate of growth of external debt for other Eastern European countries, the total external debt of all those countries in 1998 would come to about US\$330 billion; a similar assumption would bring up the debt of the developing countries to 1980 the total external debt of all the developing countries and Eastern Europe (including Russia) would be US\$2410 billion. Thus the loss in global share value alone would have more than compensated for the total value of the external debt of all the major indebted countries. The outstanding external debt of the Latin American countries and of the Asian economies in trouble from 1997 had been one of the chief contributory factors to the Mexican crisis of 1995 and the crisis of the East and Southeastern economies (Bagchi, 1998). Yet the watchdogs of the financial world, such as the IMF and the World Bank and the leaders of and G7 countries did not dare to write off any significant part of the debt of the heavily indebted countries, for in their view, this would have undermined the very integrity of private ownership and hence of the global capitalist order.

5. Managing volatile markets in India

What happened in other major stock markets in the world had its parallel and its impact on the Indian stock market as well. As we mentioned earlier, the industrial slowdown started in 1996-97 the official index of industrial production grew only by 6.4 per cent in that year compared with a growth of 12.5 per cent in 1995-96; in

1997-98, the index grew only by 5.7 per cent (GOI, 1998, Table 1.2). This slowdown squeezed the profitability of many industrial companies whose shares were traded on the stock market, and increased the value of non-performing assets of banks. Moreover, because of the current-account convertibility of the rupee and the increasing penetration of Indian stock markets by foreign financial institutions (FFIs) looking for higher profits, the foreign exchange market, the share market and the market for government securities became much more closely interlinked than ever before (RBI, 1998; pp.76-7):

In response to external shocks arising from the South-East Asian crisis and in recognition of the interlinkages, a series of monetary policy measures were undertaken impinging on liquidity, foreign exchange and money market rates. ... During the first quarter (April-June 1997), excess supply conditions existed in the forex market, and inter-bank call money rates were low. Liquidity was abundant and the Reserve Bank sold government securities to absorb liquidity through open market operations. Outstanding amounts of repos [i.e., government securities deposited with the Reserve Bank by banks and other approved organizations for short periods on condition that they would buy them back - A.B.] were also high. The first two months of the second quarter of the year reflected more or less the same trends. However, there was noticeable depreciation of the rupee in September 1997 ... and also, some sales of foreign currencies by the Reserve Bank. Reflecting the resulting liquidity drain, the average

outstanding repos stood low and the reverse repos outstanding increased sharply, the turnover in the call money market too showed a decline. In the third quarter, the months of November and December again witnessed pressures developing in the exchange markets with the FEDAI [i.e., Foreign Exchange Dealers' Association of India] indicative rates depreciating sharply against the US dollar. Foreign currency sales were marked in these months, the liquidity effects of which were partially offset by reverse repo operations. The turnover in the call money market during these two months was also lower than that in the month of October 1997. In January 1998 the foreign exchange market again came under severe pressure, necessitating the Reserve Bank to undertake strong monetary policy measures leading to a sharp withdrawal of liquidity and increase in interest rates. As a consequence, call rates increased sharply, and in line with the development, the turnover in the money market recorded a further decline. As offsetting measures, foreign currency purchases were undertaken together with reverse repo operations. The impact of monetary management was such that in February orderly conditions were restored in the forex market and liquidity showed an improvement....

I have deliberately given a long quotation from the **Annual Report** of the Reserve Bank of India in order to show the yo-yo movements and the necessity for constant intervention in the forex exchange and money markets that have been caused by the linking

of the domestic money and capital markets with foreign exchange markets and the instability in the currency markets in recent times. The Indian monetary authorities have so far managed to prevent a sudden devaluation of the rupee and extreme degrees of turmoil of the value of the rupee in the foreign currency markets. But they have done so by resorting to a generally high-interest regime, and preventing transfers of capital abroad except through certain permitted channels. But the relative stability in the external value of the rupee against the background of the Asian currency crisis has been associated with a huge depreciation in the Indian stock prices and has required deliberate action to prevent the collapse of India's oldest and largest, government-controlled mutual fund, the Unit Trust of India.

6. Is there a distinction between fully integrated money and stock markets and a casino ?



"The stock market's too risky —
I'd feel safer going to Las Vegas
and putting it on red."

By Courtesy: The Telegraph, 21.10.98

Fervent believers in the unification of the capital and money markets and deregulation of all prices and quantities in the financial markets have been victims of fallacious reasoning with grave implications for the financial stability of the whole world, including, of course, India as well. The reasoning contains a number of fallacies which bunched together, would explain all the troubles the world economy has undergone under the unregulated capitalist dispensation

since 1973, and especially since the onset of financial liberalization in the era of Reagan and Thatcher, and their mimetic successors. The first and fundamental fallacy is a confusion between equality of prices of goods and services, and of rates of all assets as a consistency relation in a state of equilibrium as defined by neoclassical economists and the possibility of achievement of that equality through a regime of unbridled competition. The fallacy is best seen in the operation of markets for liquid assets and was brought out clearly by John Maynard Keynes in Chapter 12, 'The state of long-term expectation', in his classic on the theory of involuntary unemployment in a capitalist economy (Keynes, 1936). In a market for liquid assets, if every person correctly expects the rate of return to be higher than that of some other asset, then nobody will hold the second asset, and prices of assets will fluctuate violently. If, on the other hand, the relative prices of different assets happen to be such that everybody is indifferent as to the holding of any two assets, then the allocation becomes absolutely fixed or indeterminate, and the competitive mechanism ceases to operate as a signalling mechanism for changing the portfolio mix.

Thus determinate allocation of assets requires that different persons should hold different beliefs about the way the rates of return on different assets will change. This is the mechanism by which, for example, at any moment the margins between bonds and equities, or expected rates of return of those two classes of assets, or between equities of different companies are determined. This difference in expectation of different investors, and their hopes of making a profit out of utilizing their knowledge of what they believe to be the correct state of nature is what drives the speculative motive, as Richard Kahn brought out in a classic article a longtime back (Kahn, 1954/1972).

However, states of nature in asset markets are not simply the world of objects, physical assets and their true productive powers. The theorists who want to reduce all uncertainty to an actuarial expectation commit two related fallacies even in conceptualizing how

such 'objective facts' are translated into expected values. First, they assume that individuals make correct calculations of the actuarial values, given the probability distribution of the relevant states of nature. But people in fact make systematic mistakes in this regard (Tversky and Kahneman, 1974). Secondly, the neoclassical finance theorists assume that if people know something to be against their self-interest, they will avoid it. However, faced with known risks, for example, of accident in their place of work such as the threat of nuclear radiation, many workers have been found to display what has been called 'cognition dissonance' and fail to take well-tried precautions (Akerlof and Dickens, 1982). Many investors behave very similarly when faced with the prospect of loss in the securities market.

Apart from these faulty judgments about the state of nature, the market for securities has the peculiar characteristic that people's beliefs and judgments enter vitally into the determination of returns. An investor may believe correctly, let us say, that a company set up to exploit the Himalayan snow for irrigating the desert in the northwest of the Indian subcontinent will be very profitable after the next two years. But if all the other investors and the bankers of the company hold opposite beliefs, then the lone investor with confidence in its future will come a cropper if he does not sell out his shares while the going is good, because the company will go bust owing to the lack of confidence of other investors. The lone investor will not be able to use his correct belief for the benefit of himself or the community unless he happens to be in the multi-billionaire class, or he can get other backers who share his own beliefs. (Of course, if he is a multi-billionaire he may persuade other people to his point of view even if he happens to be wrong!).

Another fallacy propagated by adherents of the neoclassical theory of the firm and the valuation and control of the firm through the agency of the stock market is that the latter throws up the 'true value' of the firm through competition between investors. If the

managers of the firm use the assets of the firm inefficiently and do not reward the equity-holders in accordance with the true returns obtainable from those assets, then the firm would be taken over by competitive bidders. By operating in this way the stock market will also bring about the optimal behaviour of the agents (namely, the managers) and minimize their tendency to neglect the interests of the principals, that is, the owners or shareholders of the firm (Manne, 1965; Jensen and Meckling, 1976). However, this theory falls foul of the fact, which was pointed out a long time back by Keynes, that if there are some investors who hope to gain simply by bidding for and holding the shares of the taken-over firm for a short time, and then selling them, the market will not reveal the 'true value' of the firm. All that will happen when a market for corporate control develops is that the managers will be more interested in defending themselves, or benefiting from, the activities of raiders than in looking after the long-term growth of the productivity of the firm. Moreover, relations between sellers and buyers, lenders and borrowers, or principals and agents are necessarily fraught with the asymmetric distribution of information between the players on the two sides of the bargain. Security markets suffer as much from such problems of asymmetric and incomplete information as the market for credit (Gertler, 1988).

Once these basic peculiarities of the market for securities are grasped, it becomes easy to understand why financial markets should be subject to herd behaviour of investors, speculative attacks by bulls and bears, contagion effects of rumours, and sudden panics caused, let us say, by investigations into the sexual behaviour of an American President. Thus security markets can be expected to be volatile. The more the behaviour of firms is constrained by the way speculators and raiders, or even ordinary investors behaving like a herd operate, the more the course of real investment simulates the operation of a casino, as Keynes pointed out more than six decades back. To call a financially liberalized world, 'casino capitalism' (Strange, 1989) sounds then tautologous for capitalism itself becomes a giant casino.

Given the above proclivities of securitized markets, the 'spreading of risks' and its minimization viewed from the vantage point of an individual profit-seeker becomes transformed into the spread of risks and uncertainty throughout the system : the invisible hand bringing about order changes into a hand wreaking mayhem and disorder.

The disorderliness of the stock market does not, of course, remain confined to itself but has its impact on the real economy, especially if the securitized firms are major foci of investment. Fall in asset values of firms through a contraction in share prices makes them less attractive as loci of investment, and the credit channels of firms become constricted. The contraction in real investment leads to a fall in income and rise in unemployment; the fall in the prices of assets and debts leads to a contraction in the borrowing capacity of bankers and lending capacity of financial institutions (Fisher, 1933; Bernanke, 1983; Bagchi 1996) and acts as a depressor of the system and adversely affects expectations of an upturn in business confidence.

Advocates of financial liberalization tend to believe that linking up local asset markets with foreign stock markets through the opening up of the local capital and money markets to foreign operators and the reciprocal permission granted to domestic investors to operate in foreign financial markets (including currency markets) allows the further spreading of risks and accrual of gains to everybody through competition and arbitrage leading to equalization of rates of return, adjusted for the risk of changes in exchange rates. New opportunities of arbitrage attracted many European and American pension funds and other financial institutions to Asian stock and currency markets, and the Indian stock markets as well. Exploitation of these opportunities by foreign investors has failed to bridge the enormous differences in interest rates or real rates of return as between, say, London, New York, Tokyo and Frankfurt, on the one hand, and Jakarta, Karachi, Mumbai and Lagos on the other. If interest rates corrected for exchange risk fail to be equalized internationally, there

is even less evidence of any tendency towards convergence of per capita incomes as between developed and less developed countries (UNCTAD, 1997). Putting everything into the casino of an internationally unified stockmarket can only create instability without bringing about equality of asset returns, let alone per capita incomes. Even in periods of relative financial stability, the process of convergence of rates of return or incomes per capita among the regions of the most financially and economically developed countries has been found to be much stronger than internationally. One reason for this is that within a single country, say, the USA or Canada, the state can, through fiscal redistribution, try and equalize infrastructural facilities and income support measures between different regions (Atkeson and Bayoumi, 1993; Bayoumi and Masson, 1994; Bayoumi and Klein, 1995; Obstfeld and Rogoff, 1996, Box 5.2). But such redistributive measures are conspicuous by their absence in the international arena.

The availability of fiscal measures by governments nationally but lack of such measures internationally stands as a strong reason against the full integration of national and international financial markets. Furthermore, a national government, can try and redistribute debts and credits (in a bid, for example, to restore the financial health of banks with large proportions of non-performing assets) by discriminating between different categories of domestic borrowers and creditors. However, under current international law, and the increasingly forceful use of the provisions of the World Trade Organization, it cannot discriminate between domestic and foreign operators in the economy. Moreover, under the convention of clubbing, virtually all debts owed to foreigners is treated as the sovereign debt owed by the government of the country, external debt has a higher priority for settlement than domestic debt. Even if this convention had not acquired the status of a legal norm, governments which have permitted the accumulation of external debt through the operation of a liberalized financial market have felt compelled to

honour even those debts which did not carry a public guarantee : the cases of Chile and the Philippines in the 1980s are two outstanding examples of inclusion of all external debts under the umbrella of the sovereign debt.

7. The recent Indian experience with equity markets and the desperate attempt of the liberalizers to introduce capital account convertibility

After six years of experience with the liberalized regime, the Reserve Bank of India, on 28 February 1997 appointed a committee 'with a view to examining the various issues relating to capital account convertibility' (CAC, 1997, Annexure I). The committee consisted of three bankers, and two economists, who were both known supporters of the policy of liberalization : thus there was very little scope for the committee to seriously examine the arguments for keeping controls on capital account convertibility (CAC). The report of the committee was submitted within a remarkably short period, on 30 May 1997 (that is, within a period of three months). The committee's examination of the experience of developing countries with capital account convertibility was extraordinarily superficial. It was confined to the period of the 1990s and skated over many episodes in Latin America and elsewhere in which such countries as Argentina, Brazil and Chile had introduced CAC already in the 1970s and had then had to suspend it because of unsustainable balance of payments deficits, capital flight and so on. The report contained no analysis of such experiences. It even failed to draw the right lessons from the mediocre growth record of such countries as the Philippines and Mexico which had introduced CAC. The committee laid down certain preconditions for the introduction of CAC in India, but failed to prioritize them properly. It concluded for example, that 'strengthening of the financial system' and not 'a strong balance of payments position' is the most important precondition for CAC (CAC,

1997, p.130). An examination of the East and Southeast countries revealed, however, that only regions or countries such as Taiwan, Hong Kong and the People's Republic of China which have been able to maintain a strong balance of payments position have so far escaped the need to appeal to the IMF to ease them out of their difficulties. Moreover, Taiwan, China and indirectly Hong Kong also have maintained various controls over inflows and outflows of capital from their respective territories (Bagchi, 1998).

Despite some recognition on the part of the Committee that the preconditions for attainment of CAC had not been fulfilled in India, it recommended that 'the implementation of the CAC be spread over 'a three-year period 1997-98, 1998-99 and 1999-2000' (CAC, 1997, p.131), while these preconditions are attained. This reasoning is fallacious on several counts of which only two will be mentioned. First, India's record in bringing down the balance of payments and fiscal deficits during the liberalization period has been extremely mixed so far. The policy stance of the government is to minimize the taxes on the rich while enriching them further and hence there is little prospect of achieving a fiscal or macroeconomic balance through its policies. Given the state of the world economy since 1997 there is little prospect also of a turnaround in the export performance and hence of attaining a balance of payments surplus for India. Secondly, suppose India manages to attain better indices of performance in its balance of payments, in its budgetary balances, its rate of inflation (which has gone up again) and in its growth rate. With CAC, all the indices can tumble down when an international financial panic occurs, or when, for some reason, the international financial community regards India's prospects with a jaundiced eye.

We have earlier noticed the gymnastics the Reserve Bank of India has had to perform in order to keep order in the markets for foreign exchange, government securities and credit, in the wake of the Asian currency crisis. Many of the same neo-liberals who had been baying for CAC are now patting themselves on the back for keeping

control on capital movements and hence avoiding the kind of predicament Thailand, Indonesia or South Korea got into. However, some of them have not given up. The chairman of the committee on CAC, for example, recently chided Indian policy analysts for giving up the idea of making the Indian rupee convertible in the near future (Tarapore, 1998).

We will end this section by examining the idea, in the Indian context, that securitization and unification of financial markets can deliver greater security for investors. The largest and oldest Indian mutual fund is the Unit Trust of India (UTI) whose total investments grew from Rs.213.75 billion on 30 June 1992 (that is, one year after the onset of economic reforms) to Rs.487.24 billion on 30 June 1997 (RBI, 1993a, p.318; RBI, 1997a, p.131). With the lifting of ceilings on new capital issues by firms and on interest rates paid to depositors or charged to creditors, the UTI invested increasingly in equities rather than fixed-interest debentures. The share of equities in its total investment rose from 27.8 per cent on 30 June 1992 to 48.9 per cent in 30 June 1997. As we have seen, however, share values went on a downward slide again from 1997, and this made it increasingly difficult to keep up the redemption value of its leading scheme for small investors, viz., US-64 and fears were expressed about the ability of UTI to continue redeeming them except at much-depreciated prices. In the US-64 scheme itself the share of equities had increased from 65.7 per cent on 30 June 1998 to 68 per cent on 30 June 1998 (BS, 1998). Between June and September 1998, the values of the shares of India's leading companies such as Reliance, TELCO, ITC, L&T, and so on declined by very large percentages - in some cases by over 60 per cent. When the news of UTI's portfolio was publicised in the papers, share prices went into a tailspin, partly because of general panic, and partly because a foreign institutional investor offloaded shares on a large scale (BS, 1998a). In fact, it is suspected that bear runs on the Indian stock market have been increasingly led by foreign institutional investors.

Ultimately, the rush for redemption of US-64 paper and the general slide in stock prices had to be contained by pledging the support of the government and the public sector banks (which dominate the money market) behind the UTI (Telegraph, 1998). Thus ironically enough, the damage caused by thoughtless securitization and linking up with foreign financial agencies could be contained only through state action, and not through the wizardry of alchemists of finance. How long and to what extent, an enfeebled state in a liberalized regime can continue to act as a fire-fighter remains a moot question in India as elsewhere.

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