

AAPOORTI

2012



Arthashastra, The Economics Society of Miranda House

A NOTE FROM THE HOD



The year 2010-11 was significant for the Economics Department because it saw a long cherished dream fulfilled with the publication of *Aapoorti*, a journal put together entirely by the efforts of the students. This year the journal has made a significant leap forward by bringing together the contributions not only from other colleges of Delhi University but also from Orissa, Kolkata, Pakistan and Nepal.

The world economy has been in turmoil in recent times. As students of economics, the writings show a deep concern and understanding of the major concerns of the day- both within the domestic economy and the world. This effort on the part of beginners of the fascinating subject to put together their thoughts on issues that have caught their attention represents the first step towards developing an enquiring mind which would enable them to do rigorous research in the future. The power of a journal of this kind is in bringing together young minds to exchange ideas on issues that are not only relevant from the perspective of affecting the common man on a day-to-day basis but also constitute the frontiers of research in the discipline. In presenting this year's journal, we hope that this effort continues to grow in strength and with each passing year we are able to draw in contributions from diverse sources and make it a major platform for exchange of thoughts among students at the undergraduate level. Our endeavor would be to make the journal an inter-disciplinary one so that we can get an enriched view of the complex issues facing the world today.

The sincere work that has gone into the production of this journal is evident from the presentation. I thank all the students who have worked tirelessly to bring this together, in particular Divya Singh and Arundhita Sud, the chief editors, for such superb co-ordination. I thank Dr. Pratibha Jolly, Principal Miranda House, for encouraging our department to reach greater heights of excellence.

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ACKNOWLEDGEMENT

We are highly indebted to the faculty of the Economics Department, Miranda House for the immense support provided to us in the making of the journal. Our special thanks to Mrs. Malabika Pal, the head of the department for extending financial and motivational support and Mrs. Meeta Kumar who helped us with invaluable information. We are grateful to authors from and outside Miranda House who made this edition of the journal possible. We are thankful to Chakshu Sharma for her indispensable contribution towards the cover page and to Vyoma Jain who was of immense help in getting sponsors. Also we thank the Arthashastra president, Ruchika Sharma and her team.

Most importantly we are highly grateful to our principal Dr. Pratibha Jolly.

To others without whom the journal would not have materialized, we extend our sincere gratitude.

The Editorial team
Aapoorti

FROM THE EDITORS' DESK

Dear Readers,



Working for *Aapoorti* was like solving a jigsaw puzzle: trying to find out the course out of commotion. That economics is not a subject of a single opinion was greatly realized during the making of this journal. Nevertheless the entire process showed us the very essence of the subject which is the ongoing effort to recognize the 'Brownian

motion' of human life.

On one hand we have traditional neo classical views supporting the IS-LM models and the role of the state; on the other hand we have daring economists challenging the mere notion of 'assumptions' in the economic literature. Things begin to change when 'indifference curves' no longer follow the 'More is better' approach; when 'giving' is no longer equivalent of 'receiving'. The article, 'Overvaluing what we own' takes up some of the basic behavioral issues to answer the question. Another stream of thought runs parallel with Marx and has gained place in greater number of hearts in the past year on account of 'We are the 99 per cent' movement across the globe. *Aapoorti* has also tried to be a part of that movement in its own way through two articles on the same. At the time of Globalization 3.0, life is no longer a myriad of distant dreams. It has shown us that dreams crash and many times they bring down stock markets and countries with them. Dubai or the wonder city of past century has gone through downslide against the hopes of many stockholders. An article focuses on the rollercoaster ride of the city. Another wonder currency of the past century- Euro is hanging by a thin thread. The problem keeps the world on a heartbeat and an effort has been made by us to shed some light on the issue. A special article on Environment and Economic growth tries to provide a feasible solution to the growing challenge of climate change. Finally the big question that looms is the state of India. . The journal has a special section called *Indianomics* which deals with the socio economic issues concerning the nation. Keeping in mind the historical and political perspective we have tried to include articles on topics which may not be considered as pure economics so that individuals from other streams could also understand and enjoy it.

Our Guest article by Osama Safeer from Lahore University of Management and Sciences, Pakistan discusses the increasing *mathemization* of the subject and the resulting conflicts. A report by SaritaBartuala assesses the financial accessibility in our vibrant neighbor, Nepal which helps in garnering some insight for the micro finance debate that India faces.

Aapoorti would not have been possible without the support of our editorial team as well as our friends

both from within and outside Miranda House. This is a packed issue, reflecting the generosity of its contributors, their enthusiasm for publishing here, and their capacity to meet deadlines. Thanks to them all, and to the team for their superb work in putting all of this material together and managing the whole editorial process.

What must not be forgotten is the great influence South Asian Economics Students Meet (held in October 2011, in Ramjas, Delhi) has on *Aapoorti*. Divya Singh was lucky to be a part of this 'not to be missed' economics adventure and this has helped us a lot in the making of this journal.

In the end, we would like to point out that this is entirely undergraduate level effort which limits the horizon of thinking and knowledge. Hence any error on our part should be forgiven.

It is a pleasure to be involved with the journal as their editors this year and it a moment of satisfaction to finally present it to you all. We hope that readers will be impressed and inspired by the intellectual rigour and depth of these discussions.

Regards,

Divya Singh
Arundhita Sud
(Chief Editors)
Aapoorti

Please note that the institution has been mentioned for authors who are not for Miranda House. The rest should be supposed to be from Economics, Miranda House.

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INDIANOMICS

How to put the Indian economy On the development track

Aruni Mitra

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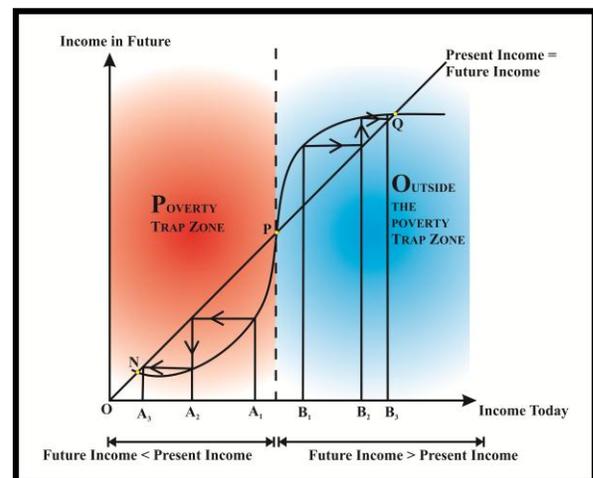
It can be naturally expected from a country like India that is experiencing growing per capita income rates, to raise unprecedented fiscal resources to finance the pro-poor developmental missions. However, despite well-intentioned and targeted pro-poor developmental strategies taken up by the Government of India, it seems that the Indian social milieu is not quite responding to such stimuli. The only possibility of why there is no significant improvement in the living standards of the Indian poor seems to be corruption. Most people would argue that it is because of extensive corruption that benefits do not actually reach the needy. But why can we not be honest, if we are the ones who are suffering from corruption? Moreover, we must also acknowledge that there are other factors pulling the reins of India's success, apart from corruption. In fact, the most basic question to

be asked is that whether government policies like subsidies, have any significant meaning to the poor, and even if they do, are they helpful in the long run?

Why does a poor farmer not use new output-enhancing agricultural techniques? Why are poor people eating less with more income? Why are government hospitals rendered non-functional in rural areas? Why building schools (even with proper infrastructure) is not enough for the spread of rural education?

This essay will throw light on all the above questions, as well as how government pro-poor policies should be designed along with corruption-fighting mechanisms. For all these analyses, I need to establish the concept of a Poverty Trap.

Figure No.: 1



The above multiple equilibria scenario is typical of the economic condition of most of the people in the developing world. **This model assumes that what you have today determines how much you eat, how much you have to spend on medicine or on the education of your children, whether or not you can buy fertilizer**

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or improved seeds for your farm, and all this determines what you will have tomorrow.

The S-shape of the curve is the source of the poverty trap. On the diagonal line, income today is equal to income tomorrow. For those who are in the *poverty trapzone*, income in the future is lower than income today: the curve is below the diagonal line. This means that over time, those in this zone become poorer and poorer, and they will eventually end up trapped in poverty, at point N. Similarly, for those who start outside of the poverty trap zone, income tomorrow is higher than income today: over time, they become richer, at least up to the point Q.

To understand the situation in a poverty trap, we consider a story revolving around the experiences of a small Indian farmer. Suppose he was given free fertilizer and as a result, the harvest from his field was 20 times what it had been in the previous years. With the savings from that harvest, it is expected that he would be able to support himself forever. The implicit argument is that the farmer was in a poverty trap in which he could not afford fertilizer: the gift of fertilizer was his only escape route from the trap. But skeptics of such subsidies would object that if fertilizer is really so profitable, why could the farmer not have bought just a little bit of it and put it on the most suitable part of it. This would have raised the yield and with the extra money generated, he could have bought more fertilizer the following year and so on.

However, adoption of such policy depends on whether the strategy is feasible: buy just a little to start with, make a little extra money, and then reinvest the proceeds, to make even more

money, and repeat. But maybe fertilizer is not easy to buy in small quantities. Or perhaps it takes several tries before one can get it to work. Or there are problems with reinvesting the gains. Or something makes it hard to save between planting seasons, so that even if the farmer can make money in one season, he cannot turn it into further investment. One could think of many reasons why a farmer might find it difficult to get started on his own.

Now we see the application of the above poverty trap multiple equilibria scenario in the context of nutrition, health and education.

Nutrition Trap

A nutrition trap implicitly assumes that low nutrition is capable of creating low incomes. This is the functional aspect of undernutrition: apart from being of social and ethical concern in its own right, it has an impact on the ability to earn. Thus, it is not difficult to imagine a vicious circle of poverty in many low-income countries, in which low incomes are responsible for undernutrition, which in turn perpetuates those low incomes. The whole point is that of a biological relationship between nutrition and work capacity. However, if work capacity affects future work output, why do not employers wish to offer nutrition-enhancing long-run contracts that take advantage of this? Because there is no guarantee that the employee will work for him, perhaps he might migrate to another village. Second, if a person in good health can be identified by other employers, the market will bid up the wage rate for such an employee. This means essentially that the employee will reap the entire benefit of the employer-financed investment in the form of a higher wage. Therefore, it is evident why there is no incentive

for the employer to increase his employee's work capacity.

This leads us to tend to believe that if there was any chance that by eating a bit more, the poor could start doing meaningful work and get out of the poverty trap zone, then they should eat as much as possible. Yet, this is not what we see. Food represents from 36% to 79% of consumption among the rural extremely poor, and 53% to 74% among their urban counterparts. In other words, the food budget does not go up proportionately faster than total spending. In the Indian state of Maharashtra, in 1983, even for the very poorest group, a 1% increase in overall expenditure translated into a 0.67% increase in the total food expenditure. Moreover, when poor people get a chance to spend a little bit more on food, they buy better-tasting, *more expensive* calories. This "flight to quality" in food consumption is a completely psychological phenomenon.

Angus Deaton and Jean Dreze have shown that despite rapid economic growth, there has been a sustained decline in per capita calorie consumption in India. It is still that richer people eat more than poorer people do. But, at all levels of income, the share of the budget devoted to food has declined. Moreover, the consumption of the food basket has changed, so that the same amount of money is now spent on more expensive edibles. Fortunately, in India, the percentage of people who consider that they do not have enough food has dropped dramatically over time: from 17% in 1983 to 2% in 2004. So, perhaps people eat less because they are less hungry.

Thus, we can conclude that whether or not a nutrition-based poverty trap exists depends on

the poor people themselves and not on some pre-fixed minimum metabolic requirement. What is important from the policy perspective is that provision of ever-increasing amounts of food grain for subsidized public distribution is not the solution to alleviating malnutrition. This philosophy renders the Food Security Bill functionally redundant.

Health Trap

It is typical of a poor family to lose any hope of escaping from the classic poverty trap --- the expensive (often debt-financed) treatment of father's illness made them poor, which is why the undernourished child stayed sick, and because he was too sick to get proper education, poverty loomed in his future. Even if the family was not in the poverty trap previously, it can be entrapped because of the ballooning debt obligations.

Thus, expensive private health facility has the potential to be a source of poverty trap. However, militating against our common sense, if the poor people are provided cheap medical facilities, especially preventive ones, then people do not take advantage of these cheap preventive technologies to improve their health. This is invariably because of the typical psychology that whatever is "free" is "worthless". Thus, if the government wants to provide cheap health services then it must invariably carry on a campaign on educating people about the positive effects of cheap but effective, preventive medication.

As far as public health services are concerned, instead of heavy subsidies in medical expenses, the government should channelize its funds to the poor in the form of easy availability of low-

interest health loans and publicly provided health insurance. This would not only increase the worth of public healthcare facilities in the eyes of the poor, but also reduce the incentive for rent-seeking activities for getting admission in the overcrowded government hospitals. Moreover, the poor people will have lesser chances of being thrown into the poverty trap by a negative shock of sudden medical expenses, if the interest rates on health loans are administered to be low by the government. It has been calculated by the distinguished economist Arvind Panagariya that such a policy of health loans and insurance will require only one-tenth of the present State-expenditure on health subsidies.

Education Trap

If the younger generation of a poor family does not receive education then the hope of achieving higher and more formal income becomes dimmer. However, making available primary or secondary education in a poor society may not always produce the desired effect of achieving higher human capital to be used for tapping the gains from growth and globalization. This is because, if the economic environment of the poor people dictate to them that returns from education are typically low (particularly, when there are rampant opportunities of informal employment) then there may not be enough demand for education. Thus, the problem of education trap cannot be solved through a unilateral treatment of the supply side. The demand side shortage needs to be addressed in a poor society.

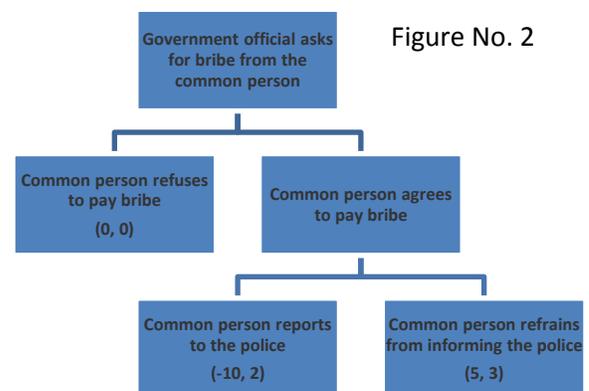
From the ongoing discussion, we have understood how a common Indian villager lives in an air of despondency due to useless public

services. Even when the public services are somewhat useful, they scarcely reach the actual poor due to massive corruption and pilferage. Although the problem of corruption is mostly tried to be solved through moral or ethical value judgements, economists have long realized that so long as there remains private incentives for corruption and rent-seeking activities, no amount of ethical deliberation will make the economy corruption-free.

Game-theoretic Approach to Corruption

Suppose a layman approaches a government official to get his routine job done. However, the corrupt official, as usual, asks for a bribe, saying that if he does not pay the bribe his job will be delayed. At this juncture, the common man can decide not to pay the bribe and remain content with a delayed completion of his job. Alternatively, he could have agreed to pay the bribe. Nevertheless, once his job is done, he always has the option to report this corrupt action of the official to the police.

The payoffs of the government official and the common person are shown in the sequential game-tree of Figure No. 2, in the form of ordered pairs.

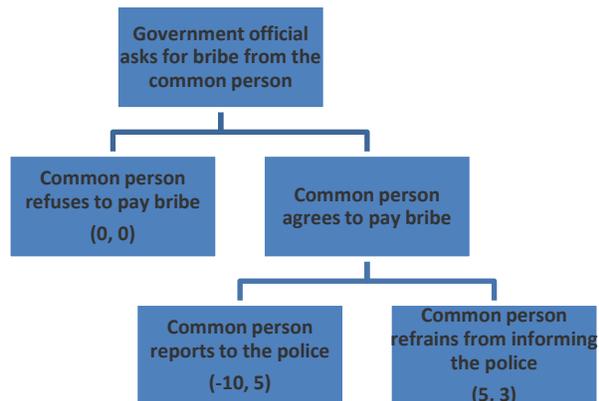


Note that since the payoff of the layman is less

if he reports to the police than if he does not, therefore the corrupt official gets away and corruption persists in the economy.

This gloomy scenario can be changed quite easily, if there is some legal reward provision for the common person (whistleblower) who reports about an act of action. In this way, his payoff can be increased in case of reporting and then the official's payoff falls to -10, thereby rendering bribe-seeking non-profitable. In this way, protection and reward of the whistleblower in the society can help reduce corruption. This case is shown in Figure No.: 3 below.

Figure No.: 3



Economics through Alphabets

Gaganjyot Kaur Narwal

On an early winter morning, 4 a.m: the villages and cities sleep soundly. A young girl, studying in 11th grade and belonging to a poor laborer's family in a small village in north Rajasthan, is wide awake. The cause of her early rise is to read a book titled "Time management". She must finish as much as possible because when the day light spreads she will get busy in tending to the cows and goats and help her mother to take milk to the milk collection center of the village. After that, on her bicycle she will go to school in a nearby town. Her family, asleep, is completely unaware of her daily conferences with the books at this hour.

Her story is no different from that of a few others in the same village. The concept is, to wake up early morning and read books borrowed from the village library which was inaugurated a few years ago. Later in the day the farm and household work will dominate the schedule of all village residents. The evenings and nights will suffer from electricity cuts making it impossible to read books, thus, the time snatched from the busy day and early morning electricity blessed hours are put effectively to gain knowledge.

A few years ago this was not the case- there was no library. The post green revolution era was marked with prosperity- increased use of machinery reduced man hours. A survey of four

villages reveals that against the principles of economics; for 2010 acres of land 89 tractors were being used, a shocking figure. An impartial assessment suggests 25 tractors would be sufficient. About 123 rich Zamindar families and about 127 labor families earned their income from this land; the result was a disturbed economy in shape of higher investment in machinery and excess availability of labor/leisure hours. Another survey further revealed that 252 families with a population of 1260 had about 7360 labor/leisure hours. The available hours were spent in insignificant recreational activities such as gossip, TV watching, and futile visits to nearby markets.

The waves of change entered the village in a sudden yet casual way when an NRI family came on a holiday visit. In one of the monthly congregations in the village temple, there came a casual remark from a member of the aforementioned family: why were 89 tractors needed when 25 were sufficient. This was a spark to ignite the minds of village leaders. They realized the high investment in machinery and wastage of increased labor/leisure hours. The NRI family returned, but in the next congregation villagers decided to persuade themselves to take a bold step towards learning. A small contributory village library with 1000 books was inaugurated. Hindi, Punjabi and simple English books on subjects of self-help, environment, agriculture, religion, auxiliary occupations, comics and story books above were made available.

Education is not at the sole mercy of schools and universities. Villagers started borrowing books according to their interests with a view to learn something new. Books on auxiliary occupations caught the attention of elders,

which created a desire to raise living standards. About 50 families, including poor labor families, paid attention to dairy and poultry. About 20 labor families went for bee-keeping and goat rearing. Women from 5 families showed interest in handicrafts. The employment structure of this cluster of villages began to change. The girls were forbidden to pursue any schooling but they were now allowed to get admission in higher classes. Environmental change became visible gradually: with one or two fruit trees and some flower plants in and around huts and houses. The paradigm shifted diametrically. The leisure hours available earlier were now being put towards gaining knowledge and creating a link with the outside world.

On my periodical visit, I engaged myself in a conversation with a village elder. I asked him to comment on the changing economic environment. Elated, he exclaimed that after the green revolution he has been able to see the second phase of change which can be credited to villagers, not any government aid. However, he was a little apprehensive and stated that village resources were exhausted to their full potential. But he was hopeful that if the pace of change is maintained, one day, national newspapers would publish success stories of these small villages transformed on the basis of knowledge and awareness. Though, laughingly, he concluded that he may not live to see that, but a ray of hope was clearly visible.

A study by 'The Economist' states that the Indian state has the potential to grow at an unbelievable rate provided it fully taps the potential of its demographic dividend. Being an agrarian economy, 60% of this dividend lives in rural areas.

The illiterate must be made literate. For the development of skills and talents, one must be given appropriate opportunities with infrastructure provisions. A small girl in a small village must, firstly, get electricity to complete her book. This is the message of prosperity coming on the wings of alphabets

“Education is both a tool of justice as well as fundamental as driver of economic development”

-Kevin Rudd

Ethics and Economics

Yatish Arya

Kirori Mal College, Delhi University

Remembering Ramayana to recall the importance of ethics may seem too dramatic but the fact remains that this epic is perhaps one of the most important and strongest stories which teach us the importance of ethics and using our knowledge in the right way. Ravan was a great scholar, strong and powerful. He knew all the four Vedas (the highest educational achievement of his time), had defeated the Gods himself and had immense power. But he put his knowledge and power to achieve a wrong end. What followed for him and his kingdom was war and destruction. Now, whether Ravan was unethical or not is another discussion and the importance of destruction is a complex philosophical topic in itself. But the important moral that should be learnt from this text is that knowledge and power without the

right frame of mind can lead to disastrous consequences.

I remember the moral of this story trying to contradict the argument of someone associated with the Delhi university who believed that scraping the Economy, State and Society course from Delhi University (or at least making it optional) was a way forward and would make our course more ‘compatible’ with universities around the world. His argument was that studying Economy, State and Society which he called nothing but ‘Ethical Economics’ is useless or at least of secondary importance. Students could do without it. Now naming the academician is not needed or important. But it is important to realize that he is not an exception who believes in such ideals; rather I have observed and noticed that there is a rising trend in economics to focus only towards what is called ‘Positive Economics’ in curriculum, educational institution and policy making.

First of all, calling Economy, State and Society as Ethical Economics is itself questionable, as the horizon of the subject goes way beyond Ethics. It gives a broader view of the world and the economic system we live in. Many of the students who read the subject with interest (most of them who are lucky enough to have a good teacher) will tell you that it is an extremely interesting and important subject which teaches us things that orthodox mainstream economics fails to do. It explains to us how the world around us is operating and the ‘system’ in which we live in. Much of this is done with without making assumptions (maybe that’s why orthodox assumption loving economists don’t like it). Secondly, but importantly it makes us realize that we should learn to analyze things not just on the basis of

efficiency. It makes us realize that 'power' exists, the society is highly antagonistic and actually the world is still divided into classes; among other sub divisions. Thus, ethics do come into play. Welfare has to be judged beyond Pareto efficiency and crises do occur most of the time because of the properties of the system itself, with its effects mainly on the working class. The whole debate on the food security bill highlights the need to take a broader view of economics. People getting food has to be considered more important than fiscal responsibility. Thirdly it introduces us to different political thoughts which an economics student should know. Knowing the background of how economics has evolved over the years is also important for a better understanding of the subject. Moreover, subjects like ESS make us think. Thinking and opening up your mind has to be the basic aim of education and learning. Albert Einstein one famously said "knowledge has to be continuously renewed or else it would be lost". Thinking, free minded individuals and academicians are essential for this purpose.

The focus on Positive Economics originates from the argument that economists just need to tell how an economic policy will affect quantitative variables like output, Inflation etc. It's not the business of an economist to give his own judgment of whether this change would have a good effect on society or nation as a whole. Doing this at the undergraduate level is a dangerous thing because a large proportion of students don't actually become economists per se but go towards many different streams. But if they actually only judge policies of the government on the basis of efficiency and growth, we are heading for trouble like the beautiful 'Golden Lanka '. When they have to

vote and evaluate government policies a broader notion of the world is important. All this is a part of a more disturbing trend of today's world where ethics and morals are getting lost somewhere between the ideals of freedom and liberalism. People have started judging things only on the basis of 'legality' and 'illegality' and considering morals as useless. Believe me, I know morals and ethics are highly subjective, but it needs to be realized that morals and a certain level of discipline is very important for any nation or an economy to function; for example maintaining a queue is nothing but a moral, otherwise in a market the one more physically powerful (or with the gun) and thus more efficient should get his work done first. History shows us that idealistic societies usually do better in the long run as all the individuals follow a common goal. If that ideal is good and inclusive then that development is also sustainable. Moral and ethics can't be left only for the families and other institutions to teach. The education system itself has to take the responsibility of creating ethical individuals. It can get very confusing for young minds to think as 'rational', emotionless individuals and at the same time believe in something greater than the petty issues of everyday life and working for the society and the underprivileged. It is individuals who build nations, so a strong, powerful, progressive and just nation can only be found if the future generations are not only strong but civilized, progressive and efficient but also accommodating and just to fellow nationals and other human beings in general .

As far as the argument of making our course more compatible with the world universities, we have to realize that ideas of Marx and

Socialism are intentionally curbed in Western countries. Moreover, what is correct and important for a developing country and its individuals to learn can be very different from a developed country. Trying to copy the syllabus of universities of USA and UK may not be the right way to go forward. This point reminds me of another paper he wanted to scrap-Economic History of India. Now to be fair to him, he wanted it to club some of its 'important' chapters with the paper Indian Economic Development since 1947. It is ironic that in that paper we hardly study India's economic development since 1947so clubbing it with a paper already facing an identity crisis will ruin it again. This argument is also a part of a general trend which I would like to call 'Scientification of Economics'. Too many people from science background who dislike history and think of it as useless support this notion. They fail to understand the fact that theoretical economics is not only needed to understand economic history' but the study of history is itself very important to verify whether theoretical economics and its results do actually hold in the real world or not. Maybe the fact that the study of Economic history and ESS makes us question the basics of orthodox neo-classical economics is the reason why many mainstream economics dislike them. Two nations who never lost their own sense of history and identity even while adopting ideologies and policies from the more developed countries are: Japan and Germany. Where would have these countries been without their own sense of history, culture and industrial innovation makes us realize the importance of these concepts.

In the end, I would like to say that I am in no way a Marxist or an anti-mainstream

economist. I am too young and too unaware to become an ardent follower of some ideology. Moreover I have nothing against that teacher who believes in no ESS and EHI. He is an excellent teacher and has tremendous knowledge of the subjects he himself teaches. He is an economist in his own right. Yet his views show the narrow mindedness that even fails to open the minds of highly educated individuals. I believe at an undergraduate level rather than reading just what the current majority of economists believe; the curriculum should open our horizon, so that we become thinking individuals who can judge theories on their results and elements themselves. We have to remember that economics is still a very young subject whose laws are far from established. It concerns human beings and their behavior affects the economy itself. It's not yet Physics or chemistry and it should not be taught like that. As Mr. AmartyaSen recently pointed out in his article in 'The Economics Times' taking a broader notion of economics is the need of the hour.

CROSSWORD ANSWERS

- | | | |
|-----|-----------------|----------------|
| 1. | Blisspoint | 11. NABARD |
| 2. | Capitalism | 12. Equity |
| 3. | Superstructure | 13. Hegel |
| 4. | Laissez Faire | 14. Debentures |
| 5. | Oligopoly | |
| 6. | Ceteris Paribus | |
| 7. | Gilt funds | |
| 8. | EXIM | |
| 9. | Kurtosis | |
| 10. | Polonius Point | |

Rural Credit in West Bengal: Distribution by Holding Class and Social Group

Soutumi Das

B.Sc. Honors

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The focus of this study is on the inequality in access to credit by different landholding classes and social groups in rural West Bengal by utilizing 59th round household level data on Situation Assessment Survey (Schedule 33) of farmers conducted by the National Sample Survey Organisation (NSSO), Ministry of Statistics and Programme Implementation, Government of India. West Bengal is one of the major agricultural states in India where land reforms have been introduced in a comprehensive manner. Operation Barga, launched by the Government of West Bengal in October 1978, is an attempt to implement the legal provisions of tenure security for bargadars and control over the crop-share between landlords and tenants. West Bengal, having the background of permanent settlement, accounts for the largest concentration of landless or land-poor households. The average holding size in West Bengal has been considerably smaller

than in other agricultural states in India, and, indeed, the incidence of marginalization of landholdings is the highest in this state. Marginal farmers and even registered sharecroppers in the state are legally entitled to apply for agricultural loans from formal credit institutions. In an agrarian economy dominated by marginal farmers, we need to investigate the extent of access to credit of the land-poor households from institutional sources. The decline of institutional credit in the phase of financial liberalization has forced peasants to depend on moneylenders more for their credit needs. Non-institutional credit puts some additional pressures on farmers. In many cases, an indebted farmer has a compulsion to sell his product to the agent to whom he is indebted at a lower price than the prevailing market price due to the pressure to clear the debts. The extreme tragic manifestation of agrarian distress in the so called high growth phase of the Indian economy under neo-liberal reforms has been the starvation death in some regions and the spate of farmers' suicides in others.

As is well documented, the agrarian reforms in West Bengal have had an appreciable effect on land distribution as well as on the nature of tenancy right in the state. Roughly one-fourth of the land area in the state was occupied by the marginal farmers in 1970-71 and this share increased to more than 58 percent in 2002-03. The patterns of distribution of landholdings and land area among different size classes indicate that agriculture in West Bengal has been dominated by the marginal farming class.

The NSS report based on 59th round survey revealed that around 49 percent of the farmer households in India were indebted in 2003. The incidence of indebtedness varied widely across

the major agricultural states in India: it was the highest in Andhra Pradesh (82.0 percent), followed by Tamil Nadu (74.5 percent) and Punjab (65.4 percent). The average outstanding loan per farmer household was the highest in Punjab, followed by Kerala, Haryana, Andhra Pradesh and Tamil Nadu. In West Bengal, roughly 50 percent of the farming households were indebted and 55 percent of them were cultivators in 2003. The marginal farmers with land size between 0.01 and 0.40 hectare suffered from the highest level of incidence of indebtedness followed by those with landholdings lying between 0.4 and 1 hectare. The incidence of indebtedness declined with the rise in landholding size. The degree of indebtedness was very low for land-poor households with land size less than 0.01 hectare simply because they had limited access to credit.

Agriculture in West Bengal has been predominated by food grains, mainly rice. The higher share of food grains area in total cropped area in the state is largely accounted for by the larger share of marginal farmers in operational holdings. The marginal farmers normally allocate a major part of their holdings for the production of food crops to meet their own consumption needs. However, a marked diversification of cropping pattern away from food grains has occurred since the early 1990s. The changes in cropping pattern in West Bengal has been associated with the changes in the forms of tenancy and the distribution pattern of agricultural credit by sources across different holding classes. As the marginal farmers have little access to institutional credit as mentioned above, they can hardly bear the higher cost and also risk associated in cultivation of non-food

value added crops. Thus the changes in cropping pattern in favour of non-food crops are propelled mainly by the medium and rich farmers.

Small is Big

Stuti Oberoi

World over, small and medium enterprises (SME) have been recognized as oil for the machinery of economy. The existence of millions of such companies together creates a force to reckon with. Large and super large companies take the limelight due to their size, money flow, influential strength, etc. But it is being argued that in the present scenario of collapsing industries, the role of small businesses is very significant.

Countries like USA and UK already have an established administration for small businesses. However countries like Japan and India have the real potential. With the technological revolution, knowledge and skill intensive industrialization is replacing material and energy intensive industrial development. But presently, if we compare the growth of SME in India with other countries in South East Asia, we lag far behind.

Policy makers have been tapping the employment potential of SME as the primary advantage. The development of small enterprises is being considered as a safety net, which eases the government's burden of creating employment opportunity of a massive scale. Some extremists also advocate total liberalization and deregulation of small

enterprise economy based on economic concepts like competitiveness and incentives. Others advocate the conventional role of the state, where SME development is largely considered as part of the welfare activities of the state.

SMEs lead to entrepreneurial development and diversification of the industrial sector. More employment opportunities are generated and the capital cost per employee is low. The government has also become more favorable to this sector and is trying to give it a boost through infrastructure development, entrepreneurship development, technology up gradation, etc. Sectors like textiles, IT, biotech, footwear, etc have shown immense potential. SMEs are being aimed to give a boost to the growth and employment of developing countries based on the assumption that there are benefits for the country as a whole from having a strong SME sector. It is being seen as a target aid for the poor in order to uplift them.

As of now, there are some major hurdles that are not allowing this sector to flourish. The first hurdle is that the credit availability for this sector is very low. The amount of bank credit available to this sector is very less because SMEs comprise of a majority of the unorganized sector. Even though SMEs fall in the category of priority lending, the focus gets shifted to other fast growing and safer areas such as home loans, etc. Arranging collateral security also becomes a major issue. Inevitably, these small units fall into the vicious cycle of debt and poverty. Hence, banks should be encouraged to give loans up to a certain amount, free of collateral and at a low interest rate to these SMEs. Also, microfinance agencies can also

prove to be of help, if regulated properly.

The second hurdle comes out to be the lack of technological knowledge. Most of the household units still work on obsolete technology because of which the cost of production remains high and the product fails to meet the quality standards of the market. To add to that, liberalization has led to a stiff competition for them from imports. Human resource is available in abundance in India but its proper utilization is possible only through proper technological upgradation especially in the sector of SMEs. There is also a need for professionals to work with these small units to gain mutual benefits and to help revive the sector and make it internationally competitive.

Another major hurdle is that these small units do not have a proper market available to them. They do not have money for market research and hence there is imperfect information available to them. Due to this, they are taken advantage of and are exploited by other middlemen. Also, the consumers are unaware of the presence of these products produced by these small units. So the government should promote these industries and create awareness of these products through innovative marketing. This would also attract a lot of investors and helping agents such as suppliers, large companies, etc. Self-help groups (SHGs) should also be encouraged to strengthen this sector.

The situation of our economy is very gloomy at present and hence, the development of small and medium industries seems like a ray of hope in this desperate situation.

The 1991 Reforms & Inclusive Growth

Arundhita Sud

In 1991, India, one of the defenders of third world dirigisme since the days of its independence embarked on a neo-liberal economic policy course, a shift which was ranked by a leading World Bank economist of the time among the “three most important events of the 20th century” alongside the collapse of Soviet Union and China’s turn to market reforms. A Balance of Payments crisis caused mainly by the Gulf war opened the way for an IMF program that led to the adoption of a major policy package often referred to as the New Economic Policy (NEP) that involved opening for international trade and investment, deregulation, initiation of privatization, tax and exchange rate reforms.

The Big Bang of Liberalization promised to liberate India from the episodic crisis and Indians from perennial poverty. As Manmohan Singh (the then Finance minister) said in his speech “I do not minimize the difficulties that lie ahead on the long and arduous journey on which we have embarked... But as Victor Hugo once said, ‘no power on earth can stop an idea whose time has come.’ I suggest to this august house that the emergence of India as a major economic power in the world happens to be one such idea.” There is widespread debate on whether the path to achieve the above

mentioned idea was one that arose from the state of the Indian economy or, given the fact that the reforms were supported by financial assistance of the IMF and the World Bank, the adoption of the NEP was under pressure from these multilateral agencies. Those supporting the former view say that the reforms were not an externally designed blueprint thrust on an unwilling government. “The driving force was endogenous; a realization by the leadership that the old counterproductive policy model had run down their economies into the ground and that change of course had to be undertaken.”- Jagdish Bhagwati. On the other hand, some are of the view that the reform package has been in use for many years in a number of Latin American and African countries and had been known by differing connotations such as the Washington consensus, Structural Adjustment program and Liberalization. The debate will no doubt go on, but acknowledging the fact that the NEP was adopted the question of relevance is why even today, after 20 years of reforms our goals seem distant and another crisis not too far. This article makes an effort to throw light on this issue, discussing the extent of success of the Indian reforms.

The purpose of initiating the reforms was stabilization of the Indian Economy and delivering growth subsequently. Infact, growth was regarded as the primary “instrument”, a strategy for pulling the poor out of poverty through gainful employment, not as an end in itself. No doubt in this span of 20 years India’s economic performance (in terms of various macroeconomic indicators) has been exceptional yet whether this performance can be termed as “inclusive” is questionable. By the term “inclusive” I’m not just talking about the

pace of growth, but its pattern with a view to cover all in the growth process. It allows people to contribute to as well as benefit from economic growth. The initial response to the reforms was an impressive acceleration in annual GDP growth which averaged 6.7% in 1992-97, slowing down a little to 5.7% in 1998-2005 and then accelerating to record levels of 9% just before subprime crisis. The view that India was an “emerging superpower” was now widespread. On the industrial front the reforms have gone a long way towards freeing the domestic economy state control, state monopoly has been abolished and opened to private sector. The license raj is a thing of the past. Though small scale industry reservation still persists but even here progress has been made. The rate of growth of industrial output was progressive as shown in table 1. The Index of Industrial Production (IIP) for 2009-10 was 10.5% with high growth in manufacturing, consumer durables, capital goods and intermediate goods. In the service sector where government regulation has been eased significantly or is less burdensome-such as communication, insurance, asset management and information technology-output has grown rapidly with exports of IT enabled services particularly strong. In those infrastructure sectors which have been open to competition such as telecoms and civil aviation, the private sector has proven to be extremely effective and growth has been phenomenal. The performance of the agricultural sector has not been so impressive. This sector has witnessed a slowdown since 1991. Some like to link it with the NEP yet others like P. Balakrishnan, R. Golait and Pankaj Kumar argue that the slowdown is due to structural factors on the supply side of

Indian agriculture.

The reforms also involved a radical reorientation of foreign investment policy with foreign investment being actively sought not only as preferred means of financing BOP deficits compared with external borrowings, but also it provides access to closely held technology and to global marketing linkages. Both Foreign Direct Investment and portfolio flows have been encouraged in the post-reforms period with positive results in both cases. Besides, the enhanced growth was associated with lifting nearly 200 million of the extreme poor above the poverty line. As far as relative economic outcomes of the disadvantaged groups is concerned, economist Amartya Lahiri have studied India's scheduled castes and scheduled tribes and concluded that the last 20 years of major reforms have seen a sharp improvement in their relative economic fortunes.

No doubt the spillover effects of India's increasing international competitiveness have helped in improving the rate of growth of export earnings making better quality, lower price goods available yet even today after 20 years when the Human Development Index Reports of the World Bank (no matter how much the HDI is criticized) are published, we realize how far we are from our goals.

Despite high growth levels the nation is gripped in poverty, illiteracy, rising inequality and poor health conditions of a large portion of the population. Such a scenario forces us to think whether India as a developing economy is heading on the path of aimless opulence? What will India be like in the future- Brazil or South Korea? Here are some of the depressing facts of

the “emerging superpower”

- 37% people in India live below poverty line. (Tendulkar Committee Report 2009). Keep in mind that Indian standards of poverty measurement are below those of the world.
- 645 million poor living under multi-dimensional poverty index (MPI) in India. (Oxford Poverty and Human Development Initiative 2010)
- 80% of India’s population lives on less than \$2 per day. (world Bank 2009)
- About 49% of the world’s underweight children, 34% of the worlds stunted children and 46% of the worlds wasted children live in India. (WHO 2009).

These are just some of the stark facts of our country. India’s record on social development expenditure has not been satisfactory considering its requirements. It’s not just the social sphere that is lagging behind we see that the reform process has not been complete and reforms have not been seen at all in labor markets which continue to be rigid in the hiring and firing processes. Another major failure of the reforms was that the overall growth experience was that of “jobless growth”. There has been little absorption of labor into growing capitalist sector. Taking two decades as a whole organized sector employment has scarcely increased at all and between 2001 and 2008 it has even fallen in absolute terms. The post reform period has also witnessed growing disparities in the distribution of income. We

often come across the government’s view that people becoming better off diversify away from food grains to other expenditures and hence acquire lesser calories. How credible is this stance? International experience clearly shows that food grain consumption rises with income until a fairly high level of income (much higher than what the bulk of Indians earn) and then flattens out. In India during the last two decades a rise in per capita real income is accompanied by a decline in per capita food grain intake. (this is also true for calorie intake) This clearly indicates that income distribution within the country is worsening to a point where the bulk of the population is becoming absolutely worse off.

In my opinion too much emphasis is being laid down on growth, and fiscal consolidation as one of the means to achieve this end. We have to realize that the government still has a major role to play, be it in the form of the food security bill or NREGA or any such programme that takes a step towards providing the basic necessities of life. India must bridge the social development gap by increasing public expenditure on social services (food, education, health) and employment generation. We must understand that the relationship between economic progress and social development is not unidirectional rather it’s a two way process with each affecting the other. Social development is not just an end in itself but also a precondition of accelerating growth. It’s time that we start helping the poor of the country in the true sense, provide them with a standard of living that each man deserves. Such serious issues of hunger, poverty, shelter etc. cannot be discussed in terms of mere trade-offs and fiscal deficits. 20 years have passed, the pie has

grown large enough and distributing it among all people cannot be delayed any further.

Table 1 Growth of Real GDP
(Per cent per year)

	1992-97	1990-02	2002-07	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8
GDPfc	6.6	5.5	7.8	3.8	8.5	7.5	9.4	9.6	9.0
Agriculture	4.8	2.5	2.5	-7.2	10.0	0.0	5.9	3.8	4.5
Industry	7.3	4.3	9.2	7.1	7.4	10.3	10.1	11.0	8.5
Services	7.3	7.9	9.3	7.5	8.5	9.1	10.3	11.1	10.8
Per capita GDP	4.4	3.5	6.1	2.3	6.9	5.8	7.7	8.1	7.5

Source: Central Statistical Organisation (CSO)

Note: Industry includes construction.

QUIZ ANSWERS

1. Stagflation
2. Reebok
3. SverigesRiksbank
4. King Gillette
5. Most stolen book from library
6. Silicon Valley
7. Trishul
8. Henry Ford
9. Bic Mac Index/Tall Latte index
10. Occupy World Street

YOURS UNCONVENTIONALLY, ECONOMICS

Guest Article

Economics as a Science: The Undergraduate Experience

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Econometrically put, being an undergraduate economics student surely must be associated with an increased likelihood of being grumpy at your subject of study. But we aren't yet sure if the causality stems from the content of the subject itself. Need further research.

And a strange kind of grumpiness at that. Dissatisfaction with studies is usual for students; expected, in fact. But what mysterious and complicated relationship with the subject is this, to hear groans about the reality of the subject matter (including the impossible spiral of the debate over applicability of models), or innocent queries

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³The observations and opinions are based solely on my own experience, hence error in judgment and selectivity bias are quite possible. Any corrections and comments are welcome.

pertaining to its “scope”, or indignant criticism of the “mathematization” of the subject?

It is perhaps that such incisive criticism is more abundant at LUMS, my place of study. It is a place of vibrancy and diversity, and plays host to around 250 courses every semester. The courses offered belong to a wide breadth of fields, that include accounting, finance, management, economics, anthropology, sociology, philosophy, literature, history, psychology, physics, chemistry, mathematics, engineering, and of course, economics – all in the confines of two buildings. The existentialist crisis, incessant comparison of each field, and critical analysis of its techniques is, hence, unsurprising. The pertinence and relevance of the issues mentioned above may vary considerably across individuals or groups, but cannot be ignored altogether.

A Harvard Professor visiting LUMS, broadly and informally ranked the forms of existence for academics, as widely considered in the knowledge circles. Mathematicians hover at the top with surety and abstraction; physicists, holding firmly to the mathematicians and sturdy at their business, follow close behind; and the other natural sciences, members of the same gang but perhaps slightly less cooler, come next. Next on the knowledge ladder is economics, huddled with the social sciences but quite overtly facing math, attempting to attract its attention. Political science, and then the other social sciences such as anthropology and sociology, follow suit.⁴

While surely the categorization is debatable and would be disagreeable for many, important and interesting observations can be drawn out of it. It seems that the ranking parameters are the certainty, verifiability, and predicting power boasted by branch of academics. Again, while

⁴ The rankings are those as described by the professor, the illustrative description are solely the product of author's imagination.

the choice of parameter is debatable, their immense relevance cannot be undermined, given their basis in the concept of scientific methodology, the corner stone of scientific knowledge. It is most interesting that the categorization be used by an economist - a hint towards the aspired course of economics as a discipline.

Having described some symptoms at the start, we now move towards possible explanations. The explanation of the curious case of economics resides in the fact of its inevitable roots as a social science and the simultaneous inroads into quantification of its predictions and techniques. Highly intensive in terms of its use of data and rigorously developed econometric techniques, it is far more quantitative than most social sciences. However, by definition its object of study is human behavior – as individuals and in social institutions such as markets. It is hence an uncomfortable pedestal when economics aims to, or is expected to produce perfect equations and models that predict, or accurately and precisely explain, hardcore results in real life akin to the natural sciences. Its ability to produce predictable results is widely criticized. Let us try to demystify that criticism.

For example, a physicist can tell the speed with which a ball shall hit the ground if he lets it fall from a certain height. Can an economist predict what would happen to the price of chicken if mutton exports got banned? Well he can make a pretty good guess. He now has tools with which, given the exact data, he can set up quantitative estimates about preferred production and consumption behaviors in each market. He will have to assume that those preferences do not change, and that nothing else that affects the markets of chicken and mutton changes, such as incomes and income distributions of consumers and supply side conditions associated with livestock. Given the data and assuming certain conditions, the

economist can make all the required estimates. He would need the data about trade volumes of mutton, demand and supply sizes in each market, consumers' overall demand for meat, and ideally an estimate of the cross elasticity between chicken and mutton (which is assumed constant across all consumers). He would then, yes, be able to tell you the new price of chicken as a result of that simple policy of export ban.

Too simplistic? Unrealistic assumptions? Useless result, since the conditions are highly unlikely to hold in real life? Right. And Wrong. Well, think again. *It is not the fault of the economist that his object of study is a part of an extremely dynamic system of forces!* The falling of a ball is not synonymously simplistic vis-à-vis the ban on mutton exports, because the motion of the ball is governed primarily by the forces of gravity and air resistance, or perhaps some other that I may be unaware of. What if the world were so that the falling ball was likely to come across a whirlpool, or to be struck by a tennis racket, or to be faced by the possibility of alterations to its shape on its merry way down to the earth -or maybe all of these? The predictive power would come under serious challenge – similar challenges faced by economist when they go about their business. Similar assumptions would then be required. Or, if the exact dynamics of these multiple forces were made known, complex calculations could actually solve the whole problem. But that holds true for the economic forces as well.

It is now that we try to decompose and discover the underpinning source of alleged failure of economics to concretely predict or explain many phenomena with the certainty of natural sciences. It lies firstly in the subjectivity of human nature – whereas the entire premise of natural sciences is to discover the objective patterns and rules that govern the physical functioning of universe. It lies, secondly, in the extremely intricate and highly conditional dynamics that contribute to our output variable

of interest. These considerations do not occur naturally to undergraduate students – frustration at economics does, which is largely a result of the way they are taught and evaluated in economics.

Perhaps for some readers, this article has raised more questions than provided answers. Indeed, it has touched upon just one aspect of only *one* of the many questions and criticism one popularly hears regarding economics. Much can be talked about the techniques and tools of economics, the large involvement of mathematics, and the issue of teaching methods in economics. It is hoped that more discussions on such issues would not only attract a larger and better student body towards the subject, but also encourage ownership, association and earnest perusal in current students of economics.

Overvaluing What We Own!

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Economics traditionally identifies the world as inhabited by cunning, dispassionate maximizers that have been called Homo economicus. The standard economic framework, that people were so used to, never took into account the studies concerning behavior by cognitive and social psychologists. This “un behavioral” economic agent was fortified by many, sometimes claiming the model to be just “right” or sometimes arguing that the model formalized was more appropriate. Behavioral

economists, who integrated study of human behavior while studying their economic interactions, arrived at the fact that neither point of view was correct.

Behavioral economists try and find out cases where they can show how irrational human behavior can be. One such example is that, when we own something, we value it more. In a simple experiment on exchange of two goods (candy & coffee mug), Jack Knetsch in his research found that preferences were not independent of the direction of the exchanges, as is commonly assumed. Rather they exhibited asymmetry; he called “A case of Non-reversible indifference curves”, where participants favored to keep their initial entitlements, whatever it be.

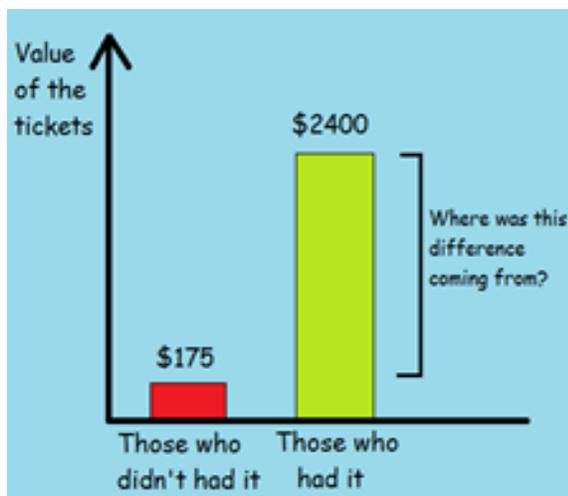
So Dan Ariely, a well-known behavioral economist, decided to find out the truth. He takes the example of Duke & says that life there revolves around basket-ball. The colors, the festivities, the rituals, everything is centered on basketball, and it’s pretty splendid too. However, there is a whole convention about which student gets to see the match and which doesn’t. So, it’s not just about the desire and passion, it’s also about stamina, persistence and spirit. Now what’s fascinating there is that since the basket ball stadium is undersized, it does not have enough seats to accommodate all fans. And sometimes, for national titles, even footing in line for a few days, camping outside the arena and all is just not enough because the tickets are distributed through a lottery process and when it gets over, some would own tickets, while some won’t.

Because a research by Jack Knetsch & Dick Thaler on the “endowment effect,” concludes

that when we own something-whether it's a pen or an I-phone, we value it more than others do, the question there was, 'Would the students who had the tickets value those tickets more than the students who don't have even when they all "strived" equally hard to get it?

Think about this for a while. Why is it that the seller of an automobile values it more than the buyer and thus envisages for a higher price? It's said that "One man's ceiling is another man's floor." So he wanted to see how much people valued their tickets. He called up people to negotiate & buy some tickets from those who had won them and sell them to those who hadn't.

When asking about the marginal willingness to pay for the ticket and the minimum amount people wanted to sell theirs, he found that, on an average, those who owned the ticket were not ready to forgo it for less than \$2400 per-ticket and people who didn't have it were not willing to forfeit more than \$170 per ticket.



So where was this difference coming from? From a rational perspective, both the ticket-owners and the non-ticket owners would have

anticipated the game in exactly the same way. They were equally passionate and the enjoyment derived from the game didn't depend on the lottery process.

Then how have the random lottery drawings changed the students' perspective of the game and the value of the tickets, so dramatically and distinctly?

The difference comes from the change in the perspectives with ownership. The price that the non-owners were willing to pay was then driven by alternative uses of the money (like spending in a restaurant or Wonderland), while those who possess the ticket, they thought about it from the standpoint of an owner & defended their worth of it in terms of the experience it would be and the enduring memoirs it would craft.

So in some sense, when we have buyers and sellers, we have two different people from two different perspectives, each viewing the transaction not as the same thing they give and get, but focusing more on what they are liable to give up in the transaction.

Ownership suffuses our lives and, in an eccentric way, shapes many of the things we do. Since ownership dictates much of our lives, wouldn't it be easier if we knew exactly how much we value everything we own and then transact? But we can't, because of three irrational whims in our human nature.

The first one, as it was observed in the case of the basketball tickets, is that we begin adoring what we already hold. It happens to everything we own right from our favorite T-shirt to our

Play-station.

Secondly, we think more about what we may lose, rather than what we are gaining. Ever wondered why we often refuse to sell some cherished gifts? Because the moment we begin thinking about giving up our treasured chattels, we are already grieving the loss.

Thirdly, we assume that our perspective will match the other party's when transacting. If we own a car, we have some emotions attached to it and when we sell it, we expect that the buyer will have the same emotions too. So we might tend to overvalue the price.

Now what's intriguing is that ownership is not limited to material things; it also applies to points of view. Once we breed an idea, we start loving it more than we should; praising it more than it's actually worth. If someone is fascinating, we keep on telling ourselves that he/she is fascinating and we find them even more fascinating. And the problem is that we can't stand letting go the idea. And we are left with nothing, but a dogma, stiff and non-transforming.

Ills of ownership can't be cured. It is woven into our lives as Adam Smith said. But being responsive might actually help. The temptation to perk up the quality of our lives, to buy expensive furniture, a larger home, a better Sedan and all should be held back, because it's psychologically painful if one is demoted to a pre-ownership state. It's a loss, one cannot put up with. So next time when you make a transaction, do put some distance between yourself and the item of interest first.

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Trading ideas, not stocks

Sukanya Iyer

The current Occupy Wall Street movement is like watching history repeat itself as a reality show. If only Marx had been here to see his prophecy come true.

He described the new stage that unfolds as soon as 'the capitalist mode of production stands on its own feet'. "One capitalist always kills many. Along with the constantly diminishing number of the magnates of capital, who usurp and monopolize all advantages of this process of transformation, grows the mass of misery, oppression, slavery, degradation, exploitation; but with this too grows the revolt of the working-class, a class always increasing in numbers, and disciplined, united, organized by the very mechanism of the process of capitalist production itself. The monopoly of capital

becomes a fetter upon the mode of production, which has sprung up and flourished along with, and under it. Centralisation of the means of production and socialization of labour at last reach a point where they become incompatible with their capitalist integument. Thus integument is burst asunder". Ironical as it may sound Marx said that the second transformation resulting in re-appropriation of property would be an easier process as the base of socialized production on which capitalism essentially exists carries with it all the ready-made potential for transformation into socialized property and the attending class struggles change not only the economic structure of society but the superstructure as well. When one of the signs at the Occupy Seattle protest read: "Dear 1%. We were asleep. Now we've woken up. Signed, the 99%." It shows that Marx and Engels had rightly said that "not criticism but revolution is the driving force of history". However, the question remains as to whether a seemingly communist movement run by socialists trying to bring down the free enterprise system is a solution? As Brett Scott rightly questions in his article in The Guardian, "Has the Occupy Movement considered subverting global finance from within?" Not to make the long march through the institutions to change the system from within, but to gain inside knowledge in order to target the system and influence the people in it from without seems like a sensible idea. In his brilliantly written article he tells us why Karl Marx would have been an excellent hedge fund manager because essentially a hedge fund manager is looking to constantly diverge and look at big picture views and ideas, something every individual in the Occupy movement is essentially looking at. As Marx had said,

development is not imposed on us from the "outside", nor do we simply adapt, in passive ways to social change. We, in fact, initiate those changes and, by so doing, make ourselves worthy of the new conditions. So to think that the free enterprise system entails corruption and lopsided distribution of wealth is pretty much initiated by us is not wrong. The misconception that finance is "complicated" actually is in interest of the industry and is something that the activists find comforting too. The insider-outsider approach of the occupy movement leaves little scope for either of the two classes in essence. Public opinion is now mass manufactured, and behaviors are created to keep the public distracted from the real issues in life. An immediate passage of "The Dream Act" leaves nothing but for the future.

The Economics of terrorism

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Ever since 9/11 in the USA and 26/11 in India, terrorism and the threat of terrorist attacks have loomed large in public debate and academic research. The economic analysis of terrorism is a fascinating area of research with sweeping policy and welfare implications. I present herewith an overview of the existing literature.

What motivates terrorists? Grossman (1991) presents a general equilibrium model that treats insurrection and the suppression of

insurrection as economic activities willingly undertaken by the participants. The ruler has to trade off higher taxes not only with the lower tax revenue that comes about when people devote less time to productive activities but also with the added cost of having to hire soldiering services to suppress insurrection. Grossman finds that economies in which the soldiering technology is effective can move themselves to no-conflict equilibriums by devoting some resources to soldiering and keeping tax rates low. Lapan and Sandler (1993) present an analysis of terrorism as a signaling game in the face of incomplete information. Terrorist attacks are devices through which the two sides learn more about each others' offensive and defensive capabilities. Lapan and Sandler (1988) examine the extent to which governments should pre-commit themselves to a strategy of never negotiating with terrorists. They show that such a strategy is not likely to be effective when terrorists have a high probability of success or when the cost of failure is low. Effective deterrence would then require taking steps to reduce the probability of success and to raise the cost of failure in addition to adopting otherwise time-inconsistent strategies of non-negotiation. On the empirical side, Enders et al. (1990) assess the effectiveness of terrorist-thwarting policies on terrorism. They find little evidence for legislative activity in preventing terrorism. Atkinson et al. (1987) examine the impact of changes in the negotiating environment (e.g. bargaining costs, bluffing) on the length and severity of terrorist attacks. They find, in general, that increases in bargaining costs lengthen the duration of a terrorist incident. O'Brien (1996) considers whether terrorism is used as a foreign policy tool by international

superpowers and concludes that authoritarian regimes are more likely to sponsor terrorist attacks following setbacks in the foreign policy arena. These papers provide, broadly speaking, the groundwork for analyzing terrorism within an economic framework, using theoretical tools such as game theory and utility maximization as well as empirical methods such as vector autoregression models and spectral analysis.

There is also literature that analyzes how economic circumstances influence conflict in general. For example, Hess and Orphanides (1995, 2001) estimate the probability of conflict for the U.S. doubles when the economy has recently been in an economic contraction and the president is running for re-election. Similarly, Stoll (1984), Ostrom and Job (1986), Russett (1990), Lian and O'Neal (1993), Gelpi (1997), and Brueck (1997) have found linkages between the incidence of war and the political cycle and/or the business cycle. Broader definitions of conflict have been considered in more recent research. Blomberg et al. (2002), and Blomberg and Hess (2002) provide more specific definitions of conflict such as external conflict (e.g. wars) and internal conflict (e.g. coups). After doing so, however, rather than finding a systematic relationship across all countries and time, they found a conditional conflict-growth relationship that can only be identified once the region and initial conditions are taken into account.

We turn to the effect of economic circumstances on terrorism in particular. The conventional wisdom among policymakers is that poverty creates terrorism but several empirical studies have challenged this view. Krueger and Malečková, 2003; Berrebi, 2003; Abadie, 2004; Piazza, 2006; Feldman and Ruffle,

2007; Krueger and Laitin, 2007; Kurrild-Klitgaard et.al. 2006; Dreher and Gassebner, 2008; Testas, 2004 have all found little or no correlation among economic conditions and terrorism. Considering the supply side of terrorism, Berrebi (2003) finds that high standards of living and educational levels are positively associated with participation in Hamas and Palestinian Islamic Jihad (PIJ) terrorist activities in Israel. Krueger and Malečková (2003) find that the connection between poverty, education, and terrorism is indirect, complicated, and probably quite weak. In an influential paper, Abadie (2004) shows that terrorist risk is not significantly higher in poor countries when we control for political freedom. Among the cross-country studies, Krueger and Laitin (2007) is the only paper that differentiates between country of occurrence, target country, and the terrorist's country of origin. The authors use a US State Department data set on international terrorism and find that a country's economic performance is not a statistically significant predictor of international terrorist attacks committed by that country's nationals. Hence, we must strive for political freedom before targeting economic grievances. The Basque and Irish secessionists, after all, come from relatively well-to-do backgrounds and yet, their involvements in terror acts are historically significant.

Economic models tend to explain behaviors as rational individual decisions. This is necessary to be able to assert that changes in certain variables of the model will make possible changes in individuals' behavior or vice versa, and to discover which one(s). Thus, terrorists' motivations are translated into economic language by saying that they aim to maximize

their benefit, subject to some restrictions. In this context, individuals or groups can be stated to be rational, but in themselves the results of their actions do not appear to stem from a rational mind. In aerial attacks, terrorists maximize the expected benefit of the rewards sought, subject to some restrictions. The restrictions may be the actions of the authorities to cause the attack to fail. An offensive act is prepared (e.g. a number of hijackings), the independent variables of which include a subjective estimate of the chances of being caught, their estimates of the chance of being found guilty, and other actions by the authorities (e.g., police presence). Landes (1978), by using data from hijackings between 1961 and 1976, shows that the increasing probability of arrest strengthens the deterrent effect.

The existing research paradigm proffers fresh insights into the motives of terrorists and possible deterrents. It is this reviewer's personal hope that informed action will bring down national and international levels of terrorism.

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SPECIAL ARTICLE

Internal and External Migration in India Socio-Ethnic and Economic Frictions

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1. Analysis of the Nature and Causes of Rural-Urban Migration

With the stabilization programs and structural adjustments in the Indian economy since 1991 there has been an increasing disparity between rural and urban development within India,

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which has contributed to significant internal urban involution. The share of work force in agricultural activities has fallen sharply even when the backbone of Indian macro-economy continues to be agriculture in terms of share in total employment. The fact that the landless poor who mostly belong to lower castes, indigenous communities and economically backward regions constitute the major portion of migrants, point out to the logic of uneven development as the principal determinant of migration. The predominantly tribal regions of India, being recently encroached upon by the corporate giants, the so-called pioneers of development, migration may have risen due to displacement of the local tribals.

Now, I present a statistical overview of the nature and trends of internal migration in India. The data is disaggregated along the lines of gender and reason for migration.

Trends of Urban Involution in India

The total numbers of migrants as per census data were 167 million in 1971, 213 million in 1981 and 232 million in 1991. In 2001, 309 (or 315) million people (30% of the total population of India) were migrants based on place of last residence. Estimates show that the present strength of inter-state migrants is around 80 million persons. It is a common belief that the internal migration in India is mostly from the rural sector to the urban centres. However, statistics show that migration from one rural area to another rural centre records the most number of migration cases: 53.3 million, followed by rural-urban migration, 20.5 million cases. Nevertheless, the rural-rural migration has been declining since 1971, while rural-urban migration has gradually increased

from 16.5% in 1971 to 21.1% in 2001.

The following table shows the splitting of migratory population according to the reasons for migration.

Table No.: 1

Reasons of Migration	Percentage of Migrants (%)
Marriage	43.8
Moved with Household	21
Work/ Employment	14.7
Moved after Birth	6.7
Education	3
Business	1.2

Since, females have dominated internal migration (66.5% of total migration flows of duration 0-9 years) in India, so it is expected that the top two reasons for migration will come out to be marital obligations and movement with households (as shown in the above figure). However, when we consider exclusively inter-state migration, employment emerges as the most significant reason for migration because in that case male migration becomes predominant. The longer the distance of migration is, the higher the share of male migration becomes. This is due to the custom of marrying off women within the close circle, not involving long distance migration. Household Survey Data of NSSO 55th round reiterates our finding that while males dominate females in inter-state migration rates, the trend is just the reverse in case of intra-state migration.

We now concentrate on various other aspects of urban immigration, e.g., educational and skill status of the migrants, nature of clustered movement of a group with active social networking, like the Scheduled Castes and

particularly the Scheduled Tribes, etc.

SC/ST Social Network

The fact that there is a large concentration of migrants belonging to SC and ST status, especially in the informal sector (Basu, Basu and Ray, 1987; Kasturi, 1990; Neeta, 2004) suggests the positive effects of SC/STs presence in urban destinations on inducing further rural-urban migration. Bhattacharya (2002) in his regression analysis of intra-state rural-urban migration models based on 1981 census data, finds that the presence of SC population in urban areas gives positive effect on the migration of SCs from rural areas while SC incidence in rural regions is seen to reduce out-migration rates.

Education and Skill Level of Migrants

ShekharMukherji in his August 2001 paper, presented at the 24th IUSSP Conference, Salvador, Brazil, noted after a statistical analysis covering 22 metropolitan cities the following facts.

- (a) Majority of the migrants are illiterate and unskilled.
- (b) The migrants are absorbed in poor quality unorganized or informal sectors.

2. Socio-ethnic and Economic Frictions in the Indian Economy

We now consider the impacts of oppressive situations of proliferation of low quality urbanization in this section.

Incidence of migration to urban areas in India has shown an increase in 2001 as compared to the consistent decline during 1961 to 1991. Since urban involution can be of two

types, namely, urban-urban migration and rural-urban migration, there are significant characteristic differences between the impacts of these two types of migrants on the urban destination. For example, the more successful group of migrants is urban to urban migrants in terms of their occupational type and income levels due to better education and skills than their rural to urban counterparts. In this section, we are going to see the impacts of rural to urban migration, which is characteristically of a low quality.

In the last decade or so, there has been an unprecedented distressed migration of people from villages to metropolises and problems of unbalanced urbanization and extreme urban decay have cropped up. The India Urban Poverty Report 2009 highlights the fact that there has been an "urbanization of poverty", that is, many Indian states are reported to have much higher poverty figures in the urban areas than in their rural areas. Although at the national level rural poverty is higher than poverty in urban areas, the gap between the two has decreased over the last couple of decades, because urban poverty has not declined with acceleration in GDP growth. This apparently confusing phenomenon can be explained through migration of poor rural people into the cities. Now, some of the key features of the adversities faced by the Indian urban poor, most of whom are the impoverished migrants from the rural areas, are enumerated below.

- (1) Given the fact that the prevalent model of urbanization has constricted space and resources for the urban poor, they are mainly employed in the informal sectors of production. Naturally, they face a constant threat of

eviction, removal, confiscation of goods and an almost non-existent social security cover. Capital intensity of formal urban productive sectors renders the unskilled rural migrants inefficient in production.

(2) The poor rural migrants are often forced to dwell in slums with no access to basic civic amenities. 13% of Indian slums located on public land owned by the Indian Railways and 53% of the urban slums are located on municipality owned land. So, lack of entitlement to proper housing and land ownership leads to more social vulnerability of the urban poor. A shocking piece of evidence is that 54.71% of urban slums in India do not have any toilet facility and 20% of the urban slums do not have any method of sewage disposal.

(3) Many of the migrated families are female-headed households in the urban centres because of disrupted and abandoned marital relationships. Now, due to the stereotyping of work assigned to women and low wages paid to them, the female-headed households are typically poorer than the comparable male-headed migrant households are. In addition, the credit worthiness and asset ownership rights are heavily skewed against women. Thus, the women and children require security from oppressive forms of employment, violence, protection from sexual harassment, etc.

Economic Impacts

Having discussed about the socio-ethnic impacts of rural-urban migration, we now turn our attention towards the economic impacts of urban involution of mostly unskilled labour. I have used the specific factor model to show that migration to the cities can not only

adversely affect the unskilled labour force of the cities, but also those migrating from the villages.

Consider an urban centre producing two goods and in two endogenous sectors of production 1 and 2. We assume full employment whether there is migration or not. The production functions are and where is the capital, is skilled labour and is the unskilled labour. Capital is intersectorally mobile. The production functions exhibit constant returns to scale in the long run and diminishing returns to the variable factor in the short run. Let , , and .

When there is migration of unskilled labour into the urban centre, that is increases, then the unskilled wage rate falls; producers of will substitute capital by unskilled labour. This means now each unit of capital is worked upon by more unskilled labour. Hence, the real rental rate on physical capital rises since the marginal productivity of capital rises. As falls and rises, rises that is, the marginal productivity of capital in sector 2 rises. Eventually, a new higher equilibrium rental rate is achieved. As real rental rate rises, given product prices, rises that is, every unit of skilled labour has more capital to work with. Therefore, the productivity of skilled labour and consequently their wage increases. Therefore, the skilled labour and capital owners gain, while the unskilled labour loses.

Thus, economic rationality and perfect foresight would have dictated the unskilled rural workers not to immigrate to the cities. However, this logic is not available to the rural masses because they are enticed by the higher urban wage structure. However, one may argue, that in reality, this irrational rural-urban

migration cannot continue for a long time because of information flow. If the unskilled rural workers were actually exposed to the information that acquiring of skills would have solved their problem of welfare reduction then they would have simply obtained the required skills after they have migrated to the cities. However, not all of them get a chance to acquire the skills. Therefore, we have to attach a positive probability to the event of the rural unskilled workers getting a chance to get skilled in the cities. Even if a handful of the rural migrants end up getting the opportunity of acquiring skills in the urban centres and earn more, then also the rest are always ready to take a chance and migrate to the urban centre.

3. Planning Strategies for Restricting Rural-Urban Migration

Policies for restricting migration must take into consideration that not only is migration undertaken for higher employment returns and opportunities, but also because of seasonal or random shocks and stresses like drought, floods, etc., that is, migration can be "accumulative" or "coping". It is a diverse phenomenon with various non-economic determinants including caste and gender identities.

Having comprehended the nature of rural-urban migration, we can devise several planning strategies to save the Indian cities from imminent degradation. The list is as follows:

(a) **Rural Development:** This can be brought about by increased access to formal rural credits to encourage investments in irrigations, mechanized farming techniques and by promoting Self Help Groups to participate in

cottage industries like weaving, rice milling, textile making, etc. through enhanced micro-financial opportunities.

(b) **Spatial Restructuring:** The hinterland of large metropolises should be restructured with greater capital investment, development of underutilized domestic markets, industrial licenses in rural areas, smaller towns and intermediate cities.

(c) **Balanced Growth:** Decentralization and devolution of developmental decision-making powers should ensure a balanced growth in different regions of the country such that the incentive for migration is lost.

(d) **Employment Generation:** Expansion of better productive linkages between urban formal and informal sectors can increase the work efficiency of the migrants. Moreover, integration between industry and agriculture through creation of agro-based industries and surplus labour transfer to non-agricultural small-scale activities, not requiring much productive skills, can be beneficial to the migrants.

(e) **Metropolitan Management:** Promoting a humane and energizing urban society involves efficient administering of the city's social environment through provision of universal access to housing, sanitation, safe drinking water, sewerage system, proper functional education and healthcare facilities. For this, a humanistic urban planning is required, like dissemination of usage of non-conventional sources of energy under direct government patronage.

4. International Migration

COUNTRY Y	→ Stop illegal infiltration (Cooperate)	Allow illegal infiltration (Cheat)
COUNTRY X		
Stop illegal infiltration (Cooperate)	(46,42)	(26,44)
Allow illegal infiltration (Cheat)	(52,22)	(32,24)

India is a country of contradictions. On one hand, we find international immigrants from relatively underdeveloped neighbouring nations entering the country with hopes of lucrative livelihood and stable political atmosphere (97% of international immigrants are India's neighbours), and on the other hand we can see a large number of skilled or semi-skilled labour and students leaving the country for better economic opportunities in the Gulf countries and other developed regions like the US, UK, Australia, East Asia, etc. This story of both-way traffic of international migration in India can be contrasted to the mostly one-way direction of rural-urban migration. However, the net migration in India is -1000000 (World Bank), the negative sign denoting that more Indians have emigrated out of the country than foreigners coming into its territories have.

For emigration into India's neighbouring countries, the workers in the destination-countries like Nepal, Bangladesh, Bhutan, etc. will lose because of a fall in their wage rates due to even larger workforce. Added to this problem, the capitalists of these neighbouring

countries will also not be willing to employ Indian workers because of a higher reservation wage of the Indian migrants. With more unemployed population, the destination-country faces an increased socio-economic hazard and turns out to be the loser, while the source country ends up being the gainer.

I have tried to use this conclusion in a game theoretic model to show that if a country and one of her neighbours are both keen on sending their own people (mainly surplus unskilled labour) to each other's territories then the illegal migration of a huge population can be solved by only coordinated effort and not through political arm-twisting of the weaker neighbours by that country.

Consider a hypothetical situation where both Country X and her neighbour Country Y suffer from the same problem of illegal infiltration across their shared borders. Then it is beneficial for both the countries to stop illegal infiltration vis-à-vis the situation under both-way trafficking. Suppose a hypothetical pay-off matrix of Country X and Country Y is as follows:

From the above matrix, it is clear that it is always profitable to defect and hence both the countries will settle for allowing illegal infiltration into the other country's territories. The first number in each of the ordered pair of payoffs represents Country X's profit and the second number of the ordered pair represents Country Y's profit. Now suppose Country X cheats for once successfully, while Country Y stays honest. Country X gains 6 ($52-46=6$). When Country Y finds out Country X has cheated, the mutual trust breaks down. The two settle down to a regime of "cheating". Relative to cooperation, Country X now loses 14 ($46-$

32=14). Even if it takes Country Y a while to detect the cheating, Country X loses in the end. For example, if it takes Country Y 30 trials of the game to detect the cheating, Country X's gain is 180. Once cheating is detected, it takes only 13 trials for Country Y to wipe out Country X's gain from cheating. Thus, in this example punishment means strategic non-cooperation.

Extending this understanding to the subcontinent scenario, we understand that a coordinated mutual agreement through constructive dialogues, consistent with the individual sovereignty of the native governments in the subcontinent is necessary along with bilateral commitment to maintain that agreement. All political trust deficits must be overcome to ensure the elimination of illegal migration. Even if migration across the international borders continues, it should be mostly legal and only for the enhancement of socio-economic conditions in both the source and the destiny.

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Environment and Economic Growth: Instruments for Sustainable Development

Divya Singh

'Am I to sign a blank cheque and give away the livelihoods of billions of people without even knowing what the EU roadmap contains?' India's minister of Environment, Jayanthi Natarajan asked the world at the Climate Change conference held in Durban in December last year. "Differentiated responsibility" emerged as the new norm. Environmental degradation has been one of the central issues to our goal of sustainable development. Barbier and Markandaya (1989) suggest an essential criterion for sustainable development is: maintaining the net benefits of economic development subject to maintaining the services and the quality of resources over time. The recent rush of higher GDP levels has often been accompanied with higher extraction and exploitation of exhaustible resources. The solution faces debate on two fronts: a) to have a cost effective incentive based approach and b)

to have an equitable solution i.e. the countries that have polluted more, should pay more. The former can be addressed through market based instruments which is the focus of my paper while the later which Natarajan called issue of 'differentiated responsibility' is rather a political issue that I leave to our political leaders.

Incentives or Lack Thereof: Root of Problem?

Markets work through incentives. Where there are no markets or costs are not truly represented, there is overuse of resources or in other words, there is an inefficient outcome. Consider the problem of climate change. In game theory sense, it can be seen as a public good. The climate change can be achieved if at least some countries say k , contribute towards it. Contribution entails a cost. Let total number of countries be n . Then $1 \leq k \leq n$. Any country is better off if it doesn't contribute and still climate change is achieved. The worst case scenario shall be when it contributes and still the good is not provided. It can be seen that the Nash equilibrium is when exactly k contribute. In this case, $n-k$ countries free ride on others.

The economic growth in modern times involves a tradeoff between environment sustainability and GDP rate. The churning of fuel in machines or the grinding of chemicals in tubes produces harmful gases or waste that is not properly disposed. The environmental degradation has emerged because apparently there is no market for pollution or that pollution is an externality. The private optimum level of pollution for an individual firm is greater than what is socially desirable.

It is pretty much clear that the environment degradation is largely a market failure problem.

A number of instruments have been adopted over time to address the issue but they have aimed far from the target.

Instruments to tackle environmental degradation

1. Command and control approach

As soon as the problem became apparent, the knee jerk reaction led to regulation. Over time, different countries have set forward their own limits on firms. In India, the Central Pollution Control Board has been entrusted with such powers under the Air Act 1981. National Air Monitoring Programme has been a big step to control and measure air quality. Though the instruments are easier to implement, they face the same problems that resulted in the problem of environmental degradation i.e. lack of incentives and cost measure. The limits imposed do not take into account the control costs that vary across the firms. Also keeping a check on defaulters incurs extra burden.

2. International cooperation

In 1992, countries negotiated the United Nations Framework Convention on Climate Change. Since then, they have been engaging in negotiations at conference of parties. It resulted into Kyoto Protocol that was adopted in 1997. The latest conference at Durban has suggested its continuation till 2020 until a modified and more 'fair' protocol is agreed upon. Nevertheless, the entire experience of 'negotiations' has shown the difficulty in coming to a consensus. This is more like a Prisoners' Dilemma situation where all countries are better off if they reduce their

emissions while each is individually better off if it continues to pollute.

		Player 2	
		<i>Abate</i>	<i>Pollute</i>
Player 1	<i>Abate</i>	{10, 10}	{0, 11}
	<i>Pollute</i>	{11, 0}	{1, 1}

The Nash equilibrium is {Pollute, Pollute}. However, each country's individual payoff (1 each) would have been higher if they would have cooperated and chosen to abate. (payoff=10 in that case). Even in the continuous strategy space, Finus (2003) shows that each country that maximizes its profits (difference between emission benefit functions and damage functions) will emit more than social optimum.

Of course, in the long run, countries shall learn from their experience and cooperation becomes a rational strategy in the repeated games. But in the immediate future, we will have to look beyond 'cooperation' to tackle the problem.

3. Market Based Instruments

Many economists have advocated these instruments since their conceptualization. The support rests on their cost effectiveness and rationality. They work though influencing the behavior of economic agents such as households and firms by creating economic incentives/disincentives. The Kyoto protocol specifically allows emissions among Annex B (mainly industrialized) countries but with a commitment to a given level. In order to emit beyond that limit, Clean Development Mechanism (which allows them to invest in emission reducing techniques in developing countries) and Joint Implementation have been

provided for. These instruments work by equating marginal costs of abating pollution across the firms. The developing countries face an advantage because they are in process of upgrading technology hence marginal cost of lowering emissions are lower there.

The cost effectiveness of MBIs have been demonstrated by Gupta (2002) by considering five highly polluting industries (Aluminum smelter, caustic soda, cement, iron and steel etc.) in five high polluting states: Maharashtra, Andhra Pradesh, Gujarat, Tamil Nadu, Uttar Pradesh. The costs of abatement under uniform limit and under limits based on marginal costs are compared. The ratio of the cost of 50 per cent reduction for CAC and MBI for each state comes out greater than 1.

India has a lot of potential for MBIs because of the 'low fruit opportunities' that she enjoys. The efficiency of implementation can be further improved by removing energy subsidies and introducing carbon taxes. Larsen and Shah (1992) estimate that reducing world subsidies at US\$230 would reduce global carbon emissions by 9% and that carbon tax is progressive and will help in reducing the fossil fuel consumption.

However caution must be taken in adopting these instruments blindly. Some of the pre-conditions for the successful adoption of incentive based instruments like well-functioning markets, reasonably effective tax administration, monitoring instruments are missing. There is too much reliance on 'pseudo-monitoring and enforcement'. Reforms like improving monitoring standards, introducing

pecuniary awards to SPCB staff for detecting violations, installation of modern techniques etc. can go a long way in making the road of MBIs in India smoother.

Remarks & conclusion

Climate change has seen intense debate over the past few decades. The alignment of interests has rarely been observed. In the meantime, it is better to rely on the markets than the fickle minded human psychology. It is not to undermine the role of state or overemphasize the power of markets. Both play a promising role. Yet, cooperation is difficult to achieve in short run because of the inherent 'tendency to cheat'. Market based instruments offer an easier, simpler solution provided adequate infrastructure exists for their successful implementation. They are cost effective as was shown in case of the study by Gupta (2002) as compared to traditional command and control approach which makes regulation a tedious job. Introduction of carbon taxes and removal of energy subsidies can help along the way. Finally, I would like to stress the role of 'cooperation' between the state and the private sector. It was observed when the German standards put a ban on leather exports from India. The government banned the use of chemicals while the government's key research institutes and export association engaged in developing more environmental friendly ones. The degree of porosity and state support helped in making the reentry of Indian leather industry in the export market possible in short time.

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BUZZWORDS OF THE YEAR

The National Food Security Bill: Food For Thought

Priyamvada Jha

The National Food Security Bill or the 'Right to Food Act' for poor Indians is the most ambitious project of the United Progressive Alliance which is about to enter the law making arena. Under this Act, all the below poverty line (BPL) households will be entitled to 25 kg rice or

wheat at the rate of Rs. 3 per kg. If this proves to be successful, it will alter the destinies of millions of India's poor and disadvantaged people by assuring them sufficient food to live with dignity as a legal right. This Bill has been approved by the Cabinet after 2 years of intense debate. It has been commented across the nation that the Bill has been adopted in a deft move, with an eye on the vote bank in the coming elections. However, this Bill, like any other, has many pros and cons, but is facing widespread criticism from the mainstream media because of its financial implications.

According to the Global Hunger Index, India ranks 66 out of 88 developing nations. Even countries which register lower growth rates are ahead of India in this regard. Every year, around 2.5 million people in India die of hunger. Even with these disturbing indicators, we have not been able to bring about a successful initiative for the fight against hunger and build a more humane and equal India. With the introduction of the Right to Food Act, the government plans to eradicate the extreme hunger prevalent in the country. However, there are several food security plans already in operation such as Antodaya Anna Yojna Program, Mid-Day Meal Scheme, Ration Cards etc, which have failed to tackle the problem, as hunger and malnourishment continue unabated. Right to Food is yet another food security measure which relies heavily on the weak Public Distribution System and therefore, its success in the future is doubtful because all food security measures depend upon an effective distribution system for their success. The food bill is expected to cost India Rs. 27000 crore annually (though this will not materialize right away, in the coming financial year), in addition to the existing national food subsidy of Rs. 70,000

crore. Along with the recurring cost, the food ministry evaluates that the country would need to invest another Rs. 350,000 crore over time in improving grain yield, bumping up government procurement and publicizing the merits of the scheme.

But these discussions on the costs and financial implications are mostly exaggerated and alarmist which are going to lead us to nowhere. Is this additional budgetary demand of Rs. 27000 crore for expanding the public distribution system so unacceptable for the world's second fastest growing economy? According to Professor Jean Dreze, after the Bill is passed in the budget session of Parliament and comes into force around mid-2012, the additional subsidy in 2012-13 is likely to be well below the estimated figure. This is not only because of the time lag but also because the Act is unlikely to come into force in the country in one go. Also, there are some efficient ways of meeting the costs-for instance, by abolishing exemptions on custom duties for diamond and gold alone would generate nearly Rs. 50,000 crore an year, according to the finance ministry's "Revenue foregone statement".

However, the real problem with the cabinet draft bill is not that it does not guarantee food to children who are not in schools or pensions for the aged. Malnutrition and starvation require much more than a meal, but all these state duties have been erased from the government draft. In situations of natural calamity, duties under the Act cease. The Bill also excludes any guarantees for farmers, who are ironically among our most food-insecure populations. It would be fitting to include a legal guarantee for minimum support price to all farmers as part of the Food Bill, to protect farmers' livelihoods and spur agricultural

production.

The other big problem which is jeopardizing this bill's implementation is the identification of the poor. The Government has not yet decided how it will select beneficiaries. Thus there are high possibilities of committing both inclusion and exclusion errors. The National Advisory Council suggests three types of vulnerabilities: residential (homeless people-obviously poor; slum dwellers-high chances of being poor), occupational (rickshaw pullers, construction labor, domestic help, beggars etc) and social (households with no able-bodied male aged 18 to 60). In rural areas, where it is harder to decide who is poor, it may make sense to follow socio-economic categories-single women, disabled women, old people, and scheduled castes/tribes. This approach may include some undeserving people (such as rich widows), but it is less likely to exclude the poor.

Although the Bill has many loopholes and flaws, it has some impact-creating strength too. Apart from guaranteeing meals to children upto age of 14, pregnant women and destitute, it also ensures a monthly allowance of Rs 1000 for 6 months to pregnant women and nursing mothers, to enable them to eat better, and breastfeed their children. It accords migrants and their families the right to access food entitlements anywhere in the country. Ration cards are in the name of adult women, who are heads of families under this law.

India has the largest number of hungry people in the world which means that food security measures are urgently needed. The Government will have to rise above politics of fulfilling electoral promises and focus on carrying out its responsibilities for the people. In order to deal with the hunger problem for a

longer term, the poor must be taught how to earn food, which implies strengthening job-oriented programs such as MGNREGA. The National Food Security Bill must be comprehensive and should incorporate supply of essential food items (pulses, oil and sugar) of good quality, means to improve the distribution system, investment in agriculture and rural development and healthcare. The Bill must be brought into action after considering the implementation problems and how to reach the poor most effectively and we, the people must rise above the fiscal prudence stand of the Bill, and try to focus more on its strengths.

Euro: Some facts

Ishita Trivedi

Greece, Portugal and Ireland struggled to finance their huge deficits; thus, weakening the Euro and shaking confidence of investors in the Euro zone. Chances of a spillover of the crisis to other countries like Belgium, Italy and the UK has led to some concerted albeit ineffective action and extensive bailout plans.

Paradoxically, while stable economies which are doing well, like France and Germany, the ones known to be holding the Euro stable(which was trading higher at the end of 2011 than at the beginning of the crisis) are also known to be behind the poor performance of other countries in the Euro Zone.

Germany, with a trade surplus of more than the deficits of Spain, Italy, Greece and Portugal taken together, at \$188 billion, is supposed to

be one of the main reasons why smaller economies like Greece can't keep track of their expenditure on imports. Since a large trade surplus appreciates the value of the currency, this makes goods of other countries like, Greece, who haven't 'earned' it, so to speak, more expensive in the international market, rendering their exports unattractive whilst they continue to import, creating a trade deficit.



In 2011, you saw regular press coverage of how the euro was faring and how countries that were making use of it were walking on thin ice. It could very easily qualify for being the economic buzzword of 2011! So, let's go back to the foundations of the Euro crisis- the euro itself and re-discover some engrossing facts.

- The first official purchase using euro coins and notes took place in the French island of Réunion in the Indian Ocean, for a kilogram of lychees.
- People in Italy had to buy purses when the Euro was introduced because Italians had almost cease to use coins, as the lowest denomination of a Lira banknote was L1000

which corresponds to €0.5. Since there are 1 and 2 euro coins, many Italians offered a purse to each other as a Christmas gift in December 2001.

- Andorra, Montenegro and Kosovo use the euro as their de facto legal tender currency. Other non- EU member like Vatican City, Monaco, San Marino have also gained the right to mint their own coins. The Euro is also very popular in North Korea, whose official currency, won, is not convertible and can't be used to buy foreign goods.

- Inspiration for the Euro symbol € came from the Greek epsilon (€) – a reference to the cradle of European civilization – and the first letter of the word Europe, crossed by two parallel lines to 'certify' the stability of the euro.

- Sweden pointed to studies that up to 20% of women may suffer from nickel allergies and insisted on a replacement alloy called Nordic gold. But in February 1998 it turned out that Europe's 7 million vending machines and the countless payphones and parking meters could not distinguish between the new 20 and 50 cent coins containing Nordic gold.

- The Maastricht Treaty created the European Union and led to the creation of Euro. The Maastricht criterion (convergence criteria) lists what economic conditions must be satisfied for a country to adopt the Euro, they are:
 1. Their inflation rate should be within 1.5% of that of the Eurozone.
 2. Their exchange rate should be stable in relation to the euro.

3. Their annual budget deficit should be below 3% of their gross domestic product (GDP - the total output of their economy).

4. The total amount of money owed by the state, known as public debt, has to be less than 60% of GDP. (At the end of 2010, only 2 countries using Euro met this criterion!)

- All new EU member states have to join the Euro once they fulfill the necessary monetary and budgetary conditions, except Denmark and the UK which have negotiated an 'opt-out' clause.

Euro Crisis: What went wrong?

VatsalaShreeti

2012 is said to be the make or break year for the wounded Euro zone. Economists and politicians worldwide seem to be in a fix. Finding a permanent solution to a problem this complicated is nothing short of a gruesome and tedious task. Before we even get close to finding a solution, we need to answer some pressing questions. What has led to this global mess? Is the notion of a single monetary authority operating with numerous fiscal authorities feasible? Are the efforts by the ECB to get things back on track having a positive effect? And finally, is the disintegration of the European Union imminent?

Adoption of Euro and the beginning of the Crisis

The euro was adopted on 16 December 1999 and was introduced to world financial markets as an accounting currency on 1 January 2002, replacing the former European Currency Unit. Doubts regarding the feasibility of a common currency for the entire euro zone were raised even back then but its adoption got a green signal based on the argument that a common currency would enable firms to invest freely across the borders in Europe without worrying about exchange rate fluctuations and related risks and costs thus facilitating growth consistent throughout the continent.

Although the currency fared well initially with trade and investment in the continent rising by an estimated 5-10% and 5% respectively, things began to take a different course when Greece faltered in 2009. The sovereign debt for Greece reached 120% of the country's GDP, bond yields began to rise and the Greek government bonds were downgraded to junk status. Portugal, Ireland and Spain soon followed suit and the situation turned into a full-fledged Sovereign Debt Crisis.

Probable Cause

The basic reason why things turned ugly is the irresponsibility on the part of European governments. Massive over spending over the last decade by these countries raised public debt beyond sustainable levels. To expect from the popular Keynesian mechanism that this spending would lead to higher growth is incorrect. Empirical evidence suggests that beyond a certain limit, debt stunts growth. (The negative or counter multiplier effect as

increased debt leads to loss of private investment due investors fearing default by the government). This limit has been set at around 85% of the GDP for government debt. Many of the European countries are way past this ratio of debt versus GDP. These countries cannot finance their deficit as they have no control over their monetary policy and rely on a reluctant European Central Bank for this purpose. Other causes include easy credit conditions in the last decade, high risk lending practices which led to formation of asset bubbles.

The severity of the situation compels us to dig deeper and to try to identify the root of the problem. Recent events call for a review of the basic foundation of the European Union. The very idea of a single monetary authority working with different fiscal authorities is flawed. When countries enter a monetary union, they change the nature of their sovereign debt in a fundamental way as they lose control over the currency in which their debt is issued. The reason why it has been so difficult to control the contagion is that government bond markets in a monetary union are very vulnerable to financial market risks.

In a recent paper by Paul de Grauwe (The Governance of a Fragile Euro zone, May 2011), the situations in UK (nonmember) and Spain (member) are compared. Even though since the start of the financial crisis the government debt ratio of UK has increased more than that of Spain yet the yield on Spanish bonds has risen strongly relative to UK bonds. This suggests that markets put a significantly higher default risk on Spain than on UK. This can be explained as follows: In case of UK, if investors fear that the government might default on its

debt, they would sell government bonds thus driving up the interest rates. Even if the UK government cannot find the funds to roll over its debt at reasonable interest rates, it would certainly force the Bank of England to buy up the government securities. Thus the UK government is ensured that the liquidity is around to fund its debt. This means that investors cannot precipitate a liquidity crisis in the UK that could force the UK government into default. Moreover, as investors sell UK bonds, the pound depreciates and the economy is given boost. All this is absent in Spain. It does not enjoy the luxury of having a superior force of last resort in the form of a central bank nor a depreciating national currency. In a similar situation the Spanish government cannot force the ECB to buy its bonds as it has no control over it. The financial markets force Spain into a liquidity crisis which soon turns into a solvency crisis as bond yields rise. Thus, in a monetary union, financial markets acquire tremendous power and can force members to default.

Response of the ECB and Effects of the Solutions Offered

Contagion between sovereign bond markets can be stopped only if there is a central bank willing to be the lender of last resort. Even though the ECB has performed this role by buying government bonds it has always expressed its reluctance to do so. This, along with misplaced political interests has worsened the situation. Even though this function of the ECB is essential, one must not forget the moral hazard that is involved. Fiscal imprudence could be encouraged if countries take liquidity provision for granted. Moreover, the establishment of European Financial Stability Facility (EFSF) followed by the establishment of

European Financial Stabilization Mechanism (EFSM) has not seen much success. These rescue funds are not big enough and lack the credibility needed to assure the investors. While doubts can be raised on the commitment of Greece, Ireland and other affected countries in imposing fiscal austerity measures, investors also fear that in case these measures are implemented, the economies would slowdown further and enough revenue would not be raised by the state to pay the debt.

More recently, the ECB has committed to provide three year liquidity to banks to deal with the situation. Despite this liquidity injection, banks seem reluctant to buy many government bonds. As per The Economist, Italy and Spain alone need to roll over €150 billion (\$195 billion) of debt in the first three months of this year. This means intensification of the crisis as the entire continent is trapped in the vicious cycle of slow growth, austerity and bigger budget deficits.

The Future of the Euro

The Euro could collapse if one of the weak links were to step out to devalue their currency or if Germany were to step out of the mess it finds itself in. This would mean high political and economic costs and a huge setback for the entire Euro Zone. For the countries that step out, it would mean tedious work in printing and circulation of old currency which would incur huge costs. Moreover, as pointed out by Barry Eichengreen of Berkeley any euro-zone country that even hinted at leaving the currency would trigger a devastating run on its banks, as depositors rushed to move their funds to safer places.

What will happen in the future depends a lot on the stronger economies. Whether they let the dreams of a unified and strong European Union shatter or act as shields for their neighbors remains to be seen. The rest of the world will have to wait and watch. And more importantly, learn.

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WORLD AFFAIRS

The U.S. Debt Crisis: Lessons learned

Aastha Gupta

The debt crisis in the U.S. during mid-2011 had President Barack Obama and the Americans on their toes since in the absence of an increase in the debt ceiling, the US government would have defaulted on its payments, leading to a tremendous blow to business and investor confidence –raising interest rates for everyone who borrows, undermining the value of the dollar and roiling stock and bond market. To deal with this, a framework for a budget deal was struck that would cut trillions of dollars in

federal spending over the next decade and clear the way for an increase in the government's borrowing limit.

Many in the US are happy that a solution has been found to such a crisis through mutual agreement, no matter what the terms of the agreement between Obama and the Republicans might be. But this is a naïve position which ignores the great damage that this compromise has done to the US society (in the form of a sharp regression in income distribution), to the US polity (in the form of a remarkable shift to the Right) and to the US and world economy (in the form of an accentuation of the world recession).

First, let's recall that archaic piece of legislation, passed in 1917, which puts a ceiling on the magnitude of the debt of its federal government in absolute dollar terms. (Since the various State governments in the U.S. are not allowed to run fiscal deficits and hence incur debt, the federal debt is synonymous with government debt). Fixing a debt ceiling in absolute dollar terms is extraordinarily silly for two obvious reasons: first, as the federal government incurs fresh fiscal deficits every year, which add to its debt, this ceiling fixed in absolute terms is naturally bound to be exceeded. Secondly, as prices and output rise, the Federal government's revenue, and expenditure also rise, and so does its fiscal deficit in absolute terms. Any absolute debt ceiling therefore must be exceeded for this reason as well. The debt ceiling in short needs to be revised upwards every so often. Not surprisingly, there have been umpteen such revisions, though, strangely, nobody has pushed for either repealing this legislation or even amending it to convert the ceiling to a

percentage of the GDP because the size of the fiscal deficit is a flow as distinct from debt, which is a stock.

Coming back to the present, Obama had to make a compromise with the deal to save U.S. from crisis. However, this is not new. In an effort to appease the Republicans, Obama in December 2010 had agreed to continue with the massive tax cuts for the rich introduced by Bush, apparently in the mistaken belief that, since one favor begets another, the Republicans would in turn do him the favor of raising the debt ceiling, a normally routine affair as we have seen, without much ado. The Republicans however insisted upon eating their cake and having it too. Having got Obama to continue with the Bush-era tax cuts, they made it a condition that they would agree to an increase in the debt ceiling only if severe cuts were affected in a range of items of federal expenditure, which were of benefit to the poor. And Obama has had to bow before them. Under the shadow of a silly piece of legislation passed in 1917, a further grotesquely regressive shift in income distribution has been affected by the Republican Party. In the process, their strength in American politics has increased greatly as they are now confident that they can push a pusillanimous Obama in the direction it wants.

Moving away from the political impact, let's analyze the economic impact. The U.S. has a deeply depressed economy. It will certainly continue to have a depressed economy all through next year. The worst thing to do in these circumstances is slash government spending, since that will depress the economy even further.

Also, a fiscal deficit can be curtailed either through garnering larger tax revenue or through effecting expenditure cuts. How it is curtailed, and upon whom the impact of tax increases and expenditure cuts falls, are important issues affecting the class distribution of income. Ironically, a good deal of the increase in government debt in the US has been caused by the government's effort to bail out banks from the financial crisis they had collectively brought upon themselves, and also by the Bush tax-cuts for the rich, which themselves not particularly anti-recessionary, could not be reversed even as the government had to work out a stimulus package against recession. But this very increase in government debt imposed by the rich and the financial interests has been used by the same interests to bring about cuts in welfare expenditures for the poor!

This deal will hurt the poorest of Americans as cutting spending means taking money from the poor. The consequence of such regressive policies is a level of inequality unknown in other developed nations. As the Nobel laureate Joseph Stiglitz points out, in the past 10 years the income of the top one per cent has risen by 18 per cent, while that of blue-collar male workers has fallen by 12 per cent.

Moreover, even though markets reacted favorably to the deal with Asian markets jumping on the news and dollar rising against the Japanese yen, I have my doubts regarding the amount of investment will increase in long term. This is because an investor would be reassured, not dismayed, by a demonstration that the President is willing and able to stand up to the blackmail on the part of right-wing extremists. Instead, Mr. President has chosen

to demonstrate the opposite.

Some would argue that Obama had no choice in the matter, but this is erroneous. He did have an obvious way out which was suggested by many, but he did not follow it. While government bonds are counted as government debt, money issued by the government is not. The Federal Reserve holds \$1.7 trillion of government bonds at the moment, which it has been buying in its effort to lower long term interest rates (for stimulating a recovery). This sum is counted as government debt and hence figures in all calculations about whether government debt is within the statutory ceiling. If the government merely substitutes money printed by it for government bonds in the Federal Reserve Board's portfolio, then its debt falls well within the ceiling (since the estimated excess over the ceiling is \$1.5 trillion which is less than the \$1.7 trillion of government bonds with the Fed). True, substituting government notes for government bonds (it does not matter to the Fed because interest rates on government bonds are near-zero, and much of the Fed's interest earnings come to the government treasury anyway), appears to be a phoney solution; but since the debt-ceiling problem is a phoney problem anyway, a phoney solution is all that it requires, and this solution is quite enough to counter the arm-twisting by the Republicans.

The fact that this would worsen the recession in the US and in the world capitalist economy as a whole has been rightly emphasized by many writers. Countering a recession requires increased spending. Since the US cannot suddenly expand its net exports (and if it did, then some other countries' recession would be accentuated since it would have to be based on

a "beggar-thy-neighbor" policy), its domestic expenditure has to increase. Since neither private consumption expenditure nor private investment are showing any signs of a recovery (they would recover once the economy begins to recover), the increased spending will have to come from the government, and, in the absence of taxes upon the rich, will have to be financed by a fiscal deficit (taxes on the poor nullify the expansionary effects of government spending). Curtailing the fiscal deficit, and that too via cuts in expenditures for the poor, will therefore aggravate the recession in the US, and hence the world economy.

Duties of Care in Finance

Aditi Jain

Financial crises in the 19th and early 20th centuries were followed by plugging of loopholes in the system or checking the practices which apparently caused the crises. One can conclude that the crises were followed by reforms in the financial system. A prominent example would be, for 50 years after the Great Depression of the 1930s, the 'Money Power' was held to account by the countervailing power of the government. At the heart of the political check was America's Glass-Steagall Act of 1933. Glass-Steagall Act aimed to prevent commercial banks from gambling with their depositor's money, by mandating the institutional separation of retail and investment banking. This cautious approach to banking was later called the 'repressed financial system', by

economists. The act ensured that retail banks fulfilled the necessary function of the financial intermediation without taking major risks, while the government kept aggregate demand high to maintain full-employment level of investment. There was a fundamental shift in the response of the system to financial crises after 1980s. Plugging of loopholes or reforms did not follow financial crises that happened after 1980s. 'Money Power' struck back. There was a demand for more free hand and loosening of controls on financial systems, this demand was aided and abetted by a group of economists. The policy makers opted in favor of this demand. The Big Bang of 1986 in London ended the separation of banking functions in Britain. This major policy shift in Britain fuelled the demand for similar policy shift in other countries, as this allowed the banks to increase their profits substantially. After prolonged lobbying by the financial services industry, US president Bill Clinton repealed the Glass-Steagall in 1999. From that point on, commercial and investment banks could merge and the composite entities were authorized to provide a full range of services, including underwriting and other trading activities.

The merging of the retail, investment and commercial banks has brought forth new set of problems. The retail banking function of banks is fairly stable and involves very low risks compared to the investment banking function. The customers of the two functions also have very different profiles and expectations from the bank. Hence the combining of these functions is definitely not benefiting the retail banking customer, however it exposes them to a far bigger risk emanating from the speculative activity of the investment bankers. Retail

customers have neither asked for nor bargained for those risks. Also, they do not profit from these risks.

Moreover, in the 1970s, post the Nixon shock, Bretton Woods system was severely dented. This weakening of international financial arrangement, laid the foundation of the financial systems to run with a relative lack of regulation. The bankers became increasingly profit centric and started to take greater risks. The opening of international capital markets since the collapse of the Bretton Woods system led to a series of financial crises. There is, however, a common thread between the four major economic crisis since the 70's; they were all preceded by over optimism & that there was a boom followed by a bust. A major part in this boom & bust was played by the banking sector.

As a consequence of the major economic crises, many of the banks went bust. The going bust of banks has been supported repeatedly by the governments. The governments bailed out the banks with large infusion of funds. This support to the banks has been at the cost of tax payers' money. The rescue by the governments is aimed at protecting the retail customers but it actually supports the speculative excesses of the investment arm of the commercial banks. This actually resulted in creation of a system in which there was an extreme moral hazard operating for the benefit of the imprudent financial system. The financial rescue by large scale infusion of public funds has a toxic effect on the economies for a fairly long period with interest rates and inflation rates becoming volatile.

There is a greater need for trust, integrity and morality in the working of commercial

establishments. However, we cannot rely upon the institutions themselves to accomplish this task. Self-regulation is often subject to conflicts of interest between their regulatory responsibilities and their business objectives; self-regulatory role lacks transparency and encourages anti-competitive practices.

The 'invisible hand' does not seem to effectively prevent the run-away greed of financial sector from rocking the boat of the financial system. The recurrence of economic crises in last few decades has illustrated that the 'goodness' of commercial establishments can't be relied upon, particularly in matters concerning interests of public at large.

Governments by the way of public policy are required to play a part in delivering a more professional financial system. Governments can effectively ensure this with appropriate policy measures, regulations and legislations. Integrity can be ensured in the financial system by an appropriate framework which would require ethical standards, management of resources, preventive and reactive capabilities. In order to avoid and tide over the financial crisis, States must restructure the banking system by decoupling their risky and non-risky businesses.

The 'Occupy Wall Street' protests in the US further testify the points made in this article. An average citizen should not suffer because the bankers are taking excessive risks to increase their profits. A pressure group is being formed in the bastions of 'free market', which is demanding a 'control' on the functioning of financial systems. There is a need for institutional mechanism to ensure morality and selfless thinking in functioning of corporations and banks.

One hopes that with the pressure of public opinion this will culminate in introduction of

framework to protect the masses from the financial crises that are perpetuated by greed in absence of adequate statutory and institutional controls on the functioning of the financial institutions.

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The rise and fall of Dubai

Aastha Gupta

In his book "Manias, Panics and Crashes: A History of Financial Crisis", Charles P. Kindleberger provides an extensive historical account of financial crises analyzed within Minsky's framework. It starts from an autonomous shock to the economic system that alters profit opportunities; the shock can either be the outbreak of war or a bumper crop or a technological advancement or an oil shock, which creates a feeling of buoyancy and leads to a reordering of investment priorities. Consequently, there is an investment boom which may result in 'euphoria' and 'overtrading' i.e, positive (and even outlandish) expectations driving up future prices, followed by more investors entering the market to speculate and earn profits. But the boom may subside by itself

when expectations of its subsidence are caused by the inability of a few investors to repay, which sets in motion a stampede for liquidity. This rush back into money triggers panic, seizure of credit and eventually crisis.

Dubai exemplifies a similar boom-bust phenomenon. The economy was steered by the speculative excess and over accumulation of the boom, which was the outcome of the growth strategy followed by its ruler Sheikh Mohammed bin Rashid-al-Maktoum. The objective behind such a strategy was to transform oil-poor Dubai from an Arab backwater into a global city, so that by the early years of this century, it had become a global hub: the largest international financial centre between Singapore and Europe. But with the current financial crisis, the ensuing contraction in aggregate demand all over the world has led to an inevitable crash that was followed in Dubai. This became clear by the sudden announcement of the state-owned conglomerate, Dubai World, on 25 November, 2009 that it would suspend payments on its \$26 billion debt- these loans involved payments to bondholders of the world's biggest sukuk or Islamic bond issue. It is the presence of this instrument that has thrown serious doubts on the Islamic financial system, particularly, when it was believed that this segment was relatively unaffected by the ongoing crisis.

Dubai is one of seven small states that make up the United Arab Emirates (UAE), and in terms of the size of its economy, it is second to Abu Dhabi (which has most of the oil reserves). Although the economy of Dubai was originally built with the might of oil, but with a significant decline in its oil reserves, revenues from this sector currently account for less than 6% of its

total revenues. Thus by late 1980s, Sheikh began the process of transformation by adopting a strategy to diversify the economy away from oil and a shift to trade, finance, tourism and shipping as engines of growth. Hence, exemptions from corporate taxes, import and export duties were given to international companies which were accompanied by an absence of restrictions on the movement of funds, tax-free incentives and an easy hiring of labor. For instance, the Jebel Ali Free Zone (JAFZ), an industrial area surrounding the port 'Jebel Ali' in Dubai, was established during this period to lure foreign investors. The combination of a huge port and a tax-free industrial zone enabled Dubai to become a major entrepôtcentre and became a transshipment zone serving the Gulf region.

As a result of its continued growth, Dubai owned a world-class air carrier in Emirates Airlines and an iconic seven star hotel 'Burj al-Arab' within a decade. The subsequent decade saw its emergence as a global financial hub of the developing world. It was during the early years of this decade (i.e. 2000s) when the Government created holding companies that spanned the public and private sectors, namely, 'Dubai Holdings', 'Dubai World' and 'Investment Corporation of Dubai', each include several property developers with significant interests in trade & services. All of them pursued business activities designed to achieve profits for private sector investors and were encouraged to buy companies around the world.

The huge expansion seen in Dubai's economy during the period 2002-07 has been partly funded from an increase in borrowing from abroad; Dubai-based corporations became the major borrowers in international capital

markets, at the same time, the UAE banking system also procured loans, although it had adequate capital and remained profitable until mid-2008. These vast sums were borrowed to finance rapid growth, especially in real estate, which heightened the exposure of the financial system to consumer and real estate loans. This was further propelled by strong speculative increases in the value of stocks and real estate that created an uncertain future for asset prices. In view of this, acceleration in the growth of credit to the private sector was observed, which in turn, raised risks from the increase in non-performing loans. Consequently, loans-to-deposits ratio of the banking system rose continuously.

Dubai's success was also intensified by its involvement in re-exports. As a transshipment centre, it imports billions of dollars of goods that are subsequently sold mainly in Iran and Russia. This, in turn, has attracted Iranian investments and thousands of Iranian residents.

Another crucial factor responsible for the recent boom is the huge inflows of capital and labor. This aspect can be described with the exchange rate mechanism. The UAE maintains an exchange rate pegged to the US dollar, so that $1\$ = 3.67$ Dirham. Between 2005 and mid-2008, Dubai's GDP grew by an annual average rate of 7.8% in real terms, while its inflation rate doubled from 6.2% to 12.3% during the same period, very little of this growth is attributed to oil income since Dubai produces scanty oil. These high inflation rates along with the strong growth rate of the economy called for a tightening of its monetary policy. However, as the credit crunch hit the US economy, it eased its monetary policy and reduced the interest rates, so that dollar

became less attractive in currency markets leading to its depreciation against a basket of major global currencies. Simultaneously, the UAE continues to stick to Dirham's peg to the dollar, thereby causing a decline in its currency against other currencies. This made UAE exports cheaper and competitive, particularly for Dubai since its re-exports also got a boost. But the country's trade with non-dollar zone (like Yen or Euro) became expensive leading to the impact of 'imported inflation'. In addition to this, UAE's tight monetary policy accompanied by an open capital account further reinforced the above process and this, in turn, added to the already high rates of inflation.

Negative real interest rates provided another stimulus to the economy. This was in consequence of high inflation rates, which exceeded the nominal interest rates, so that the cost of borrowing became essentially free. It can be interpreted like this – debt secured today will be devalued by say 5% in a year's time or that the cost of repayment will be 5% lower in real terms. In such a situation, saving is discouraged and the prices of precious metals & other commodities face an upward pressure as people seek out alternate stores of value. This makes real estate an important source of investment. Since the rental costs go up due to rising prices, buying property becomes more attractive. This also provides an explanation of the sustained nature of Dubai's property boom and a persistent rise in private sector's credit

A continuous upsurge in oil export prices in 2007 and an incessant growth of the UAE economy led to the speculation on a revaluation of the Emirati Dirham. This triggered large capital flows into the economy,

which exacerbated credit growth and inflationary pressures. In Dubai, the outstanding stock of credit to the private sector rose further and a vast speculative bubble in real estate, stocks, and bonds was thus generated. Its success became all the more illusory when it constructed the tallest building in the world and the most expensive luxury hotels, complexes and shopping malls. In contrast, other economies of the Gulf have huge oil deposits, for instance, Abu Dhabi currently has oil reserves estimated at over \$65 billion annually. They have been less integrated with the world economy and were more sober during the boom years.

This hedonistic expansion of Dubai was hugely based on global integration, be it trade or financial flows or the movement of people. An integral part of its strategy of encouraging foreign investors was to use Dubai as the Middle Eastern base for their activities in Asia and elsewhere, so was the implementation of much more liberal policies towards dress, drink and other matters of personal norms than other states in the Gulf (including those in the UAE), which proved to be a remarkable success.

The global crisis that began with the decline in real estate values in the US inevitably hit the Gulf's most globalized economy. Dubai's fall began with the outflow of capital, as investors needed money to cover their losses in the US market, and they foresaw that emerging markets would be deeply affected by the recession. Hence the greatest advantage that Dubai enjoyed over the past six years – its interconnectedness with the global economy – has come back to haunt them. From then on, the collapse of non-tradable sectors, especially real estate and construction, was immediate.

Global markets for luxury goods and services also shrank. Real estate sector in Dubai, both commercial and residential, has seen values drop up to 50% since August 2008 and the twin issues of debt & falling property prices would act as an impediment to its recovery. Jumeirah Lake Towers (JLT) serves as a convincing example of the intensity of the property meltdown; it is a landmark development of 87 towers supposed to provide housing & offices for residents and workers, but is now largely empty. Local banks are also heavily exposed to this sector. A spectacular plunge in the property prices accompanied by a shrinking population as expatriates flee from mortgages & consumer debt has complicated the bank's problems and confounded their risk-management models.

Due to contraction in the volume of world trade in goods and services because of the credit crunch, the trading and shipping industries have also been hurt. But these sectors still offer a ray of hope for Dubai's embattled economy as it has certain key advantages of a good geographical position, logistical infrastructure and very low custom duties, so that it continues to be a significant gateway for goods for the rest of the region. The main port Jebel Ali remains one of the main drivers of the Emirates' economy. No other city in the Middle East either has the infrastructure to act as a services hub for the rest of the oil-rich region or the ability to compete with Dubai in the years ahead. This may give Dubai's economy some benefit amid the turmoil since these hydrocarbon-fuelled economies are expected to rebound from the global downturn faster than other areas.

Despite the financial turbulence that has

beleaguered the world economy, the latest GDP figures of Dubai show that the economy continued with its upward trend in 2008. According to the Department of Economic Development (DED), its GDP grew by 5.7% from 2007 to 2008. But these figures indicate a sharp denial in the fourth quarter of 2008 as the recession struck home. From the second half of 2008, the economy sank and the current account balance became sharply negative. This explains that being a small, globally integrated hub, Dubai felt the full blow of the crisis. All the principal drivers of its economy into which it diversified – trade, real estate, retail, tourism, and finance – have suffered. The rate of expansion in the services industry too has slowed down as the tourist arrivals have plummeted. Wages are also falling around the region and the situation is even tougher for the manual workers who slogged on the now-desolate construction sites. Many projects have been stalled or even abandoned that several workers have been sent home on unpaid leave. It was on 25 November 2009 when the state-owned conglomerate, Dubai World, unexpectedly declared that it would suspend payments on its \$26 billion debt. The loans involved a \$4.05 billion repayment on a \$3.52 billion sukuk (Islamic bond). Abu Dhabi has already offered some assistance by lending \$10 billion loan to its debt-laden neighbor, part of Dubai's \$20 billion package launched in 2009. The Federal Finance ministry has also deposited about Dh50 billion with banks across the country. This has helped in averting the debt meltdown and improving the outlook of the region to some extent.

To conclude, the ambitious city of Dubai is one of the biggest casualties of the global credit

crunch. Strong federal support for all the UAE banks may help its economy in managing the current situation, but broader questions of speculative growth and irrational exuberance in housing and real estate sectors remain. Global capitalism is at a point where it must deal with the consequences of the previous phase of worldwide over-accumulation in these areas. As real estate prices continue to fall in the US, default and dispossession continue to increase. At the same time, the multiplier effects of the collapse of the construction sectors are still working their way through the global economy. This crisis has not only questioned the optimistic discussion of global recovery, but has also shown how this can affect the developing world.

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Latin American crisis and Comparative Lessons from it for Eurozone crisis

Anjali Priya

In 1981-83, the world economy suffered a steep recession. Just as the great depression made it hard for the developing countries to make payments to their foreign loans-quickly causing an almost inevitable default, the great recession of early 1980s also sparked a crisis over developing countries debt. The crisis began in August, 1982, with Mexico announcing its central bank running out of foreign reserves, and that it could no longer meet payments on foreign debt. In response, banks in industrial countries, largest private lenders to Latin America, started cutting off new credits and demanding payments on their earlier loans. The result was widespread inability of developing countries to meet prior debt obligation and a generalized default.

The crisis was mainly based on the debt build-up phenomenon. So the reasons underlying the crisis were mainly the factors that led to debt build up, which were as follows:

- There was collapse of Bretton woods system, which was accompanied by the re-emergence of international capital markets and an increase in international commercial banks. Also, in

1973 the OPEC quadrupled the oil prices, their surplus being deposited in international commercial banks.

- Oil importing countries of Latin America increasingly needed capital to finance their external deficits associated with the oil inflation.
- Change in loan structure in Latin America: from a long term official loans with low interest rates to short term commercial loans with variable high interest rates-this being a major factor in contributing to the debt crisis.
- A good part of Latin American debt went to finance the growing trade imbalances.
- Many Latin American nations kept the real exchange rate strong against inflation worsening the current account.
- The continuous real ex rate appreciation made international interest to be negative in real terms. This exacerbated indebtness.

The lost decade and the Eurozone crisis

This lost decade of Latin America's growth was a result of misguided economic policies and institutions that brought on the crisis and worsened its effects.

There are obvious similarities among the various crisis and hence, there is a lot to be learnt from one crisis to tackle another. Here is a comparative analysis of Latin American crisis with the Eurozone crisis, and thus presenting a set of solutions to some of the mistakes that led to the lost decade for Latin America.

1. The first lesson of the Latin American debt crisis is that politics matters. To a

significant extent, the crisis of the 1980s had political roots. Latin American governments ostensibly borrowed from abroad to finance infrastructure projects and boost economic growth. In reality, however, much of the borrowed money was used to maintain consumption standards and, in that way, political support for incumbent governments.

This was especially true after 1979, with the second OPEC oil-price increase and then the sharp increase in interest rates by Paul Volcker's Fed designed to bring inflation out of the U.S. economy. Imported oil and payments on the foreign debt both having become more expensive, Latin American governments and households should have adjusted their borrowing and spending. Instead, Latin American debt more than doubled from \$159 billion to \$327 billion between the beginning of 1979 and end of 1982. Failure to rein in spending made the subsequent crisis inevitable.

Similarly for southern Europe, capital was meant for productive investment. In reality the imported finance fed an enormous consumption boom. In Greece there was a sharp increase in public-sector pay that spilled over to the private sector. Spain experienced a real-estate bubble and Portugal a combination of these problems. The underlying cause was the same: fall in interest rates to German levels and the ready availability of finance.

2. During Latin America's crisis, money center banks in New York engaged in the process of petro-dollar recycling

were flush with funds and hence were so willing to lend. The banks could not claim ignorance of the fact that there existed gaping budget deficits and other economic problems in Latin America. But given ample liquidity and the fact that the big U.S. banks were losing large corporations to the commercial paper market made loans to Latin America an attractive alternative.

We have seen precisely the same thing in Europe in recent years. The world economy was swimming in liquidity, and European financial institutions, in desperate competition with one another, were aggressively ramping up their leverage. Under these circumstances, German, French and British banks found it irresistible to lend to their Spanish and Irish counterparts, which turned around and lent to local property developers.

3. The reluctance of the United States and other creditor countries to contemplate debt forgiveness reflected not any deeply held belief in the sanctity of contracts but simple fears for the stability of their banks.

The loan portfolios of the money center banks were more than double their aggregate capital.

Thus, significant write-downs, on the order of 50 per cent, would have bankrupted them and precipitated a major financial panic.

So U.S. regulators, in their wisdom, insisted that Latin countries were able to pay. They piled more debt on the borrowers' existing debts, through official loans co-financed by the IMF

and the creditor countries. They insisted on structural adjustment programs as a condition for the extension of official credit. But spending cuts meant recessions, which produced an even larger debt overhang, discouraging investment.

The result was Latin America's lost decade.

All this made debt restructuring inevitable. And the inevitable finally came starting in 1989. By that time the money-center banks had fortified their capital base, enabling them to withstand it. But much better would have been for the U.S. to have recapitalized its banks in 1982-83 in order to avoid this destructive seven-year delay. This is precisely the situation in Europe today. French and German leaders are deluding themselves into thinking that debt restructuring can be avoided. In demanding that restructuring be avoided at all cost, they are consigning the Euro-zone periphery to a lost decade. A better use for their funds would be to adequately recapitalize their own banks, rather than co-financing emergency loans to the crisis countries.

Conclusive remarks

In recent years, the international economy and market have undergone vast changes that have strengthened and diversified international financial flows. The problems of the present needs tailor made solutions. I, therefore, strongly recommend handling of future economic crisis in developing countries on a case-by-case basis.

Prevention is better than cure. Industrial countries should continue to reduce fiscal deficits, implement prudent monetary policy, and face up to structural challenges so that interest- rate shocks do not recur and sustained growth is realized. Emerging market economies

should reinforce their commitment to fiscal balance, exchange-rate realism, and ongoing structural reforms, which have played the major role in the normalization of emerging capital markets in the 1990s. The IMF for its part should continue to improve its surveillance efforts by strengthening its dialogue with private market participants.

Sustainable and sound economic policies must be favored over populist policies.

'Occupy Wall Street': Call for a fairer Society

Bhavyaa Sharma

The year 2011 was unusual in a variety of ways. From a tsunami triggering a nuclear disaster in Japan to the busting of countless scams in and out of the corporate world, the previous year was eventful to say the least. But what makes it so different from the past years were the unprecedented revolts, both peaceful and violent, across almost all continents. One uprising led to another, heralding the emergence of a new society, which prefers to uphold the ideals of democracy, to make its voice heard by those at the higher echelons of bureaucracy and corporations rather than keeping mum.

One such protest that has been gathering steam ever since it was initiated (in September, 2011) and quite fortunately refuses to die down is the OWS protest in USA. One may call it the child of the Arab Spring or the product of the

frustration of countless Americans with their economy in the doghouse, but on a different note, it has also helped the eternal debate between capitalism and communism to resurface. Economic slowdown with unemployment at a dismal 9% and the continued widening of the income gap between the rich and the poor (as can be inferred from the self explanatory slogan- WE ARE THE 99%) sponsored by the excessive corporate loot and lobbying in addition to the excessive financial bailouts by the government has led to widespread anger, dissent and despair.

Between 1979 and 2007 incomes of the top 1% of Americans grew by an average of 275% vs. just 40% for 60% of the Americans in the middle of the income scale. Over the last 30 years, the tax burden has grown more on the '99%' rather than the higher income group. Yes, definitely prior to 2008, the U.S. economy grew at a decent pace but that was mostly on account of the rich getting richer. Post 2008, the condition has worsened. With the U.S. capital markets crashing to touch a record low, the U.S. government decided to bailout the big banks (while completely neglecting the smaller ones) making them 'too big to fail', who after leveraging up and gambling with the taxpayer- insured deposits lost big in the 2008-09 crisis. However that has only made the corporations more reckless than ever. Most of them are either sitting on \$2-\$3 trillion of bailouts or are investing them almost without thought in the market. Here is when 'crony capitalism' enters the story. If the investments turned out to be profitable, the winnings were privatized, while the risks, if realized, meant an overwhelming burden on tax payers, i.e., the losses were socialized. While increasing corporate influence

on the government ensured bonuses for failures, the average taxpayer buckled under the massive weight of increasing taxes, inflation and recession. The 9% rate of unemployment does not only reflect the impact of recession, it mirrors the growing disconnect between one's contribution to the society of the corresponding dividends. More and more Americans as well as other people in developing as well as developed economies getting deprived of their basic entitlement to education, health and most importantly, economic freedom points out the absence of a social democratic state and the desperate need for countervailing movements and parties of the lower income groups to counter the power of the corporate elite. The recent cut in the government expenditure (in U.S.) by \$1.2 trillion has thus proved that the bailouts exist only for meeting the insatiable greed of the corporate elite and not the worthy classes, in particular the poor and middle class, inviting the public's wrath and the protests as we see them today.

The protests have been repeatedly criticized for incoherent demands, violence and their inability to bring about the requisite changes in a short span of time. But what most people fail to notice is that the protests don't claim to be the solution of the problem. Instead, OWS is an expression of the public's anger, frustration, a channel through which the ordinary citizen has not only demanded more action to reduce corporate loot but has also called for a free market capitalism, one that is different from the monopoly capitalism which we are habituated to. It has, turned the much deserved spotlight to the fact that the unequal concentration of wealth is not, as many like to call it, the result of free market economy and capitalism, not when

it fails to provide 25 million people with employment opportunities. Instead, it precludes the development of a strong and powerful middle class, thus acting as a drag on the growth and development of both the society and economy. Higher taxes for corporates with better tax administration, anti-carbon tax, reduced material costs through free trade and merit and performance based pay are some ways that ensure that profits are redistributed in an efficient way. At the same time, governments all around the world need to understand the inefficiencies associated with the bailouts and take a cue from Argentina and Iceland's economies which channelized the revenues towards more productive expenditure instead of bailing the banks out, pulling themselves out of recessions effectively. In a paper authored by Jeffrey A. Miron, the problems accompanying bailouts have been put forth and unsurprisingly, America has been seeing them all. In Miron's opinion, "instead of bailing banks out, policy makers should have allowed the standard process of bankruptcy to operate. This approach would not have avoided all costs of the crisis but it would plausibly have moderated the effects for a longer term." It is foolish to believe that policy makers mustn't have foreseen that but the ever increasing corporate influence has led them to do otherwise. If not doing away with them completely, a cap on funds should certainly be put.

The Wall Street protestors, varying in their demands, stand alike in their call for more economic inequality. The fact that most democratic countries (including our own) are unable to provide their citizens with social and economic democracy and fail to ensure a free

market and equal rights is a cause for concern indeed. It is thus imperative to make proper amendments relating to equitable redistribution of wealth, lest the burgeoning sociopolitical movement should obstruct the growth of not merely America but other economies as well.

Guest Article

A Report on Financial Access in Nepal

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1. Introduction

Access to finance enables individuals and enterprises to do what they desire. Financial access is the availability of financial services like credit, savings, deposit, ATM services, payments, insurance and other risk management services. According to World Bank, access to financial, physical and social infrastructure are necessary to complement the efforts of the poor people for living better lives and coping with risks. It is considered as one of the means to attain Millennium Development Goals (MDGs). Well- functioning financial markets are pre-requisites for the economic development of this region.

In recent years, delivery of financial services to the poor has increased worldwide. The numbers of public and private commercial banks, state-owned rural development banks,

cooperative banks and informal institutions- such as self-help groups, and savings and credit associations that provide financial services to the poor have grown. Delivery approaches have varied based on population densities, type of clients, growth of financial institutions and in some countries, the history of community and self-help initiatives. This growth has led to introduction of innovative products that have improved the means of livelihood for the poor, by building their assets and increasing their earnings (WDR 2009).

Lessons learned from other countries have shown that formal financing system is essential for economic development process as it helps in mobilizing and allocating funds towards productive investments, reducing information costs, providing better access to markets through their intermediation process. Financial sectors are a major element of any developed economy. The opposite is the indomitable truth for all the developing nations. According to the World Savings Banks (2004), only 20%- 30% of the population in most developing economies has access to formal financial services. The adverse impact of limited access to financial markets is not only suffered by the poor but also by the non- poor. It's not only the problem of developing countries but also of the developed ones. Sometimes, it may be worse in a developed nation due to existence of a complicated financial system.

In a typical developing economy like Nepal, the formal financial system at best serves no more than three fourths of the population. It is because most of the population lives below the poverty line and they cannot afford to participate in the elegant formal financial system. Though some of these people are not able to use formal or semi formal financial services, at the same time, they may have access to finance via informal financial services. It is imperative that the development of each and every country is based on its geographical,

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political, socio- cultural and demographical dimensions. Geographically landlocked, social-culturally diverse, politically unstable and demographically dispersed are the major factors for the downward trend of financial activities in the context of Nepal. Though the country seems to have remarkable improvement in access to physical and social infrastructure, access to financial markets still remains limited and declining.

2. Financial Market in Nepal

2.1 Growth of financial institutions in Nepal:

Over the years, though the number of financial institutions is increasing in Nepal yet access to finance is limited. Financial access in Nepal is guided by the provision of deprived sector lending requirements for banks and financial institutions in the annual monetary policy, Microfinance Policy 2008, Bank and Finance Institutions Act 2006, Act for NGOs involved in Financial Intermediation 1999 and Co-operative Act 1992. Within this provision, financial institutions engaged to promote financial inclusion are Commercial Banks (CBs), Development Banks (DBs), Finance Companies (FCs), Microfinance Development Banks (MDBs), Financial Intermediary NGOs (FI-NGOs) and financial cooperatives. There are networks of financial service providers namely Nepal Federation of Savings and Credit Cooperatives Union Nepal, Grameen Nepal Network, Centre for Microfinance, Microfinance Association of Nepal, Institutional Network of Alternative Financial Institutions, Nepal Micro Bankers Association, Nepal Bankers Association and Association of the Development Bankers and four wholesale microfinance service providers such as RMDC, SKBB, CBs/DBs/FCs and Rural Self Reliance Fund that are directly engaged on promoting financial access to the unassisted. Further, large number of national and international NGOs are also engaged on

promoting community based financial services for the poor and disadvantaged groups.

The table below shows the growth rate of 3 decades of financial institutes in Nepal.

Growth of Financial Institution in Nepal

Types of Financial Institutions	Mid – July				Mid-Jan
	1980	2000	2005	2010	2011
Commercial Banks	2	13	17	27	30
Development Banks	2	7	26	79	87
Finance companies		45	60	79	79
Micro- finance Development Banks		7	11	18	21
Saving and credit Cooperatives limited banking Activities		19	20	15	15
NGOs (Financial Intermediaries)		7	47	45	45
Total	4	98	181	263	277

Source: Nepal Rastra Bank

Before 1980 there were only two commercial banks and two development banks providing banking services to the firms and individuals. As of May 2011, there are 31 commercial banks, 89 Development banks, 87 finance companies, 21 micro finance and development banks, 15 cooperatives, 45 NGOs financial intermediates and over 8,000 financial cooperatives and over 230 small farmers cooperatives limited (SFCLs). The table above shows that the banking sector

underwent tremendous improvement in year 2000 as the number of banking institutions increased by 84 percent. Similarly, the banking institutions significantly grew by 55 percent in 2005. Coming to year 2009, the growth rate declined to 2.98 and again increased by 7.984 in 2010. Despite the government's effort in enhancing poor peoples' access to financial markets, the capital market in Nepal is still at developing stage. Only 26 percent of the households have a bank account and 45 percent of the households prefer to save at home while 53 percent prefer to borrow from the informal sector.

2.2 Indicators of Banks in Nepal:

With the increasing trend in GDP of the economy, the number of the bank branches in the economy has also increased significantly which has definitely mounted the amount of monetary transaction. Since 2001 when the population per bank branch used to be 53.84, it has now decreased to 26.58 which suggest that financial access has certainly increased.

The commercial banks have extended their services all over Nepal, 1,063 bank branches are spread over different parts of Nepal. This allowssmall businesses and low-income households outside Kathmandu valley to have easy access to financial services and other economic benefits. The banking services are concentrated in Kathmandu valley where 290 bank branches are present. The other branches are not enough to serve the population living outside the Kathmandu Valley. Because of the limited number branches in rural parts of Nepal, there are problems of saving, credit and investment among poor people. Access to banking infrastructure measured in terms of number of population per bank branch has decreased considerably over the years. Though the total amount of deposit, loans and advances and investment seem to increase over the years, the number of bank deposits and loan accounts per 1000 people has decreased over

the years. This indicates declining access to financial services.

2.3 Household access to financial service:

Despite repaid expansion of formal financial sector, informal system is still popular in Nepal. Current supply of finance for the poor and disadvantaged groups is estimated to be around Rs. 20,000 – Rs. 24,000 million (casual discussion with financial experts). Potential of thousands of informal savings and credit groups (PAF and other) and financial cooperatives that exist throughout the country are inadequately utilized and almost forgotten.

Household Borrowing and Access to the Bank Credit

Description	1995 /96	2003 /04	20 10
Household borrowing loan	61.3	68.8	65
Borrowing from bank	16.2	15.1	20
Borrowing from relatives & friends	40.8	54.5	51 .1
Proportion of poorest quintile having access to bank borrowing	8.2	8.3	9. 0
Proportion of richest quintile having access to bank borrowing	21.8	26.8	34

Source: NLSS I and NLSS II (1997, 2004, 2010)

The table reveals that, the proportion of household borrowing increased by 7 percent from 1995/96 to 2003/04 but coming to year 2010 it decreased by 3.8 percent. The most common source of household loans in the

country, relatives/ friends and money lenders decreased slightly in 2010 whereas borrowing from bank increased by 4.9 percent. But the poorest quintile having access to bank borrowing has remained constant over the year. The proportion of the richest quintile households having access to formal bank borrowing is almost three times higher than that for the poorest quintile and it has increasing trend. Besides, more than 70 percent of the loans that are borrowed are for the purpose of personal use. Households in richer consumption quintiles are more likely to borrow for business/ farm purpose whereas households in poor quintiles tend to borrow for consumption purpose.

The different indicators show that despite the government effort and increasing number of financial institutions in the country, formal financial institutions have not been able to provide services to the population significantly. More than 50 percent of banks and financial companies are concentrated in urban areas whereas largest proportion of rural population depends on FINGOs/ cooperatives.

Households with credit from formal sources (urban/rural)

	Banks	Finance Companies	MFDBs/ RRDBs	FINGOs /Cooperatives
Kathmandu	43.2	43.2	4.5	9.1
Other Urban areas	56.1	9.6	10	9.1
Rural	31.7	1.4	22.4	44.6

The study shows, urban population is able to utilize the economic benefits from financial market significantly whereas the rural

population is still excluded from well functioning formal financial market. Since majority of Nepalese population resides in rural Nepal, formal financial institutions have not been able to cater to the needs of Nepalese population at large and access to such services has been very limited for low income households. Since population from rural areas do not have proper access to formal financial institutions, they may access to financial services via informal financial institutions. The majority of people these days are involved in informal financial markets like mother group. In this market, people regularly save money as per the rule of the institution. Basis loan is provided to the member in need. The interest rate is very low and it's easy for poor rural households to participate in this market. It also avoids the complexities of formal financial institution. This type of financial market is very popular in rural Nepal.

Conclusion

Access to finance is crucial for significant economic growth. The developed countries have seen the different drivers converge and hence an exponential growth in access to finance for those at the lower end of the markets. In Nepal, despite decades of efforts to motivate and push people to use formal financial institutions for the financial access.

Nepalese financial market was dominated by money lenders. The decreasing proportion of people dependent on money lenders shows the significant change in financial access at household level. But the preference of borrowing from relatives and family members is still a major constraint for development of a well-functioning financial market.

Banks should expand lending to small businesses and low-income households and microfinance institutions can also go a long way. Financial inclusion and continuous government involvement are quintessential for

the road ahead. If Nepal can allow diverse institutions to enter the industry and play an active role, she undoubtedly can see much higher growth rates.

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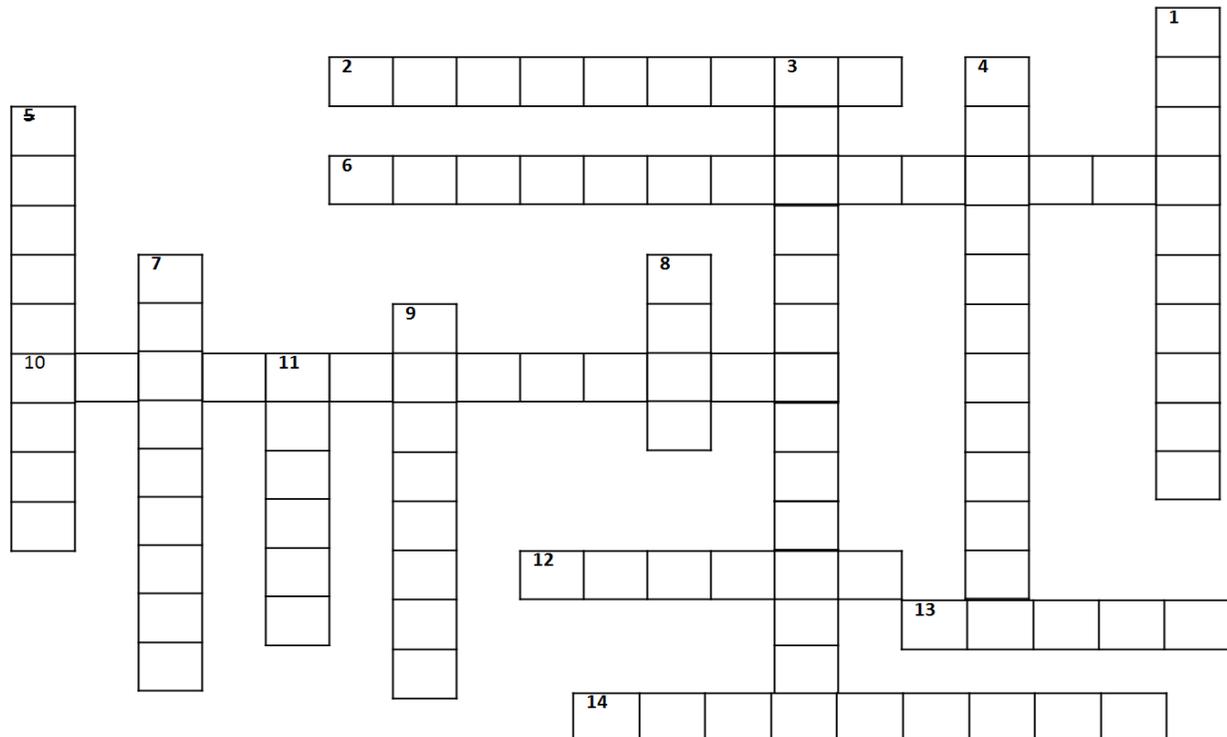
QUIZ

1. Ian MacLeod, a British MP, coined this term in 1965, which is widely used nowadays. The term refers to a situation or context that can be described as the 'worst of both worlds'. What is the term?
2. How do we better know JW Foster & Sons?
3. Who instituted the Nobel Prize for Economic Sciences in 1969 (though the prize is not a Nobel Prize but the announcements and presentations are made with other Nobel prizes)?
4. Who said, "I have done more than anyone else to change the face of mankind."?
5. Under what category does the Guinness Book of Records enter itself?
6. What term was coined by Don Hoefler in 1971 describing a particular area of the United States?
7. What does T in the name of T-Series stand for?
8. He called his wife 'the believer' because she encouraged him at a time when everyone else called him crazy. Who is he?
9. Published by The Economist, X is an informal way of measuring the purchasing power parity between two countries and provides a test of the extent to which market exchange rates result in goods costing the same in different countries. What is X?
10. We are the 99%. This refers to which of the recent movements or protests?

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[For answers, please turn to page 21](#)

CROSSWORD PUZZLE



DOWN:

1. Maximum utility in the absence of budget constraint
3. Includes culture, institutions, politics and power, structure, votes, rituals and the state; defined by the base
4. Let it be
5. Few sellers, strategic decision making
7. Mutual funds that invest in only government securities
8. Catalyst for promoting foreign trade in India
9. Measure of peakedness of a probability distribution
11. Apex development bank with focus on rural elevation

ACROSS:

2. Social, economic and political order aimed at creation of classless, moneyless state
6. Other things remaining constant
10. Neither a borrower nor a lender be
12. Fairness or just
13. Notion of dialectics, had an influence over Marx
14. Document creating a debt or acknowledgement without collateral

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RUPADEEPANJU

For answers turn to page 14

JUST LIKE THAT

- What do you get when you cross the Godfather with an economist?
 - An offer you can't understand.
- What does an economist do?
 - A lot in the short run which amounts to nothing in the long run.
- What is the difference between a recession and a depression?
 - A recession is when your neighbor has lost her job. A depression is when you lose yours.
- Bad economic times can actually be good for you because people tend to exercise more and eat less. This is not a recession; this is the Health Care Plan.
- Achieving free trade is like going to heaven. Everyone wants there, but not too soon.
- "I am a market economy", a woman was surprised to say. "My hair is in recession, the waist is a victim of inflation, and together they put me in a deep depression."
- "Someone once said about economists that they use economic data the way a drunkard uses a lamppost--for support rather than illumination."
- "Or as Disraeli put it, there are three kinds of lies: lies, damn lies, and statistics."
- Economic forecasting is like trying to drive a car blindfolded and following directions given by a person who is looking out of the back window.
- For economists, reality is a special case.

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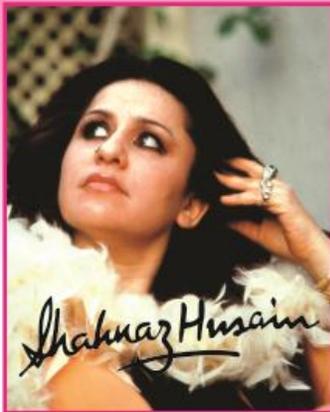
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