CHAPTER - III

BRETTON WOOD INSTITUTIONS AND DEVELOPING ECONOMIES

INTRODUCTION:

Historically 'Economic Liberalism' was of Western thought where economic institutions like International Monetary Fund (IMF) and World Bank were in fact the front institutions of the western economic systems comprising of the early western colonisers who subjugated the colonies of third world during last three centuries. In other words, western economies adopted subtle packages for their imperialistic tendencies to be imposed upon less fortunate countries. Such a mission had been extended universally that the western missionary zeal have now been changed into a international model of economic development through the vehicle of its preachings, a model that has yielded such wealth in the west that has now become a source of hope and emulation to the whole world. One consequence of this success is that economic affairs of a growing number of countries in the third world have been totally subjugated to the western financial institutions, General Agreement on Trade and Tariff (GATT) negotiations, Multinational companies (MNCs), experts and specialists, all those creators of wealth.

The manpower and natural resources of the developing countries were arrogated to serve the interests of western economic and industrial systems. When discussing the terms and procedures of international trade treaties and agreements concerning GATT and intellectual rights and negotiating the terms
of servicing our debts obligation to the west, historicity of developing countries debts playing an adverse role with unequal treaties and open door trade agreements, imposed by the invasion of western companies. The developing countries can not retaliate the invasion of the west nor can quantify the western debt to them. International trade with unequal though apparently to be mutually advantageous but the combative cost advantage in the historical experience of trade has been one of domination by the strong and deprivation of the weak as an instrument of exploitation of the developing economies.

According to the world bank and IMF, the crisis of the country would undergo certain stabilization programmes in order to overcome the problems. This chapter 3 divided into four sections 1) Bretton woods institutions and Role of India, 2) Stabilization policies and Economic reasons, 3) IMF packages - some case studies and results, 4) Development Assistance and MNCs.

1.1 BRETON WOOD INSTITUTIONS AND INDIA:

The Bretton Woods conference held in 1944, designed an institutional infrastructure that embodied the principles of liberal international economic order, while adherence to the rules of the IMF would provide macro-economic equilibrium, without which the maintenance of a liberal trading system was economically less compelling and politically more difficult. The GATT provided rules reflecting multilateralism and non-discrimination that would enable the contracting parties to reap gains from trade according to the principles of the theory of comparative advantage.
India did not take an active role in the past rounds of multilateral trade negotiations (MTNs). An outside view is that by taking a back seat, India took advantage of a free rider position. Its own trade restrictions were safeguarded by the special and differential treatment (S&DT) accorded to developing countries in GATT while India got the benefit of tariff reductions negotiated in the successive rounds owing to the principle of the most favoured nation (MFN) status.

But India view is very different on GATT, India was placed at a disadvantage in terms of negotiations and the net outcome of the negotiations was that the tariff reductions on export products. Besides the beneficial effect of tariff reductions was offset to a certain extent by non-tariff barriers set up by the developed economies on which the rounds of negotiation have had little effect. It is a process in which countries trade power they command by virtue of their imports and exports in huge numbers for trade concessions. India whose share in world trade is 0.7% does not have any leverage to obtain concessions.¹ United States (US) used to obtain significant concessions from the EEC in Kennedy round. India which probably suffered more in relative terms from Britain's entry into the community, tried hard but got no compensation from EEC. In the recent round US sought compensation from EEC for losses it has suffered through the entry of Greece and Spain into EEC, and has threatened punitive tariffs on a

number of EEC products. India's textile products have suffered
too. The low levels of India's perceived economic interest in the
Uruguay round made its position there particularly vulnerable to
India's over all foreign policy. This has a positive and negative
aspects.

The net advantages to India from GATT until the Kennedy round
were two fold.
1) India received the benefit of the opening up to developed
countries. It did not have to abandon its quantitative
restrictions or bind its tariffs owing by Special and Differential
Treatment (S&DT) for developing countries for joining.
2) If the structural adjustment programme aims to help and
assist the third world in their advancement and economic
betterment, then poverty alleviation must be integral to the
adjustment packages.

Since the basic objective of a poor country is to over-come
poverty and to improve economic betterment of the poor
classes, India's efforts to promote exports manifest a number of
contradictions. Thus, the export of certain products puts them
beyond the reach of low income consumers. The consumption gap
between the rich and poor therefore widens, with a consequent
receding of the goal of a reduction in economic inequalities.²

The present day interdependence is one which combines
²Samuel Parmer - Self Reliant Development in an interdependent
world in "Beyond - Dependency" edited by G F Erb and V.Kallab,
sophistication comes from enhanced technological capabilities and expanded social intellectual awareness, the symmetry emerges out of a new egalitarian morality combined with a more balanced capacity for mutual harm. The combination of an egalitarian ethic and reciprocal vulnerability within a framework of wider technological and intellectual frontiers provides the essence of mature interdependence.³

II. STABILIZATION POLICIES AND ECONOMIC REASONS:

Stabilization program consists of five kinds of policies they are:

a) 'Austerity' in the sense that the public sector is expected to contract its fiscal deficit (in real and even in nominal terms) and to borrow less from the Central Bank, and include cuts in state spending for public investment and social service programmes resulting into higher prices for products supplied by public enterprises and increased taxes.

b) Revision of the exchange rates in most cases directed towards weakening or devaluation of the host country. Appreciation is occasionally recommended as a anti-inflationary measure.

c) Monetary restrictions, involving not only restriction on credit to the public sector, but also reduced private credit limits, interest rate increases, and similar manoeuvres as applicable in the institutional context.

d) Policies aimed at improving economic performance in the medium

term. Since the IMF and Bank are market oriented their suggestions usually include 'liberalizing and privatization' if the system by removing state interventions in domestic markets. Lowering trade barriers and easing off on exchange controls. More specific recommendations may include interest rate increases consistent with tight money aimed at raising saving cuts in the real wage. Price incentives for exports and usually non price supply policies such as directed planning and public investment are given short shift.

e) Income policies consistent with the manoeuvres just enumerated are used to redirect specific payments flow, wage restraint, revision of subsidy and transfer payments programmes and stimulate for import-substitution or export promotion which favour certain economic groups are frequently observed. Thus all these are called as stabilization measures of the fund and bank. 4

II.A. URUGUARY ROUND OF GATT AND INDIA :

Though, initially India opposed to active participation in GATT rounds and earlier plagued by the bitter disputes e.g. on Agriculture, as well as between the developed and developing countries, the Uruguay round was successfully concluded in April, 1994. A key feature of the agreement was the carefully balanced set of concessions between the developing and developed countries that covered the three main sets of negotiating issues.

In brief they are as follows:

X) The issues not previously covered by GATT and involving forms of deep liberalization previously mentioned, specifically a) trade in service, b) trade based aspects of investment measures.

2) Issues covering areas that had initially been subject to standard GATT rules but were later excluded from GATT discipline for special reasons namely, Agriculture and Textiles / apparels; and

3) Those related to traditional GATT issues such as tariff Liberalization, subsidies, dumping, Govt.procurement, technical barriers of trade, dispute settlements and institutional reforms.

India earlier to mid-1991 twice tried stabilization policies, the first programme involved a devaluation in 1966. The other one the process of trade liberalization was supplemented by some easing of industrial licensing and fiscal reform in Sri.Rajiv Gandhi's early administration. It was not until the macro economic crisis of 1991 forced into the arms of World Bank and IMF 5

Robert Baldwin - Development prospects under increasing Globalization - a paper presented in International Conference on India's Economic Reforms, 12h February, 1996 at ICRIER, New Delhi * ICEG, Sanfransico, USA.
so that a more serious attempt at Liberalization.\(^6\)

It is argued that growth in Indian Economy constrained by one or more of three factors.\(^7\)

1. Potential Savings
2. Food Supply, and

During the last 3 decades trends in Agriculture output growth accelerated due to new technology, public investment in irrigation and supportive price policy, although the economy remained vulnerable to adverse food supply shocks from bad monsoons. At the same time, the rural incomes of agriculture origin, and income distribution shifted towards the urban middle class and upper middle class and rich class for several reasons (worsening terms of trade and falling wage share) making the aggregated consumption basket more towards non-food intensive items drawn from imports and less of food intensive items due to demonstrative effects of change in imports and consumer preferences. With the rise in oil prices of 1973 onwards the above trends drained off foreign exchange causing binding restriction on growth.

III. IMF PACKAGES- CASE STUDIES:

Trade liberalization may stimulate output (at least in medium

\(^6\)Deepak Lal : India & China Contrasts in Economic Liberalization? World Development Vol.23. Great Britain-

\(^7\)Abjit Sen - Stabilization - Indian Experience - in Wider Studies in Development Economics. op. cit.
term) by creating neo-classical economic efficiency gains. It may also hold down inflation rate, if the law of one price broadly applies, such views are typically Brettonwoods institutions. By contrast the wider studies\textsuperscript{8} suggests that liberalization may force de-industrialization if it draws in imports and not have much effect on inflation, if the laws of one price is not enforced by a visible presence of price, competitive traded goods in the system. Anti-liberal policies such as import quotas and export subsidies have positive effects under these circumstances. Colombia and Kenya provide successful test cases.

Exchange liberalization may facilitate capital inflows and create financial depth in the downside it can permit flight and precipitate examples of the latter events as well as situations like Colombia's and Brazil's where exchange restrictions held down capital flight. The World Bank and Fund (IMF) feel that, because it removes distortions exchange liberalization should be pursued.

Interest rate hikes typically reduce aggregate demand in the short run, will they also be inflationary by driving up working capital finance costs? several wider studies reports that stagnation after interest rate hike in their economies is observed IMF says that such outcome never occur.

In the short-run devaluation tends to be inflationary by driving up intermediary import costs and there by final goods prices through markups. The higher prices cut real wages while

\textsuperscript{8} Lance Taylor - Varieties of Stabilization Experience - in Wider Studies - op. cit.
devaluation itself reduces national purchasing power when imports initially exceed exports. At the same time real depreciation may stimulate import-substitution and an export response through the first two channels devaluation will make output contract especially in a stagnant economy. Better trade performance may make GDP to go up.

Devaluation has economy wide repurcussions dependingant on institutional circumstances, in primary exporting countries. It is a tool of fiscal policy, the cash flow of state marketing boards and depends on the difference between producer prices and the exchange rate determined by broader price of export crops. Else-where Wealth effects may be important, aggregate demand probably feel no further, that happened in Mexico after 1982 due to devaluation which increased the value of capital that has flown across the border in Peso (Mexican Currency) terms, stimulating tp spend on the part of rentiers. The country studies emphasize such linkages ; but Brettonwoods approach is to turn them down in favour of price induced substitution effects.

One may ask whether devaluation and other price policies will improve readability (reducing import co-efficients and increase export market penetration) by themselves ? Alternatively is devaluation effective only in connection with other policies such as direct credit, import tariffs, holidays for exporters and commodity targeting along South Korean lines of 1960s and 1970s and so on.

The Brettonwoods institutions view is that devaluation and
other price signals do not require complementary interventions to work. The authors studies are opposed to it.

Latin America caught in Debt-trap by raising interest payments on foreign debt and falling exports proceeds due to recession-structural adjustment became the order of the day replacing basic needs of growth with equity in developing economies. Govt.s have to take Draconian measures to cut public investment programmes and imports, workers have to accept reduced levels of purchasing power and employers had to adjust to protectionism abroad and lack of foreign exchange at home.

IV. DEVELOPMENT ASSISTANCE - MNCs

As the result of World Bank and IMF packages into developing economies the liberalization and privatization takes place as a result of multinational enterprises / companies (MNCs) comes into the picture.\textsuperscript{10}

IV. 1 MNCs pursue their foreign investments for three main reasons.

a) To take advantage of sales potential or to avoid barriers to imports in the host countries.

b) To take advantages of cost-opportunities (particularly


\textsuperscript{10}Constantino, V.Vaisots-Foreign Investment & Productive Knowledge-in Beyond Dependency, op.cit.
low-wage / cheap labour) in the host countries that are critical to the competitive position of their products in world markets, and

c) To secure access to foreign sources of critical inputs, such as mineral resources.

IV. 2 A study by United States of America (USA) Senate indicated that the late 1960s the USA obtained significant overall benefits from the World-Wide operations of US based MNCs.

There are at least two different perspectives from which the economic effects of foreign investment on developing countries can be evaluated, the first involves analysis of different economic indicators of the impact of foreign investment (eg. income effects, BOP effects and employment etc) on host country alone.

The second requires analysis of the total benefits obtained from such investment and the way they are distributed among all participants.

CONCLUSION

Some of the negative effects could have been reduced or even avoided by correcting certain Govt, policies such as the high level of protection of foreign affiliates although, such policies

U.S.A. - Senate Committee on finance "Implications of MNCs for World Trade and Investment and for US Trade and Labour
Washington D.C.
are not independent of the terms set by such firms as conditions for their entry into the country. Not all investments are in the interest of host-countries, in such cases developing economies need to have an evaluating and regulatory capability and the political will to refuse the entry of such investments in the first place. After coming across all these facts and results of studies of different economies, it is clear that IMF and the World Bank could and influence the developing countries development.