Global Finance and Integration of Developing Economies with Special Reference to India

Date: February 9-11, 2005

Summary Report

IDSK organized an international conference on *Global Finance and Integration with Developing Economies with special reference to India* during February 9-11, 2005. Eminent economists in the area of financial and economic policy participating in the conference included:

- Gary Dymski (Director, University of California Centre Sacramento)
- Ajit Singh (University of Cambridge, U.K.)
- John McGuire (South Asia Research Centre, Curtin University of Technology, Australia)
- Marc Flandreau (Professor d'economie, Institut d'etudes politiques de Paris, France)
- Virginie Coudert (Banque de France)
- Giuseppe Tattara (University of Venice, Italy)
- Porus Olpadwala (Cornell University, USA)
- Sunanda Sen (University of Jamia Milia Islamia, New Delhi)
- Prabhat Patnaik (JNU)
- C. P. Chandrasekhar (JNU)
- Jayati Ghosh (JNU)
- Romar Correa (University of Mumbai)
- S. L. Shetty (EPW Research Foundation)
- Parthapratim Pal (Economic Research Foundation, New Delhi)
- Pranab Das (Centre for Studies in Social Sciences, Calcutta)

Pinaki Chakraborti, Sankalpa Bhattacharjee and Indrani Chakraborty of IDSK also presented papers at the conference. There were intensive interactions among the participants, who also included representatives of trade unions active in the Indian finance sector. The following summary sketches some of the main issues brought out by the various presentations.

Gary Dymski

Gary Dymski's paper, The Globalization of Financial Exploitation sets out a micro approach to financial globalization, emphasizing market access and financial inclusion/exclusion. It argues that financial exploitation affects many lower-income households and lower-income areas and is being transformed but not eliminated by financial globalization. The paper also focuses on the implications for financial exploitation of the increasing occurrence of low-wage migratory labour. The paper notes that the extent of financial exploitation depends not only on market dynamics but also on domestic regulations of banking markets and on domestic social movements.

Ajit Singh

In his paper, Shareholder Wealth Maximisation, Stock Market and Technology: Should the US Corporate Model be the Universal Standard, written jointly with Jack Glen, Alaka Singh, Bruce Weisse and Ann Zammit, Ajit Singh critically examines the finding of Michael Porter, leading a group of economists and published in 1992 that the US stock market-based corporate model was misallocating resources and jeopardizing US competitiveness. Two main conclusions of Singh's analysis are: (a) there is no warrant for revising the conclusions of the Porter group and (b) even US corporations let alone developing country ones would be better off if they did not seek to maximize stock market valuation of their firms.

Marc Flandreau and Clemens Jobst

In their paper, The Ties that Divide: A Network Analysis of the International Monetary System, 1890-1910, Marc Flandreau and Clemens Jobst used network analysis technique, to identify countries belonging to the core and periphery respectively. They conclude that the international monetary system of the late 19th century is best described as three-tier system. Other findings include the existence of a closely knitted European financial system, and the complete lack of foreign exchange linkages within Latin America.

John McGuire

In his paper, The Imperial Impact on the Globalisation of Indian Finance Prior to World War I: The Role of the British Colonial Exchange Banks, John McGuire examines the role of the British colonial exchange banks in shaping the process of globalisation of Indian finance between the middle of the nineteenth century and the outbreak of World War I. The paper shows how 1850-73, 1874-93 and 1894-1914 represent three stages of development, the first and the third of which reflect a significant expansion in India's economy and the second of which reflects a stagnating economy.

Giuseppe Tattara

In his paper, Emerging Hubs in Central-Eastern Europe, Trade Blocs and Financial Co-operation, Giuseppe Tattara focuses on the issue of liberalisation of trade and financial capital in Central-Eastern Europe and its consequences for the sub-contracting activity. The intensification of trade, since the collapse of Soviet-style central planning, between East Europeans and the European Union, has been accompanied by a significant growth in outward processing trade (OPT). The OPT transactions are largely concentrated in sectors generally characterized as labour-intensive. The paper notes that the low-labour cost in East Europe which has stimulated OPT could be maintained only over the short and medium term, but over the longer-run the lower wages increased upward to West European levels. This resulted in a shift of OPT operations to some other countries of the former Soviet Union.

Virginie Coudert

In her paper, European Experience in Monetary and Financial Integration: Are There Some Similarities with the Asian Situation, Virginie Coudert compares the European experience of monetary integration with that in the Asian region. According to her, the currently high level of monetary integration in Europe was obtained after two decades of pegging exchange rates within the framework of the European Monetary System from 1979 to 1999. This implied strong constraints on the monetary policy of member states. As for other regions of the world, the benefits of fixing exchange rates are to be compared with their costs and in regions outside Europe they may outweigh the benefits. The paper addresses the issue of a "dollar zone", as a substitute for stabilizing the parities within Asia.

Porus Olpadwala

In his paper, Making Trades, Producing Goods and Managing Business: Finance and Production in the United States, 1928-2001, written jointly with Yuri Mansury, Porus Olpadwala examines the empirical relationship between the finance and real sectors of the US economy between 1928 and 2001 and finds that trading in stocks, bonds, and futures and options registered a significant upward shift starting in the early 1970s. The analysis reveals statistical breakpoints in the trading of stocks in 1973, 1987, and 1995; of bonds in 1981; and of futures and options in 1976 and 1996, all relative to GDP. The structural shifts suggest that at those times the U.S. financial sector grew faster relative to the production economy.

Prabhat Patnaik

In his paper, The Illusionism of Finance, Prabhat Patnaik argues that the fetishism of commodities is carried much further now than in Marx's time: even the world of commodities, and hence ipso facto the underlying world of social relationships, is obscured by the world of finance whose basic role was supposed merely to mediate the exchange between commodities. The paper illustrates the illusionism of finance with specific examples from the Indian economic policies pursued in the recent years.

Sunanda Sen

Sunanda Sen, in her paper China in the Bull Shop: Dealing with Finance after WTO, discusses the issue of the extent to which China can tame the financial sector, especially after its accession to the WTO. The fast rate of economic growth is an instance of a state-led industrialization that seeks to build up strong domestic markets as well as conquer external markets. A large part of the FDI inflows in China is related to the success of China in having a "guided financial market". The success achieved so far, in taming the financial flows and gearing these in the direction of the real economy, indicates the exemplary ability of the state to keep in control the speculative advances in the era of financial globalization. The process, however, may have to face formidable hurdles if China has to fulfil its obligations as a WTO member

C.P. Chandrasekhar

According to the analysis in C.P. Chandrasekhar's paper, Credit Risk and Bank Fragility in the New Financial Environment, in the era of globalization, a typical bank's principal activities have been transformed: its sources of income are different, its role as a financial intermediary has acquired new dimensions, and the regulatory framework within which it functions has also substantially changed. The paper examines the implications of that process of transformation both for the development options open to developing countries such as India as well as for the health of their banking systems and overall financial structures.

Jayati Ghosh

In Central Bank 'Autonomy' in the Age of Finance: the Implications for Developing Countries, Jayati Ghosh critically analyses the rationale of providing legal status to central bank independence or creating much more instrumental autonomy for the central bank, so as to make a focus on price stability rather than increasing employment as the basic aim of central bank policy. The paper further analyses the role of the central bank in the changing scenario with the liberalization of capital inflows in the developing countries during the decade of the nineties.

Amelia Correa and Romar Correa

The paper by Amelia Correa and Romar Correa, Venture Capital and Microfinance: An Instrumental Approach basically addresses the debates of the previous century concerning the relative merits of capital-goods-led growth and consumer-goods-led growth. In this exercise, Correa and Correa have included some standard inter-temporal considerations in incorporating financial contracts in a growth model. They have also incorporated the role of venture capital in this model. The case is made for the encouragement and patronage of venture capital from home or abroad in the production and financing of basics.

S. L. Shetty

In his paper, Credit Flows to the Vulnerable Sections, Sectors and Regions of the Indian Economy: A Review, S. L. Shetty provides a thorough evaluation of banking performance in the pre- and post-reform periods in India in the light of the role played by finance and credit in promoting economic development. The study emphasises the importance of promoting financial intermediation by spreading branch networks, mobilizing savings and bringing about better regional, sectoral and functional reach of institutional credit in India. One principal conclusion of the paper was that institutional credit played a crucial role in the acceleration of industrial and agricultural growth in India in the eighties.

Parthapratim Pal

In his study, Stock Market Development and its Impact on the Financing Pattern of the Indian Corporate Sector, Parthapratim Pal finds broad support for the so-called 'Singh paradox' that during the early 1990s, as in many other developing countries, the stock market has been a major source of finance for corporate growth in India: this refutes the common assumption that stock markets are more potent in developed countries. The study, however, finds that since 1994 the relative importance of equity and debt finance changed considerably in favour of the latter.

Pranab Kumar Das

The paper by Pranab Kumar Das, Fundamentals, Financial Factors and Firm investment in India: a Panel VAR Approach, analyses the role of fundamentals and financial factors in determining firm investment in India with imperfect capital market in the panel VAR framework. It appears that the effect of marginal profitability of capital shock on investment is slightly larger for smaller firms but it adjusts more quickly than for the larger firms. On the other hand, the role of cash flow as a fundamental variable is greater for the larger than for the smaller firms

Pinaki Chakraborti and Sankalpa Bhattacharjee

In their paper, Some Financial Implications of Innovating Oligopoly, Pinaki Chakraborti and Sankalpa Bhattacharjee seek to uncover the financial implications of technological progress in oligopolistic markets. Starting with borrowing-based innovative activities of a representative firm in an industry, the paper argues that the process will have a tendency for over-borrowing, and will be constrained by the limits imposed by the growth of the market. It is stated that for escaping utilization-shortage, more and more innovations will be necessary, leading to unsustainable spiralling of debt.

Indrani Chakraborty

In her paper, Liberalization of Capital Inflows and the Real Exchange Rate in India: A VAR Analysis, Indrani Chakraborty analyses the dynamic impact of liberalization of capital inflows on the real exchange rate in India following the liberalization of the external sector since July 1991. Using the vector auto-regression (VAR) method, the study observes that (a) as in the East Asian and Latin American countries, the real exchange rate appreciates as capital inflows increase, (b) the dynamic impact of random disturbances generated by capital inflows on the real exchange rate is persistent and (c) the dynamic response of the real exchange rate to capital inflows shock has largely been influenced by monetary policy and not by fiscal policy.