



Isher Judge Ahluwalia and
I.M.D. Little (editors)

India's Economic Reforms and Development

Essays for Manmohan Singh
Oxford University Press, Oxford, 1998,
viii + 412 pp., £19.99 (cloth).

WHEN ASKED to name economic reformers in South Asia, most economists would put Manmohan Singh at the head of the list. The late Harry G. Johnson used to say half-seriously that economists have their best ideas by the time they are 35 years old but are only in a position to implement them when they are over 50. By that time, unfortunately, their ideas are 15 years out of date! Manmohan Singh does not fit this pattern. It is true that his ideas on the relation between foreign trade and India's development were formed when he was studying at Cambridge University in the early 1960s. He then became part of the Indian policy-bureaucratic establishment, holding a number of senior government posts, including Deputy Chairman of the Planning Commission and Governor of the Reserve Bank of India. In 1991, he was appointed Minister of Finance, when India was in the midst of a very serious economic crisis. The time was opportune and Manmohan Singh put in place a series of measures designed—and destined—to change the Indian economy in a fundamental way. His ideas on the importance of macroeconomic stabilization and opening up the trade and payment system were hardly outdated; indeed, they were completely consistent with the economic thinking and philosophy sweeping the world at the time.

In putting together this volume to honor Manmohan Singh, the editors have created required reading for those with more than passing interest in the Indian economy. The topics covered in the volume deal with virtually all of the important economic policy issues in India—development strategy, transition to an open economy, poverty, and fiscal federalism. The editors were also able to attract the very best of Indian economists to write on these issues, including a number who have settled abroad and attained worldwide fame. The result is a first-rate volume that will be of value for the economics profession at large.

The volume contains an excellent introductory chapter, followed by 15 papers covering 4 major themes. The first three papers—by Jagdish Bhagwati, Meghnad Desai, and Amartya Sen, respectively—reexamine the development model India adopted in the 1950s and then show how the reforms associated with Manmohan Singh fundamentally altered India's development strategy. Desai argues that the early strategy—with its emphasis on self-sufficiency in capital goods production and neglect of agriculture and exports—was flawed to begin with. Bhagwati disagrees with Desai's thesis, claiming that the strategy only started to fail in

the 1960s, when India continued to rely on import substitution and did not follow the East Asian export-oriented growth model. But export orientation was not part of the basic development model India had chosen, so a shift to the East Asian model, as suggested by Bhagwati, would have been inconsistent and unlikely. It was only when Manmohan Singh came on the scene that Indian policy and attitudes toward exports and export promotion changed. Sen, for example, outlines in considerable detail the thinking of Manmohan Singh, as contained in Singh's 1964 book on trade and development in India, *India's Export Trends and the Prospects for Self Contained Growth*. He points out that many of the now-standard arguments for export-led growth are in the book, although very carefully and cautiously worded, reflecting, no doubt, Indian politics and Cambridge University economics at that time.

Expanding further on the export theme, T.N. Srinivasan demonstrates that openness has positive effects on both the level and growth of output. This theoretical result runs counter to the neoclassical growth-theory proposition that foreign trade has only level effects in the steady state. He backs up his theoretical hypothesis by referring to the large number of empirical studies that have shown the positive effects of openness on the growth rate. While Indian exports have risen significantly as a consequence of the Manmohan Singh reforms, Srinivasan believes they remain hampered by the lack of infrastructure, particularly port facilities, and the bureaucratic red tape that has inhibited foreign investors from moving into the export sector. This is where the next set of reforms should be instituted.

From the standpoint of theory and experience, macroeconomic stabilization is a necessary condition for structural reforms to succeed in permanently raising the growth rate. Manmohan Singh recognized this, and the first thing he did upon coming into office was put in place a macroeconomic adjustment program with IMF support. This program combined monetary, fiscal, and exchange rate policies to reduce the gaping internal and external imbalances that had emerged in India. Unfortunately, the volume does not contain a paper analyzing the Indian macroeconomic stabilization experience during Manmohan Singh's stewardship. The entire volume makes no mention of the critical role the IMF played in assisting India at the time of the crisis. Why this is so is a matter of conjecture. Perhaps macroeconomic policy issues associated with the IMF do not appeal to Indian academic economists and are left largely in the hands of bureaucrats, who, in turn, tend not to write about them. The two macro-oriented papers in the volume—by C. Rangarajan and Vijay Joshi—have somewhat narrow perspectives, in that they look only at specific policies. Rangarajan, for example, concludes that while monetary policy was on the right track, more could have been done to reduce inflation. But monetary policy in India, as in many developing countries, plays second fiddle to fiscal policy. Here, as Joshi shows, there was limited success. Fiscal deficits

continued to be large, forcing monetary policy to bear the burden of controlling inflation, at some cost to growth.

While the export promotion strategy was broadly successful, with the growth of exports and output rising well above previous trends, the Indian reforms did not go deep enough and particularly did not reach the sectoral level. As Isher Ahluwalia points out in her paper, investment in infrastructure did not expand sufficiently; the lack of investment became a growth bottleneck. The public sector continued to dominate infrastructure development, and, with the exception of the power sector, the private sector was not allowed to participate. Similarly, Ashok Gulati details the limited opening up of the agricultural sector to foreign trade. Ajit Singh notes that financial liberalization has been only partial but, even so, this has allowed Indian corporations to raise substantial amounts of equity finance both at home and abroad. Capital controls are, however, still in place in India, and there is considerable debate on whether and when further relaxation will occur.

In any discussion of India, the issue of poverty has to be addressed. The papers by Deepak Lal, Kirit Parikh, and Suresh Tendulkar look at the relationship between reform policies aimed at raising the growth rate and their effects on poverty. Deepak Lal makes the standard neoclassical, market-oriented point that there is no conflict between growth and poverty alleviation. He claims that if India reached the (pre-crisis) growth rates of East Asia, poverty would be

eliminated in a generation. Parikh agrees with this view but goes on to argue that this growth has to be labor intensive to absorb the increase in labor supply and that the skills of the labor force need to be broadened. Tendulkar makes the valid point that the transitional effects of a reform program may have a negative effect on the poor, but this really is an argument for providing temporary and targeted relief rather than for postponing or abandoning reforms.

The last three papers—by Amaresh Bagchi, Raja J. Chelliah, and V.A. Pai Panandiker—deal with center-state relations. Basically, the picture has not changed significantly as a result of the reforms. The center dominates economic policies and activities, rendering the states dependent on the center. In a sense, all three papers are forward looking, since they outline the reforms that are needed to better allocate taxation and expenditure functions between the center and the states. But, of course, the transfer of power to the states carries some risk. It is possible that the reform process would suffer, as the states tend to have a more parochial view of the advantages and disadvantages of economic reforms.

All in all, this volume is worthwhile reading and will have a long shelf life as a reference book on India and on economic development in general. With its long list of unfinished business, it will also serve as a helpful guide to the next Indian economic reformer, as well as to reformers in the rest of South Asia.

Mohsin S. Khan

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Daniel Yergin and
Joseph Stanislaw

The Commanding Heights

The Battle Between Government and the Marketplace That Is Remaking the Modern World
Simon & Schuster, New York, 1998, 464 pp., \$26.00 (cloth).

CAPITALISM ruled the world at the end of the nineteenth century, and capitalism—rechristened as market economics—rules in the vast majority of countries as our century draws to a close. Between these end points, far-reaching experiments with different types of economic systems have had profound effects on the countries they have touched. In this excellent, very readable book, Daniel Yergin and Joseph Stanislaw explore this evolution by looking at the role of government in different economic systems or, as they put it, exploring where and why the frontier between state and market was drawn. Their book entertainingly chronicles the massive intellectual and political battles that determined the rise of central planning and its downfall, the appeal of the welfare state in Western Europe and its transformation under the influence of Thatcherite policies, and that peculiar form of capitalism found in the United States—“free markets” tempered by more or less heavy doses of government regulation. The book also devotes considerable space to analyzing the shifting economic and political approaches that influenced the role assigned to government in the developing countries in the postwar period.

Why was the state permitted to intrude into so many corners of economic life during the first three quarters of the twentieth century? Yergin and Stanislaw show that the answer is complex and differs from country to country. At one extreme, the communist system of central planning was driven by a brutal ideology of equalization under which government would be all knowing. All aspects of economic life would be planned centrally, with the state owning all of the means of production. In many Western industrial countries, the need to protect their populations from the economic dislocations caused by the Great Depression, the socially leveling influence of two world wars, and the need to rebuild their economies in the aftermath, as well as the intellectual influence of economists such as J.M. Keynes, provided a compelling rationale for governments in those countries to move to a “mixed economy” model. Under this model, governments step in to correct market failures without completely stifling the market mechanism.

Some of the most interesting parts of the book concern the rise and fall of the state in economic life in developing countries. The

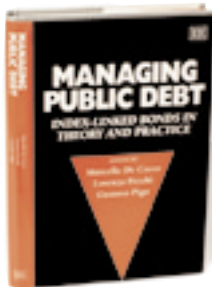
issue for the newly independent governments was how to free themselves from economic dependence on the colonial powers. For many countries, this took the form of a plunge into self-sufficiency, with the state taking a majority stake in key sectors of the economy and/or weaving a dense web of government regulation around the economic system. The chapters dealing with Ghana, India, and countries in Latin America ably discuss the different roads taken in these countries. China’s transformation since the early 1980s is also well covered, as is the rise of the now-tarnished Asian miracle countries.

Why were these systems discarded? Yergin and Stanislaw argue that countries have shed economic systems that were underpinned by heavy government intervention because these systems utterly failed to deliver what they had promised—growth and a better life for their populations. As the authors note, “Instead of market failure, the focus was now on government failure—the inherent difficulties that arise when the state becomes too expansive and too ambitious.”

What comes next? Can we definitively crown market economics, with a minimal role for government, as the ruling economic system? Yergin and Stanislaw wisely hedge their bets, responding that this will depend on how a number of key factors turn out. Just as countries rejected the excesses of government intervention, free market economics will also be rejected unless it delivers the goods in terms of economic growth, employment, and higher living standards. Although the dramatic redefinition of the market and the role of the state has brought with it rising living standards in many countries, it has also brought anxiety about the effect of competition on jobs and incomes. Globalization and technological innovation are proceeding at such a pace that countries must take great care that the inevitable hiccups, in the form of economic crises, do not derail their progress under the current brand of market economics.

The Commanding Heights provides a sweeping vision of where government and the market have come from over the past century. Although the book cannot tell us where government and the market will be heading over the next century, it is a great read and highly recommended.

Claire Liuksila



Marcello De Cecco, Lorenzo Pecchi, and Gustavo Piga (editors)

Managing Public Debt

Index-Linked Bonds in Theory and Practice

Edward Elgar, Cheltenham, United Kingdom, 1997, xviii + 221 pp., \$85.00 (cloth).

PRICE-INDEX-LINKED bonds have had a checkered history since their introduction in 1782 in the U.S. state of Virginia; several countries have introduced the instrument, but not all have persevered with it. Why haven't price-index-linked bonds or real bonds become universally accepted in sovereign debt-management strategies, even though real assets figure prominently on most sovereign countries' balance sheets? Arguments for and against index-linked bonds, and suggestions as to why the private sector and many governments have been reticent to issue these securities, can be found in *Managing Public Debt*.

This book comprises a collection of nine papers presented at an international conference on "Index-Linked Bonds in Theory and Practice," which was held in Rome in October 1995. One group of contributors discusses the theoretical case for price-index-linked bonds, including whether these instruments have any role in macroeconomic hedging in the face of various types of exogenous shocks. These authors are strong advocates of index-linked bonds. Inevitably, given the makeup of the book, many of the arguments are repeated. A second group of papers explores whether price-index-linked bonds have lowered debt-servicing costs in individual countries. While most of the authors in this group conclude that this has been the case, measurement difficulties—particularly with respect to quantifying risk premiums—can be considerable. Conceptually, the challenge is much simpler. An issuer will achieve lower debt-servicing costs through price-index-linked bonds if inflation turns out to be lower than what investors had originally priced into nominal bonds—assuming that these represented the alternative financing mechanism. Putting aside the question of possible differences in tax treatment, investors will be prepared to accept lower real returns on price-index-linked bonds than those expected on nominal bonds when the lower real yield investors are prepared to accept for inflation certainty more than offsets the additional return required to compensate them for the relative illiquidity of these instruments.

This trade-off has encouraged some advocates of price-index-linked bonds to suggest that if a government believes that financial markets are underestimating its resolve to maintain price stability, then issuing these securities will lower its debt-servicing costs. Governments, however, change regularly and tend not to have superior information about the medium- or long-term paths of inflation. It is perhaps not surprising that some of the strongest advocates of these instruments are the more independent central banks—such as the U.S. Federal Reserve, the Bank of England, and the Reserve Bank of New Zealand—that are arguably confident of

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Ravi Kanbur

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The New Global Economy and Developing Countries: Making Openness Work

Dani Rodrik

Rodrik argues that successful integration into the world economy requires a complementary set of policies and institutions at home. Policymakers must reinforce their external strategy of liberalization with an internal strategy that gives the state substantial responsibility in building physical and human capital and mediating social conflicts.

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retaining independence and maintaining price stability or low and stable rates of inflation. These institutions feel that issuing such instruments provides a signal that can further strengthen their credibility in pursuing anti-inflation objectives.

While many sovereign debt managers will find *Managing Public Debt* very useful, it is unfortunate that the book does not deal more comprehensively with the practical issues that confront managers. Issuers of price-index-linked bonds confront considerable challenges in designing and introducing these instruments. Given that index-linked bonds are not

risk-free instruments, how does the interplay of taxation and inflation affect overall investor returns? What is the best way to sell these bonds? Should they be tapped, or should they be auctioned through discriminatory price or uniform price auctions? Is it necessary to use primary dealers? How does one establish critical mass for these instruments, given the reticence of the funds management industry to establish separate asset classes and benchmarks? How can governments best assist secondary trading in these instruments? How can a sovereign-debt-management agency protect itself from a central bank that might wish to see reservation prices exercised in auctions in an attempt to signal information on real interest rates and inflation expectations?

More discussion on these types of practical issues would have enhanced the book's value for sovereign liability managers who, after all, usually manage the largest liability portfolio in each country and carry the government's reputation in financial markets.

Graeme Wheeler



Louis W. Pauly

Who Elected the Bankers?

Surveillance and Control in the World Economy

Cornell University Press, Ithaca, New York, 1997, xiv + 184 pp., \$25.00 (cloth).

UNDER the catchy title *Who Elected the Bankers?* Louis W. Pauly traces the evolution of international monetary arrangements since the 1920s, with emphasis on the development of mechanisms for coping with what he sees as the inevitable tension between the logic of increasingly integrated global markets and the politics of sovereign states. In so doing, he focuses the book on the role of the IMF, which he views as symbolizing today's machinery of economic policy coordination and crisis management. Certainly, its nearly global membership, legal mandate, and significant financial resources place the IMF at the

center of the mechanisms for multilateral oversight of the actions of states that, though politically independent, accept accountability for the external implications of their economic policy decisions. The reader interested in the evolution of the international monetary system in the postwar period will find in Pauly's book a very readable description, and an often insightful interpretation, of events, supported by detailed notes and references.

Pauly argues that the IMF's work was foreshadowed in that of the League of Nations. Indeed, even in the absence of a legal foundation and without any lending capacity of its own, the League was involved in restoring the financial position of several countries in Central Europe in the 1920s through the design and monitoring of stabilization programs that in many ways presaged the IMF's application of conditionality. Pauly's case for the view that the League prefigured more generally the surveillance work of the IMF is less compelling, however. To be sure, a succession of international economic conferences, some sponsored by the League, sought to establish a broad consensus on the appropriate

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principles to guide national policies, and, in Pauly's view, the seeds of multi-lateral economic oversight were sown in the Brussels conference of 1920. But the fact is that—in the divided political world of the interwar years—these seeds did not take root. With the Great Depression in full swing, the London World Economic Conference of 1933 ended in disarray, as governments—led by the United States, which had just abandoned the gold standard—moved in directions contrary to the recommendations of the experts. The most significant cooperative initiative in the remainder of the 1930s—the tripartite agreement of 1936 between the United States, the United Kingdom, and France, to which Belgium, the Netherlands, and Switzerland also adhered—is not even mentioned. Pauly emphasizes, instead, the League's technical analysis, which was conducted by both its secretariat and outside experts. For all its excellence, however, this work can hardly be defined as an exercise in surveillance. The plain fact is that the League did not do surveillance because governments were not ready to undergo it and the League lacked organs where agreement on financial matters could be reached.

Who Elected the Bankers? goes on to describe the negotiations leading to the

creation of the Bretton Woods institutions and the subsequent evolution of the IMF. Pauly traces the origin of IMF surveillance to the consultations with countries that initially availed themselves of the transitory arrangements of Article XIV of the IMF's Articles of Agreement. He explains both how the annual consultation process was extended to all members in the early 1960s and how—following the breakdown of the par value system—the second amendment of the Articles formally enshrined in 1978 the surveillance role of the IMF in the new Article IV. That role has been enhanced further by events of the past two decades, including the increasing acceptance of market principles by developing countries and the demise of central planning, which have increased the scope for consensus among countries on economic policies and aims. The way was thus opened for the current efforts to codify “best practices,” which provide standards against which countries' actions can be assessed.

The book's historical coverage ends with the IMF's response to the Mexican crisis of 1994–95. As lessons are beginning to be drawn from the Asian crisis, another chapter in the annals of surveillance is being drafted, with greater attention being paid to the soundness of

financial systems and capital account issues. The crises of the 1990s have been quite properly defined as capital account crises, which ties in with Pauly's view that international surveillance is needed to reconcile the requirements of freedom of capital movements with those of legitimate governments. Indeed, the IMF's role in the process of capital liberalization is currently the focus of the debate on an amendment to the Articles to extend the IMF's jurisdiction over the capital account.

Pauly may go too far, however, in arguing that the expansion of international capital markets has raised significant legitimacy issues for states. Free capital movements certainly limit governments' freedom of action, but since worldwide prosperity is not a zero-sum game and capital liberalization, with adequate safeguards, is welfare enhancing, the tension between the two imperatives need not be insurmountable. There is certainly much evidence of this tension around the world, in both industrial and developing countries, but there are also examples of governments rising to the challenge. It would be too pessimistic to assume that governments subject to the electoral process cannot take the high road.

Joaquín Ferrán

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