CHAPTER - VII

SUMMARY AND CONCLUSION

SUMMARY :

An important objective of the International Monetary fund was to extend short term financial assistance to its member countries to help them tide over temporary deficits in their balance of payments. On the other hand, the World Bank was expected to provide long term loans primarily to the war-devastated economies of Europe and Japan. Once these economies succeeded in rebuilding their manufacturing industries, the World Bank began to give long term loans to the poor countries of the world.

After the first major oil price increase of 1973, the IMF recognized the need to provide financial assistance on a larger scale to the developing economies whose balance of payments situation was adversely affected. As a result, the IMF added a few more lines of credit to the existing ones. The second oil price increase of 1979 made the balance of payments situation of the developing countries worse than before. These economies suffered from unsustainable rates of inflation together with unsustainable deficits in their balance of payments. The member country was required to reduce its fiscal deficit as a result of which the volume of domestic spending will be reduced and this was expected to reduce demand for imports. Under the monetary policy, it was expected to keep growth of money supply under control to enable them to bring down rates of inflation to the sustainable level. A member country was expected to devalue its currency as in most cases, the domestic currency was overvalued. The implementation of the economic stabilization programme was expected to reduce the balance of payments deficit as well as inflation rate as would help to place them on the higher growth path after three to four years.

Economic Stabilisation and Structural Adjustment Programme :

Indonesia :

Indonesia, unlike other non-oil developing economies of the world benefited substantially from the oil price rise of 1973 and 1979 as it is a major oil and gas producing country. The substantial increase in oil revenues enabled it to pursue ambitious import substitution foreign trade policy with government investment in large projects. During 1974-75 to 1983-84, Indonesia's GDP growth rate on an average remained at 5.5%. During these ten years, it became more protectionist in its foreign trade policy, imposed tariff and non tariff barriers on imports and made restriction on foreign investment more stringent. However, with substantial inflow of capital resulting from the oil price rise, it suffered from high rates of inflation and even when its currency Rupiah was devalued in 1978, Indonesia could not benefit from it by way of substantial growth of the export sector as devaluation was accompanied by high rates of inflation.

However, oil price began to fall from 1982. These was substantial fall in the price of oil from early 1981 when its price was $ 35 per barrel to $ 9.86 per barrel in 1986. This brought about significant deterioration in its balance of payments deficit that was 3% of GDP in 1981-82 to 8% of GDP in 1982-83 and remained at 6% in 1986-87. Indonesia's external debt increased in value after 1985 and its debt service ratio deteriorated significantly from 16.8% in 1982-83 to 38% in 1986-87. All these adverse conditions in the first half of 1980s required a qualitative change in the prevailing economic policies to save the economy from chaos and eventual collapse.

Indonesia adopted and implemented reforms with some initial hesitation in 1982. However, it adopted outward oriented trade policy aggressively from 1986. Thus the entire set of macroeconomic policy changes including fiscal, monetary and exchange rate polices as well as industrial and trade policies were vigorously liberalized from 1986.

The effect of these wide ranging economic reforms can be seen from the following table :

Table : VII.1 – Recent Economic Development : Indonesia, 1984-85 to 1990[1]

	1984-85	1986	1987	1989	1990
GDP	4.5	5.9	5.0	7.4	7.1
Non oil GDP	5.2	6.2	5.8	8.1	7.7
Manufacturing	12.7	11.1	11.4	11.6	12.8
Fixed Investment/GDP	20.5	20.1	19.2	21.1	21.1
National Savings/GDP	21.6	17.5	19.2	21.3	--
Domestic Inflation	8.1	5.8	9.6	6.3	7.9
Current Account / GDP	-2.6	-5.8	-2.3	-1.9	-3.8
Debt Service/Exports	25.1	38.0	35.5	32.1	27.3

In 1984-85, Indonesia had a growth rate of 4.5%. For the next five years, it could achieve a substantially higher rates of GDP growth ranging

[1] Mishra Veena, "Indonesia : Adjustment in the 1980's in Agrawal Pradeep et el (ed) Economic Restructuring in East Asia and India, 1995.

from 5% in 1987 to 7.4% in 1989. Its manufacturing sector expanded at the rate of 12.7% in 1984-85 and for the remaining years upto 1990, it could maintain rate of growth of the manufacturing sector above 11%, to reach 12.8% in 1990. Its rate of saving and rate of investment remained at about 20%. For most of these years, its rate of inflation fluctuated between 6% and 10%. Its deficit on current account of the balance of payments as a percentage of GDP was quite high at -5.8% in 1986, fell in the intervening years, to reach -3.8% in 1990. Its debt service ratio was 25% in 1984-85 and remained at a much higher level upto 1989, to come down to 27.3% in 1990.

Thus, during the initial five years of adopting and implementing wide ranging economic reforms, Indonesia could maintain high rates of GDP growth and high rate of growth of its manufacturing industries. Its rate of inflation that was quite high at 16.2% on a average during 1975-83 period, came down considerably. Its current account deficit was quite high during 1986 and was at sustainable level during other years. Its debt service ratio was quite high and was a source of concern to the economy.

Indonesia continued to implement the economic reforms vigourously in the 1990s. It became an export oriented economy integrating into the global economy very rapidly. Its rate of saving and investment touched 35% - highest among the developing economies of the world, making it possible for the economy to maintain growth momentum at about 7% of GDP rate. The following table gives information on its important macroeconomic indicators for the first half of 1990s.

Table : VII.2 – Major Economic Indicators : Indonesia (1991-1995)[2]

	1991	1992	1993	1994	1995
Gross Domestic Product (% change)	6.9	6.4	6.5	7.5	7.6
Gross Domestic Investment (% of GDP)	35.0	34.6	35.2	34.0	38.3
Gross Domestic Saving (% of GDP)	35.4	37.3	38.2	35.3	36.0
Inflation rate (% change in CPI)	9.2	7.5	9.0	8.5	9.4
Money Supply Growth (% Change)	17.1	20.2	15.3	20.2	24.1
Merchandise exports (% change)	9.8	10.4	10.0	9.9	11.1
Merchandise imports (% change)	14.8	7.5	10.0	13.9	23.1
Current account balance (% of GDP)	-3.5	-2.9	-2.1	-1.6	-4.0
Debt Service Ratio (% of Exports)	32.6	32.1	29.9	30.0	33.7

The Indonesian economy could accelerate its rate of growth during 1994-95 over its earlier performance. Its investment rate remained around 35% in 1995. It could also maintain an equally high rate of saving. Similarly, it could contain inflation rate to less than 10%, though for most years, it was around 9%, that was higher in comparison with the developed countries of the world. Indonesia, for most of these years, could maintain the rate of growth of exports and imports at high level. It could keep the rate of growth of imports around 14% during 1991 and 1994, that went upto an all time high figure of 23.1% in 1995. This was required to support the investment rate above 35%. However, this also kept its balance of payments deficit for most years at about 3% and took it to 4% in 1995. In spite of the substantial increase in exports, Indonesia's debt service ratio remained at high level of about 30%, indicating substantial increase in its external debt. Thus, while the economic reforms produced favourable impact on the Indonesian economy enabling it to maintain high savings-investment rate

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[2] Asian Development Bank, Asian Development Outlook, 1994 and 1997.

and through them, high GDP growth rate, these reforms did not succeed in moderating inflation rate which together with high current account deficit and high debt service ratio constituted major concerns by mid 1990s.

While Indonesia could maintain even a little higher rate of growth of 8% in 1996, its rate of savings and investment came down significantly. The rate of growth of exports and imports were also much lower. That the balance of payments situation in the South East Asian region had become unsustainable was becoming evident from the continuing high current account deficits. The relevant information for the second half of the 1990s is presented below :

Table : VII.3 – Major Economic Indicators : Indonesia (1996 to 2000)[3]

(Percent)

	1996	1997	1998	1999	2000
Gross Domestic Product	8.0	4.6	-3.0	1.0	4.8
Gross Domestic Investment / GDP	30.8	31.6	25.0	27.0	15.8
Gross Domestic Saving / GDP	30.2	31.0	24.0	25.0	25.1
Inflation rate (Consumer Price Index)	7.9	6.6	20.0	15.0	3.7
Money Supply Growth	29.6	27.7	25.0	26.1	15.6
Merchandise Exports	5.8	11.2	5.0	7.0	27.6
Merchandise Imports	8.1	4.8	-5.0	2.0	31.9
Current Account Balance / GDP	-3.4	-2.7	-1.6	2.5	5.0
Debt Service / Exports	29.5	30.0	28.0	30.0	--

Practically all macroeconomic indicators of Indonesia in 1996 were comparable to those during 1991-95. Indonesia's situation in one important respect was much better than Thailand and Malaysia. Both Thailand and Malaysia had significantly higher deficits in their balance of payments

[3] Ibid, 1998 and 2003.

during 1994 and 1995. However, once the financial and currency crisis hit Thailand in July 1997, it spread very rapidly to remaining three countries in this region. Once the Thai Baht was devalued, the Indonesian Rupiah had to follow as both these countries were competitive in their export markets. Again Indonesia did not follow the system of pegged foreign exchange rate as was done by Thailand and as a result, Rupiah was not as much an overvalued currency as Baht and yet Rupiah depreciated by 80% between July 1997 and January 1998.

In the three years that followed, Indonesia suffered in all its macroeconomic indicators. Saving and investment rates sharply came down. Exports and imports recovered dramatically in the year 2000 and its balance of payments situation also improved. Indonesia, before 1997 followed the foreign exchange rate policy under which it could accommodate increased flow of foreign capital including the volatile short term portfolio investment and the debts undertaken by the private sector corporations. Its Central Bank kept on widening the nominal exchange rate band. All this failed after the financial and currency crisis hit Indonesia and once Thailand's currency was allowed to float, Indonesia had to allow its Rupiah to float from August 1997.

While IMF the World Bank and neighbouring countries provided financial assistance on a sufficiently large scale to Indonesia to meet its serious crisis, it also agreed to adopt further economic reforms by closing down or merging its weak financial institutions. It relaxed its rules regarding entry of foreign capital and considerably reduced import duty on large number of commodities.

In comparison to Thailand, Indonesia's macroeconomic fundamentals were far sounder and yet, the crisis hit it in a far more severe manner. The large flow of capital, consisting of large amount of short term capital with serious weaknesses of its financial institutions exposed it to severe financial crisis. Economic reforms including convertibility of the domestic currency without strong financial institutions adopt which did not prudential norms can expose any country to grave risks associated with free movement of capital. This message was loudly conveyed by Indonesia to the developing countries adopting the structural adjustment programme and the multilateral financial institutions.

Thailand :

Thailand's economy took an adverse turn under the impact of the second price rise in 1979 and it was faced with large deficit in its balance of payments, high rate of inflation and increasing volume of external debt as well as rising debt service ratio. To meet this difficult economic situation, it approached the International Monetary Fund in 1981 and received a two year standby loan. With this financial assistance also came loans under compensatory and contingency financial facility. During the next year, Thailand was sanctioned larger financial assistance under the standby arrangement. These loans to Thailand by the fund were quickly followed by the loans from the World Bank covering the period 1982-84. Thailand, in turn, agreed to implement to Fund-Bank structural adjustment programme under which appropriate changes in fiscal policy, monetary policy, industrial policy and foreign trade policy were introduced.

The policy reforms met with a spectacular success during 1986-90 when its GDP growth rate and export growth rate was 10% and 20% each year and its per capita income doubled from $ 786 to $ 1413. Thailand emerged as one of the fastest growing economies of the World by 1990.

Thailand could continue with its rapid economic growth during the decade of 1990s. The relevant information is presented in the following table:

Table : VII.4 – Major Economic Indicators : Thailand 1991 to 2000[4]

(Percent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Gross Domestic Product Growth	8.1	7.6	8.3	8.7	8.8	5.5	-0.4	-3.0	1.0	4.6
Gross Domestic Investment / GDP	42.0	40.1	40.4	41.0	41.6	41.7	35.0	26.0	29.0	23.9
Gross Domestic Savings / GDP	35.2	34.8	35.0	35.2	33.6	33.7	31.0	31.4	32.0	31.0
Inflation rate % Change in CPI	5.7	4.1	3.4	5.1	5.8	5.9	5.6	15.4	9.0	1.6
Money Supply Growth %	19.8	15.6	18.4	12.9	17.2	12.6	16.4	6.8	7.5	2.2
Merchandise Exports Growth (% change)	23.8	13.7	13.4	22.2	24.8	-1.9	3.2	5.0	8.0	19.5
Merchandise Imports Growth (% Change)	15.8	6.0	12.1	18.5	31.9	0.6	-9.3	-15.0	3.0	31.3
Current Account Balance / GDP	-7.7	-6.0	-5.6	-5.9	-7.9	-7.9	-4.0	3.4	2.0	7.6
Debt Service / Exports	13.1	13.4	18.5	15.6	11.4	12.2	25.0	15.0	15.0	15.4

[4] Asian Development Bank, Asian Development Report,1994, 1997, 1998, 2003.

Thailand continued with its robust growth performance between 1991 to 1995 during which except for the year 1992, it could achieve and sustain a GDP growth rate of above 8%. Its domestic investment rate was above 40% and its domestic savings rate was around 35%. Its inflation rate was less than 6%. Its exports and imports growth was quite sound. Exports growth rate exceeded 20% for three years out of five and imports increased by little over 30% in 1995. All macroeconomic fundamentals were in sound state except one and very critical parameter namely current account deficit as a percentage of GDP which was dangerously high at -7.9% in 1995 and was well above 3% during all years between 1991-96 generally regarded as safe and sustainable.

Thailand was struck by an unprecedented financial crisis in July 1997. One important factor contributing to the crisis was the financial resources transfer that was -9.9 billion per year during 1986-90 and increased to $ 77.8 billion per year during 1991 to 1996 per year. Apart from these staggering figure in absolute number, its composition had undergone a qualitative change. Private flow of capital in the form of foreign direct investment and medium and long term foreign credit had turned negative in a big way during 1986-90 - $ -25.3 billion, which became positive $ 73.6 billion per year during 1990-96. Foreign direct investment increased practically 10 times from $ 3.2 billion per year during 1986-90 to $ 30.3 billion during 1991-96. On the other hand, flow of capital under official account which was $ 15.5 billion per year during 1986-90 came down steeply to $ 4.2 billion per year during 1991-96. Official grants remained stagnant at about $ 13 billion per year during both the periods, while official credit that was $ 1.8 billion became negative $ -8.8 billion per year during 1991-96. In other words, the flow of capital from the multilateral financial institutions was dramatically substituted by the private flow of capital guided solely by the profit considerations.

Like many developing economies of the world. Thailand had pegged its currency baht to dollar and had remained on a stable foreign exchange rates system. In other worlds, it had not gone over to the floating foreign exchange rates which was warranted by such substantial flow of capital. As dollar rose in value, Baht's value also went up, making it overvalued in a big way. However, as Baht's value was pegged to dollar, it could not be devalued, thus creating an adverse impact on its balance of payments. Thus, Thailand's unsustainable deficits on the current account were increasingly financed by large short term capital inflows on private account from abroad which carried the potential to become volatile on the slightest pretext. Making Thailand's financial situation vulnerable was the fact that substantial portion of these foreign funds were channeled by Thailand's financial institutions into the real estate sector and contributed to a bubble in property prices.

Thus unsustainable deficits in the balance of payments together with substantial flow of capital on private account coupled with the pegged foreign exchange rate led to the serious financial and currency crisis in July

1997. Again the IMF, the World Bank, other multilateral financial institutions and friendly countries provided substantial financial assistance to Thailand. Its baht was devalued by about 50% by December 1997. Thailand agreed to adopt and implement further economic reforms to bring about requisite correction in its financial system.

The slowing down of the Thai economy became visible in 1996 when its growth rate came down to 5.5% - lowest in the past ten years and under the heavy impact of the currency crisis, remained negative for the next two years before it could recover to about 5% in the year 2000. The savings rate and investment rate remained at the existing high level in 1996, but from 1997, these two rates went on falling steeply. The investment rate was about 24% in 2000 which showed a decline of 40% over the average investment rate of little over 40% since 1991. Money supply growth was reduced by the monetary authorities to keep the rate of inflation under control. The rate of growth of exports and imports both came down steeply under the impact of slowing down of the growth momentum and fall in the volume of baht in relation to dollar and other currencies.

Thailand in any case, was not a planned economy before the economic reforms were adopted in early 1980s. It pursued both import substitution policy and export promotion policy. Its banking business was entirely in the hands of the private sector. To switch over to the Fund's economic stabilization programme and the Bank's structural adjustment programme was thus not a big ideological issue in Thailand. Under policy of economic reforms, Thailand could achieve spectacular economic performance after mid 1980s upto 1995. With high rates of export and import growth, its economy got integrated into the world economy in a big way.

Thailand's experience, however, shows that once there is large flow of foreign capital, the pegged foreign exchange rate system has to be abandoned in favour of the floating foreign exchange rates, leaving the foreign exchange rates to be determined by the free market forces with intervention from the Central Bank, when the movements in the foreign exchange rates become volatile. With spectacular movement of capital across the world, a country has to adopt a system of floating exchange rates.

Thailand's experience also shows that the country receiving flow of capital under private account should carefully watch its composition. A developing economy has to carefully regulate the inflow of short term capital – primarily under portfolio investment in equity and bonds. This is not long term capital and can leave the domestic economy abruptly causing lot of damage.

Its experience also demonstrates that the economy must adopt and impose prudential norms for the commercial banks as well as non bank financial institutions. Their loans, particularly to the real estate sector and the investment in equity should be kept under close supervision. Indiscriminate investment in these two sectors can easily lead to artificial overpricing of these assets, leading to wrong decisions in matter of giving loans to borrowers.

And lastly, a big question that should bring the attention of the multilateral financial institutions is whether under the prevalent practices of globalization, they should allow the current practice of movement of capital or whether these movements should be subjected to certain healthy regulations.

Sub-Saharan Africa :

These countries had made reasonable progress from 1960 onwards when they started becoming free from the colonial rule one after another. The oil price increase made their balance of payments situation vulnerable and their economies were also suffering from high and unsustainable rates of inflation. These economies had to approach the IMF for financial assistance and also agreed to implement the economic stabilization programme. The following table provides information regarding the key economic indicators for Sub-Saharan Africa.

Table : VII.5 – Evolution of Key Economic Indicators for Sub-Saharan Africa, 1967 – 88[5]

(Average annual percentage change, unless indicated otherwise)

Item	Pre Reform		Reform Period		
	1967	1974	1981	1985	1988
Gross Domestic Product	7.0	2.7	-1.1	2.6	2.5
Export Volume	17.1	0.2	-7.5	2.1	1.2
Import Volume	4.3	7.6	-6.8	-0.7	-2.8
Gross Domestic Investment (Percent of GNP)	16.7	22.3	16.7	15.0	16.6
Gross National Savings (Percent of GNP)	13.0	17.2	9.0	8.8	8.0
Private Consumption	4.1	1.8	1.1	1.3	2.2
Gross official development assistance (Percent of GNP)	3.2	3.6	4.2	6.6	8.9
Terms of trade index (1980-100)	83.9	84.4	101.3	83.0	74.2
Gross National Income Total	3.9	4.5	-1.1	0.7	2.4
Per Capita	1.2	1.7	-4.1	-2.4	-0.9

Sub Saharan Africa performed reasonably well in the pre reform period – 1967 to 1980. GDP increased at the rate of 7% during 1967-73 while the growth rate became very slow during 1974-80. During both these sub-periods, exports and imports increased. While export growth was robust during 1967-73, its increase was extremely small during 1974-80. Gross domestic investment was at the rate of 16.7% and 22.3% respectively during these two sub-periods. Similarly gross national savings also registered increase from the rate of 13.0% to 17.2% respectively. Private consumption increased from the rate of 4.1% during 1967-74, though its growth slackened considerably during 1974-80. The terms of trade was unfavourable even

[5] Germany Marin Cristine, Humphreys Charles P, and O'Brian Stephen, "Estimating the Cost of Financing African Development in the 1990's in Patel I. G. (ed) Policies for African Development, International Monetary Fund 1992, P.157.

before 1980s, one of the major causes for the economic set-back that this region suffered after 1974. Inspite of the extremely high population growth in this region (of around 2.8% per year), it could achieve some improvement in per capita income during 1967-1980.

While the economic reforms were undertaken from 1980, the economic crisis of the region went on deepening. GDP growth rate became negative during 1981-84, it could partly recover by 1988, though it was lower than the pre reform period. Volume of exports and imports both registered negative growth rates during 1981-84. While there was small improvement in the export growth during 1985 to 1988, the import volume went on declining, indicating this region's inability to pay for imports. The negative import growth dealt a serious blow to the manufacturing industries of this region. The domestic rate of saving during 1981-88 was practically half of what it was during 1974-80. After 1982, the western commercial banks reduced their lending to these countries and for most years of 1980s, the private capital transfer became negative dealing a severe blow to these countries. To some extent, this loss was partly compensated by official development assistance that increased to 8.9% of GNP – the highest level since 1967. In spite of the crumbling economic situation in the region, private consumption could increase at small and reduced rate of 1.1% per year during 1981-84, financed by a rapid decline in the savings rate and increasing net official development assistance flows. However, the consumption growth was lower than the population growth and per capita consumption went on declining after 1981.

Thus in the 1980s, the slowing down of the GDP growth rate was caused by the very low efficiency of investment high population growth, oil price and interest rate shocks, war and drought contributed to the economic crisis in this region. Moreover, bad investments and inappropriate domestic policies weakened domestic economic productivity, reduced its flexibility to respond to shocks and created high debt service ratio that absorbed a growing share of both domestic and foreign resources. The Fund-Bank supported structural adjustment programme did not suit the essential requirement of this region. As a result of contractionary fiscal and monetary polices, the GDP decreased and that in turn led to reduction in saving and investment. Import compression, while it helped to correct their balance of payments deficits to some extent, produced adverse impact on manufacturing activity. With low elasticities, the devaluation of domestic currencies did not help to bring about improvement in their balance of payments problems. Their financial need was for a sustained flow of assistance over medium term and long term.

The Sub-Saharan Africa continued with the structural adjustment programme during 1990s and the economic situation in the region went on improving slowly but steadily. The following table gives information on macroeconomic indicators during 1990-97.

Table : VII.6 – Africa : Macroeconomic Indicators 1990-97

	Indicators	1990	1994	1995	1996	1997
1	Real GDP Growth Rate	2.4	2.6	2.8	5.0	3.7
2	Real Per Capita GDP Growth Rate	-0.4	-0.3	0.0	2.2	0.9
3	Inflation (%)	16.7	4.4	32.5	24.4	17.6
4	Investment Ratio (% of GDP)	21.2	19.9	20.3	19.6	20.3
5	Fiscal Balance (% of GDP)	-4.7	-5.4	-4.0	-3.2	-1.9
6	Growth of Money Supply (%)	18.9	35.1	22.9	20.3	13.3
7	Export Growth Volume (%)	3.6	2.8	10.2	8.9	6.7
8	Import Growth, Volume (%)	4.2	3.5	5.5	5.1	7.4
9	Terms of Trade (%)	5.1	-1.7	-1.8	2.2	-0.2
10	Trade Balance ($ Billion)	6.9	-5.5	-4.0	2.5	1.7
11	Current Account ($ Billion)	-4.3	-12.0	-12.5	-7.0	-7.2
12	Current Account (% of GDP)	-1.0	-2.8	-2.4	-1.3	-1.2
13	Debt. Service (% of Exports)	26.3	22.3	18.7	19.4	21.7

Source : ADB Statistics Division and IMF.

During 1990s, the real GDP growth rate remained positive and during 1996 and 1997, it was higher than the population growth rate, making it possible for the per capita income to improve. The major weakness during this period is reflected in the high growth rates of money supply and high inflation rates. The inflation rate was higher than 30% during 1995 and 1996 and even at 17.6% in 1997, it was quite high and unsustainable. This clearly reflects the failure of fiscal and monetary policies. Similarly, while the rate of growth of exports and imports was positive for all the years, it went above 5% after 1995. This is also true about the imports. Thus, in the second decade of the structural adjustment programme the degree of integration of the African economies into the world economy remained rather low. The current account deficit as a percentage of GDP remained within safe limits.

The debt service ratio though above 20% for some years, remained within manageable limits.

During 1990s, financial assistance from the IMF was less than \$ 1 billion during 1994, 1995 and 1996. There was infact, net negative capital transfer to IMF during 1990 and 1997. Under the impact of the structural adjustment progrmame, these countries started receiving non debt creating capital flows from the developed countries of the world and the private firms could receive sizable funds under external borrowing. After the global debt crisis of 1982, the commercial banks of Europe and America had stopped giving new loans to these countries, and there were large negative capital transfers for repayment and interest payments. These developments had arrested economic development process in this region between 1985 to 1990. After 1990, this trend was reversed and these economies could meet their balance of payments deficits with the help of non debt creating flows.

Thus, while the first decade of 1980s proved to be quite disastrous with slow growth and negative per capita income growth, falling rate of investment and falling and low rates of savings, the positive impact of the structural adjustment programme began to be witnessed in these countries after 1991. The growth rates remained positive all throughout and per capita income became positive in 1995 after a lapse of fifteen years. Investment rate also showed considerable improvement. High rates of monetary expansion and high inflation rates remained the areas of concern. A big success finally could be seen with non debt creating capital flows, large enough to meet the deficit in the current account as well as outflow of capital. While social strife, drought and other calamities continued to exert adverse pressure on the growth process, increasing degree of economic integration with the rest of the world under the structural adjustment programme remains a ray of good hope for this region.

India :

The oil price rise of 1979 created balance of payments difficulty for India like many other non-oil developing countries of the world. India approached the IMF for a big loan to tide over the deficit tin the balance of payments and the IMF sanctioned the $ 5.1 billion financial assistance with the attached set of conditionalities. There was lot of opposition to these conditionalities and the government could repay the loan before the maturity due to substantial improvement in the balance of payment situation in the first half of the 1980s. At the same time, the government took some policy measures to liberalise the economy by removing some restrictive policies for the private sector industries. However, these policy changes can not be regarded as comprehensive economic stabilization and structural adjustment programme.

In the second half of the 1980s, India's balance of payments situation went on worsening year after year and it went on losing foreign exchange reserves from September 1990. The invisible receipts took an adverse turn and the year 1990-91 closed with a current account deficit of 3.3% of GDP and India was left with about $ 1 billion of foreign exchange reserves, enough to pay for imports for a fortnight. India took some quick measures like mortgaging part of its gold stock and in June 1991, approached the IMF for a loan to tide over the severe foreign exchange crisis and agreed to adopt and implement the economic stabilization programme. The government had to bring about substantial import contraction as there was serious shortage of foreign exchange reserves. It also brought about monetary contraction to bring down the rate of inflation. It devalued the rupee by 20% in July 1991 to encourage exports and made a beginning of outward oriented trade policy by reducing import duties year after year. The economic stabilization programme succeeded in a big way in correcting the weaknesses of the Indian economy. This can be seen from the following table :

Table : VII.7 – Key Indicators[6]

	1990-91	1991-92	1992-93	1993-94
Gross Domestic Product (1980-81 prices)	5.6	0.9	4.3	4.3
Agricultural Production	2.6	-2.0	4.1	2.2
Industrial Production	8.5	0.6	2.3	4.1
Wholesale Price Index	12.1	13.6	7.0	10.8
Money Supply (M_3)	14.9	19.4	15.7	18.2
Foreign Currency Assets (US $ Million)	2236	5631	6434	15068
Exchange rate	20.0	24.65	28.96	31.37
Current Account Balance	-3.3	-0.4	-1.8	-0.1
External Debt ($ Billion)	-	71.6	77	85.2
Debt service Ratio % of Exports	26.7	29.0	25.6	31.01

[6] Government of India, Economic Survey, 1991-92 and 1994-95

While the GDP growth rate at 4.3% in 1993-94 was much higher than 0.9% to which it came down under the immediate impact of import compression, it was still lower than 5.6% rate of growth achieved in 1990-91. In any case the Indian economy had considerably recovered from the crisis situation. The current account deficit that had reached to an unsustainable level of 3.3%, showed considerable improvement during the next three years showing the favourable impact of the economic stabilization measures. The Indian rupee was no longer pegged to the basket of currencies, and its value was allowed to be determined by the market forces, subject to the intervention by the Reserve Bank of India to maintain stable and orderly movement in the foreign exchange market. Its value fell from $ 1 = Rs.20 in 1990-91 to Rs. 31.37 – devaluation of about 50% in three years that encouraged export growth substantially in 1993-94 when it increased by about 20%. Similarly, an impressive success was achieved in the accumulation of foreign exchange reserves – from $ 2.2 billion in 1990-91 to $ 15 billion in 1993-94 keeping the unpleasant spectre of a default in honouring its external commitment way behind.

The economic reforms that were initiated under the economic stabilization programme were further continued after 1993-94 and wide ranging structural adjustment programme was undertaken. The prudential norms were applied to the commercial banks and the entire financial structure, including private commercial banks and the non-bank financial institutions, were strengthened and by regulating them to reduce their non-performing assets from unsustainable level of above 20% to gradually bringing them down to around 5%. The Indian economy had switched over to the floating foreign exchange rate system under which, consistent with the continuing current account deficit of the balance of payments, the Rupee was allowed to fall to a level largely determined by the market forces. While many countries in different parts of the world were severely hit by the financial and currency crisis, that first engulfed the South East Asian economies in 1997-98, the Indian economy was not adversely affected, largely because of the improved health of its financial system and the timely monetary policy measures adopted by the Reserve Bank of India, that allowed the rupee to make downward adjustment without panic and chaos in the foreign exchange market. Similarly, number of measures were initiated to sell partly or wholly the public sector units, to encourage flow of FDI, and to strengthen the working of the capital market. The performance of the Indian economy after initiating the structural adjustment measures can be seen from the following table :

Table : VII.8 – Key Indicators[7]

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
	(% Change over previous year)					
Gross domestic product	7.8	7.2	7.5	5.0	6.5	6.1
Agricultural Production	5.2	-2.7	9.3	-6.1	6.5	7.3
Industrial Production	9.4	12.1	5.6	6.6	4.1	6.7
Wholesale price index	10.4	5.0	6.9	5.3	5.3	6.5
Consumer Price Index for Industrial Workers	9.7	8.9	10.0	8.3	8.9	4.8
Money Supply (M_3)	22.3	13.7	16.2	18.0	19.4	14.6
Imports at Current Prices (US $)	22.9	28.0	6.7	6.0	2.2	11.4
Exports at Current Prices (US $)	18.4	20.7	5.3	4.6	7.4	16.6
Foreign Currency Assets (US $ million)	20809	17044	22367	25975	29522	35058
Exchange Rate (Rs / US $)	31.40	33.45	35.50	37.16	42.07	43.33
External Debt ($ Billion)	99	93.73	93.47	93.53	97.68	98.44
Debt Service Ratio (% of Exports)	26.3	26.7	26.8	27.6	18.0	16.2

The GDP growth rate during three years 1994-95 to 1996-97 was 7.5% on an average per year, that can be regarded as a favourable impact of

[7] Government of India, Economic survey 1997-98 page 2 for the statistical information for the years 1994-95, and 1995-96 and economic survey 1999-2000 and 2000-2001 for the years 1996-97 to 1999-2000.

the reforms. However, under severe impact of external factors like the South East Asian crisis and economic sanctions imposed by the UN and the internal factors like the Cargill War, the performance of the manufacturing sector slowed down considerably, producing unfavourable effect on the GPD growth rate. India's external debt was $ 99 billion in 1994-95 and remained more or less at the same level in 1999-2000, largely due to the substantial flow of non-debt creating foreign capital. The foreign exchange reserves increased from $ 20 billion in 1994-95 to $ 35 billion in 1999-20000, reflecting the strength of the economy. With all these favourable effects, one area namely the process of fiscal consolidation, did not show much improvement and the combined fiscal deficit of the Central Government and the states remained at a high level of 10% of GPD in 1999-2000, the level where it was in 1990-91. The volume of internal debt increased and the seriousness of this problem can be appreciated from the fact that the interest payment on public debt by the Central Government was Rs. 21,498 crores in 1990-91 which increased to Rs. 90,249 crores in 1999-2000. Similarly, the revenue expenditure was 12.9% of GDP in 1990-91 and the interest payment of public debt which is an important component of the revenue budget was 3.8% of GDP – about 30%. After ten years, the fiscal situation had worsened in 1999-2000 when revenue expenditure was 12.9% of GDP and the interest payment on public debt had become 4.7% or almost 40%. While the process of fiscal consolidation, a crucial ingredient of the economic reforms, could not make much headway during the first ten years, an important legislative measure was undertaken – Fiscal Responsibility and Budget Management Bill – in December 2000 which subsequently became an act under which the revenue deficit would be brought down to zero and the fiscal deficit to 3% of GDP by March 2009.

Looking to the three decades of slow growth during 1950-80, monetary policy under which interest rates on loans to the productive sectors of the economy would be high and under which a little over 50% of the deposits of the banking system could be impounded, fiscal policy under which fiscal deficits and public debt were allowed to reach unsustainable level, foreign exchange rate policy under which rupee was heavily overvalued, discouraging and supporting the self fulfilling hypothesis of export pessimism and foreign trade policy under which India's current account deficit reached an unsustainable level and foreign exchange reserves were reduced to level that brought the economy on the brirk of a disastrous default in honouring its external commitment, Indian economy's performance during the first decade of economic reforms can be regarded as both creditable and well founded. The economy has witnessed the fruits of the process that was initiated with much hesitation in mid 1991 after 2003 in the form of high saving – investment rate and growth rate above 8%. However, much still remains to be done in the area of economic development with a human face – a promise that has eluded the quarter of India's population for the last more than 50 years.

Success and Failures of Economic Stabilisation and Structural Adjustment Programme :

The Indonesia, Thailand, Sub-Saharan Africa and India have one thing in common-namely that they were adversely affected by the oil price rise of the 1970s and had developed serious deficits in their balance of payments. They approached the International Monetary Fund and the World Bank for the financial assistance. These economies in turn adopted the economic stabilization programme and then the structural adjustment programme. Thailand in any case was largely free enterprise economy with the background of fast economic development upto 1980. Indonesia is an oil rich country that substantially benefited from the oil price rise. But with rapid inflow of capital, it suffered from high rate of inflation and when the oil price declined during 1982 to 1986, it suffered from deep economic crisis. Sub-Saharan Africa was adversely effected by oil price increase and to begin with, borrowed heavily from the European and American banks which received Euro dollar deposits from the OPEC countries after 1973. Private Multinational Banks stopped lending further to developing countries, including Sub-Saharan Africa. It caused net negative capital transfers from Sub-Saharan African countries, adversely affecting their growth prospects. India, from 1952, began its economic journey with planning as a strategy of rapid economic development with dominant public sector. Monetary and fiscal policies guided from this approach of enlarged fiscal deficit, import substitution, overvalued exchange rates of Rupee. As a result India faced frequent financial crisis, 1965-66, 1975, 1981, 1991, the letter two crises forced it to borrow from the IMF and World Bank with conditionalities.

An attempt is made to examine the macro performance of these countries under the economic stabilization programme and the structural adjustment programme.

Table – VII.9 : Macro Performance during Economic Stabilisation Progrmame by country

Countries with relevant periods	GDP Growth	Balance of Current Account as % of GDP	Debt Service Ratio	Inflation Rate (CPI)
Sub-Saharan Africa (1981-1984)	-1.1%	-1%	35%	21.8%
Thailand (1986-1990)	8.5%	-3.5%	20%	8%
Indonesia (1986-1990)	6.5%	-3.5%	33%	7.5%
India (1991-92 to 1993-94)	1.5%	-0.8%	28%	10.5%

Note :
(1) GDP Growth Rate – 5% or more – Satisfactory
(2) Balance of Current Account – 1% of GDP or less – Satisfactory
(3) Debt service ratio – 20% of less – Satisfactory
(4) Inflation rate – 5% or less – Satisfactory

Thailand and Indonesia performed well during the period of economic stabilization. Both countries could achieve GDP growth rate of more than 5%. Their inflation rate was quite high at about 8%. Their current account balance was also quite high -3.5% of GDP on an average per year. Indonesia's debt service ratio has been on the high side.

Sub-Saharan Africa's performance under the economic stabilization was disastrous – its GDP growth rate was negative, export – import growth rate was negative, inflation rate was very high and so was the debt service ratio. In fact, Sub-Saharan Africa was the worst affected region as its external debt became a recurring issue for decades to come.

While the growth rate for India was on the lower side, it could bring about substantial correction in its balance of payments situation from where the economic crisis was triggered. The debt service ratio as well as inflation rate, while showing considerable improvements, were still in the unsatisfactory zone.

Having overcome the balance of payments crisis, Thailand, Indonesia and India undertook wide ranging economic reforms. These countries could build further on the achievements of the earlier period. However, the world as a whole was shaken badly by the financial and currency crisis that hit the South East Asian economies in 1997-98, adversely affecting the growth momentum of not only Thailand and Indonesia but other countries like India as well. Sub-Saharan Africa started performing better with the beginning of the 1990s. However up to 1995, the growth rate though positive, was lower than the population growth rate which is among the highest in the world – 2.8% per year. These countries, however, could show positive growth rate from 1997 onwards only. Because of the negative growth rate, this region's the per capita income in 1990s remained at the same low level where it was twenty years before in 1980. The following table presents comparative positions of these countries with the help of some common indicators.

Table – VII.10 : Macro Economic Indicators during Structural Adjustment Programme by Country

(Percentage)

Country	GDP Growth rate	Inflation Rate	Current Account Balance	Debt Service Ratio	Rate of Investment	Rate of Saving	Export Growth	Import Growth
Indonesia 1991-95	7	8.5	-4.6	32	35	36	10	14
1996-2000	4	10	3	29	17	27	11	9
Thailand 1991-95	8	5	-6.5	14	41	35	20	17
1996-2000	3	7.5	-4.6	16	32	32	7	2
Sub-Saharan Africa	3.5	20	-1.9	20	20	18	7	5
India	6.5	8.3	-1.5	23	27	25	12	13

Source : The figures in the table are average figures for the period taken from the tables in their respective chapters.

Indonesia performed quite well during 1991-95 except for inflation rate and debt service ratio. During 1996-2000, growth, inflation and investment suffered from the adverse impact of the currency crisis, though the current account deficit and debt service ratio showed some improvement.

Thailand performed extremely well between 1991-95 with respect to all indicators, except the current account of the balance of payments which was alarmingly high. Thailand was hit badly by the financial and currency crisis in July 1997 adversely affecting growth, inflation and investment.

Sub-Saharan Africa was on its way to recovery with GDP growth rate of 3.5% on an average that was higher than the population growth rate. Inflation rate was quite high – at unsustainable level of 20%. Debt service ratio showed satisfactory performance. The rate of investment was still quite low and the balance of payments situation was satisfactory.

Under the structural adjustment programme, India showed satisfactory performance on all indicators, except the rate of inflation that continued to remain at high level. The balance of payments situation remained remarkably satisfactory. While some external factors adversely affected the growth rate, Indian economy was not much affected by the meltdown in the South East Asian economies. The far reaching reforms in the Indian banking sector have considerably improved the financial system in the country, that was major defect in Thailand and Indonesia.

Barring the setback of the currency crisis of July 1997, Thailand, Indonesia and India have shown creditable performance under the economic reforms. There is a ray of hope even among the Sub-Saharan Africa with the flow of private external capital moving into this region.

Conclusion :

The study has covered Indonesia, Thailand, Sub-Saharan Africa and India. We have tried to analyze the impact of major economic reforms on the growth performance of these countries. The study has shown that Thailand, Indonesia and India have successfully made use of outward oriented trade policy together with devaluation of their currencies. These measures have encouraged exports and imports and considerably reduced their current account deficits.

Thailand's experience has shown that the economy keeps on receiving non debt creating capital flows into the economy and with this a system of pegged foreign exchange rate is not compatible. In other words, with increase in the capital inflow, a country must switch over to a system of floating or managed foreign exchange rates. Thailand's economy suffered severely because it kept on defending the pegged foreign exchange rate even when its currency baht became overvalued as dollars value in terms of other currencies went on increasing. Indonesia and more particularly India have followed a correct policy with reference to their foreign exchange rate. India not only devalued its rupee by 20% in early July 1991 but allowed its rupee to keep on falling against the dollar and other major currencies of the world as its balance of payments continued to be in deficit.

The study has also drawn attention to the fact that it is not enough for a developing economy to receive non debt creating capital flow. In other words, the composition of the foreign investment also needs to be carefully worked out. A developing economy can not afford to have large proportion of short term capital which is difficult to roll over as and when necessary. This kind of situation creates pressure on the currency for its further devaluation. Thailand and Indonesia both suffered heavily from the financial and currency crisis because both of them had unsustainably large amount of short term capital. India on the other hand fell into crisis in mid 1991 because of the similar reason. However, once it implemented the economic stabilization programme and economy was paced back on the path of recovery, it has been very careful about short term capital.

Still another area to which the study has drawn attention is that it is dangerous and risky to go for full convertibility of the currency without putting its financial institutions in sound conditions. The experience of Thailand and Indonesia shows that their financial institutions had unsustainable levels of non performing assets, therefore once they were hit by the financial crisis, about 50% of their financial institutions had either to be closed down or merged with other financial institutions in better financial health. This point is also shown by the financial and monetary policy followed by India. The Narasimham Committee one and two on banking and financial reforms strongly recommended that banking and non banking financial institutions must strictly follow the prudential norms regarding income recognition, capital adequacy ratio, substantial and doubtful loans etc. It is for this reason that while Thailand, Indonesia and some other economies were hard hit by the financial crisis, India could sail through those difficult months practically unhurt. India has been following a cautious approach on capital account convertibility. The competent committee that has examined this problem has recommended that unless some fundamental macroeconomic indicators like rate of inflation, fiscal deficit etc. are in sound health, it is not advisable to go over to capital account convertibility.

Sub-Saharan Africa is a typical case where structural adjustment programme with emphasis on contraction of aggregate demand would be counter productive. Their level of income and output is so low that any further reduction through contractionary fiscal and monetary policy would produce very harmful effects on these economies. Moreover, we have to carefully study the elasticity of demand for export and import before recommending devaluation of their domestic currencies. If these elasticities do not carry favourable value, the economy would end up earning less amount of foreign exchange after devaluation making its balance of payments situation much worse than before. Again, the poor economies in the Sub-Saharan region could not be expected to complete the economic stabilization programme within a short period of three to four years. If their economy is not brought back on the path of recovery and the flow of financial assistance from the IMF and the World Bank is suddenly stopped, very harmful effects would be produced on these countries. In otherwords, these countries have to be supported on a long term basis. Moreover, Sub-Saharan African countries do not have financial institutions well equipped to cope with the complex financial issues associated with the banking, monetary and foreign exchange issues. These economies must be taken up, up to a certain minimum level and then should be advised to go over to more comprehensive economic reforms. As a result, Sub Saharan Africa lost very heavily for two decades – 1980 to 2000.

Areas for Future Research :

Number of countries in the world have adopted economic stabilization and structural adjustment programme. If we wish to get a clear view of the effectiveness of these new economic policies, we should take up a more detailed study of eight to ten countries across the world for a period of twenty to twenty five years. While there is a general agreement among the economists that the process of globalization based on the new classical theorem of comparative cost advantage would result into the gain in terms of increase in total world output, the more pertinent question is, how is this gain divided or distributed among the developed and the developing countries of the world. The developing countries would agree to the growing integration of their economies into the world economy only so far as they also benefit from the total gain. This is a difficult and complex issue and has to be very carefully examined. An area of further research is thus to include another four to six countries – some from Latin America, some from Eastern Europe and a few more from Africa, and a more comprehensive inquiry needs to be made after examining the emerging trend over a period of twenty five years. The Bretton Woods institutions were created in 1946 and by 1971, some of the important corner stones of that edifice like a system of stable foreign exchange rate and the convertibility of dollars into gold had collapsed. Similarly, this new economic philosophy of a globalised world based on specialization also to be tested. We can suggest that Argentina, some countries like Poland and Czechoslovakia from the communist block and a few countries from Africa other than Sub Saharan region should be studied in greater detail with reference to their experience of structural adjustment programme.