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Reforms and Macroeconomics: Theories and Experiences

The Indian Economy: Rising to Global Challenges

Kaushik Basu

Abstract

The central concern of the paper is with the challenges confronting India's growth trajectory in the context of globalization. After a long stretch of remarkable growth, starting in the early 1990s, the Indian economy ran into choppy waters since the start of the recent global financial crisis. It is possible for the nation to navigate through this and return to rapid, inclusive growth. The paper outlines a series of policy measures that India ought to undertake, ranging from reforming the food distribution system, through more pro-active foreign policy and active engagement with the global economy, to reforms of political institutions to create a more stable governance system.

Economic Reforms for Sustainable Growth

Subir Gokarn

Abstract

The paper identifies four issues – food, human capital, infrastructure and financial sector development – which are critical to sustain the growth process of the Indian economy. With regard to policy strategy for reforms, it is argued that in situations in which heightened risks are unavoidable for some stakeholders, reliable safety nets need to be an integral part of the strategy. The paper also emphasizes an optimal mix of the bottom-up thinking, which draws on local knowledge to design appropriate solutions and a top-down element which addresses common goals and policy principles, increases efficiency in resource mobilization and allocation and facilitates learning across jurisdictions.

A Note on the Solow-Swan Growth Model with a Fixed Wage

Vivek H Dehejia

Abstract

This note considers the effects of a modification of the standard Solow-Swan model by assuming that the level of the real wage is fixed at some exogenously given level (which can be thought of as a Malthusian "subsistence wage"). It is shown that, in steady- state, the per capita output level, the capital-labour ratio, and the population growth rate are determined endogenously as functions of the subsistence wage, and, furthermore, that, if the economy starts out of steady-state, it converges in a stable fashion to the steady-state if Malthusian population dynamic are assumed. As for comparative statics, it is shown that, starting from steady-state, an exogenous increase in the subsistence wage increases the per capita output level and capital-labour ratio and decreases the population growth rate. An exogenous increase in the savings rate has no effect on the per capita output level or capital-labour ratio due to an offsetting increase in the population growth rate. Finally, a Hicks-neutral positive technology shock has ambiguous effects on the per capita output level, decreases the capital-labour ratio, and increases the population growth rate. The important message of the model is that a country can achieve a higher capital-labour ratio and per capita output level by increasing its subsistence wage. For a country such as India, which still has a huge percentage

of its population living at near subsistence conditions in the rural or informal sector, even this simple, stylized model may have some policy relevance that scholars reading this article may wish to consider in future.

Monetary Operating Procedures: Principles and the Indian Process

Ashima Goyal

Abstract

As markets deepen and interest elasticities increase, it is optimal for emerging markets to shift towards an interest rate instrument since continuing monetization of the economy implies money demand shocks are large. In an extension of the classic instrument choice problem to the case of frequent supply shocks, it is shown the variance of output is lower with the interest rate rather than a monetary aggregate as instrument, if the interest elasticity of aggregate demand is negative, and the interest elasticity of money demand is high or low. It is necessary to design an appropriate monetary policy response to supply shocks. An evaluation of India's monetary policy procedures and of the recent fine-tuning of the liquidity adjustment facility finds them to be in tune with these first principles and in the direction of international best practices. But a survey of country experiences and procedures, and some aspects of the Indian context suggest further improvements.

International Trade, Trade Costs and Middlemen: A New Look at Mirror Data

Arne Melchior

Abstract

In international trade, every trade flow is reported twice; as exports at one end and imports at the other. According to the traditional belief, CIF-FOB ratios (CFRs) between the two values reflected transport costs and had a typical value around 1.1, with the import value slightly larger. This paper examines CIF-FOB ratios for the trade of 12 countries and shows that country averages deviate considerably from this expectation, and bilateral CFRs vary even more strongly. The CFRs are often of large magnitude; e.g. for India, the import CFR has a range of variation over time equivalent to 7% of GDP. CFRs are correlated with transport costs but contain other components. We survey possible explanations and in the paper, some evidence is provided for the hypothesis that high CFRs are driven by indirect trade via intermediate countries. This can lead to a high CFR through a "Rotterdam effect" whereby exports to the final destination country is underreported by the exporting country, or due to a price mark-up driven by higher transport costs or profits to middlemen. We provide evidence confirming the existence of both phenomena.

The Reserve Bank of India and Organizational Form

Romar Correa

Abstract

We reflect on the 'Report of the Working Group on Introduction of Financial Holding Company Structure in India' (RBI, May 2011). Our conjecture is that the role of the Central Bank of the country in supporting the monetary process will be attenuated.

Corruption and Trade in General Equilibrium

Sugata Marjit and Biswajit Mandal

Abstract

In this paper we attempt to search for a connection between corruption and pattern of trade, not just its effect on volume of trade. The specific concern is not explored in the existing literature hitherto. Here we construct a standard HOSV model of international trade to prove that greater corruption in labour-abundant countries will restrict volume of world trade by working against factor endowment bias and conversely for the capital-abundant nation. Comparatively corrupt economy will export capital-intensive goods. However, corruption does not necessarily reduce global volume of trade. Relatively capital-abundant country will be worse off with increasing degree of corruption at home and abroad, whereas labour-abundant country may gain from corruption. So, in a sense this paper may shed some light for trade pattern, welfare etc of developing countries like India that are significantly beset with corruption related unproductive transactions.