A note from the Editor

The debate on what would be an appropriate exchange rate regime for a developing country operating a semi-open economy, i.e. whether the exchange rate should be primarily fixed or primarily floating, has never been satisfactorily concluded. During the 1990s there arose a strong body of opinion that prefers a floating to the quasi-fixed crawling peg type regimes that are currently in vogue over much of the developing world. This view is based partly on the premise that markets should determine exchange rates and partly on the contention that any discrepancy between the official and parallel rates of exchange indicates a hidden subsidy paid to those who can acquire foreign exchange at the official rate by those who cannot. These points of view are not without justification. However, on the other side of the coin, freely floating rates, whatever their theoretical merits, have not, at a purely pragmatic level, proved to be the panacea they were claimed to be. This long-standing policy dilemma is addressed from the perspective of Bangladesh, where the Government is currently looking at the trade-offs involved in pursuing one or the other course. Broadly speaking, the author favours the existing arrangements that revolve around an adjustable peg, with little, if anything, to be gained by shifting to a floating rate regime.

Exchange rates do not, of course, exist in isolation. The exchange parity is an integral element in any macroeconomic framework whose objective is stability in the financial and asset markets. Given this background, the problem of devising early warning systems that revolve around a system of macroprudential indicators (MPIs) is addressed in the paper on efforts made by the Asian Development Bank (ADB) to develop a system for measuring the economic and financial vulnerability of countries to another 1997-type crisis and its attendant contagion effects. The paper highlights the central problem of having either an over-elaborate system with too many numbers or having one with only a core set of indicators and thus exposed to the risk of missing some vital sign in the months prior to the onset of a crisis. The problem of making finely balanced policy judgements, often on insufficient information, inevitably creeps in and Governments with an eye on the politics of the situation may opt to do nothing even in the direst of circumstances, whatever the early warning signals. Early warning systems are unlikely to override political inertia, one of the reasons for the recurrent financial crises in Latin America.

The 1997 crisis left China and India largely unaffected. But both countries have State-dominated banking systems that nevertheless have to contend with an array of major systemic issues and problems. Both countries had, in fact, been carrying out banking sector reforms in the 1990s, i.e. both before and after the crisis. Assessing the efficacy of these reforms thus far provides a basis not only for comparing the two countries but also for forming a view as to the kind of role that the banking system in each country is likely to play in facilitating growth in a rapidly evolving economic environment in the years ahead. One of the important conclusions that the paper reaches is that freeing up the management of banks and reducing State intervention in the financial system as a whole has to be accompanied by the vital quid pro quo of interest rate liberalization if banks are to price risk properly and thus perform their resource-allocation function effectively.

The Indian perspective provides the backdrop for an analysis of stock market behaviour in that country since 1990. The paper shows that the years since 1990, coinciding with progressive deregulation of the capital market and other liberalizing measures in the economy, have also been a period of unprecedented volatility for the stock markets of India. The volatility has been closely correlated with that in the international and the more open regional stock markets. What implications does this correlation have for investors, both individual and institutional? Are they likely to become more risk-averse and how will they diversify their portfolios to counter the volatility? How can the Indian Government deal with the problem? These are cogent issues requiring further discussion.

On the environment front, again from the Indian perspective, the economic reforms of the 1990s are seen to have been closely associated with higher energy consumption and, hence, higher CO2 emissions. The authors suggest the need for much greater stress on a national energy policy for the country with more emphasis on energy conservation. Above all else, there is a need to confront the difficult issues involved in using the price mechanism for energy conservation and better balance between alternative energy sources, on the one hand, versus the need to provide affordable energy to the less well-off members of society on the other. Energy policies became de rigueur all over the world in the 1980s. Their importance declined in the 1990s as oil and gas prices declined. The first decade of the new millennium could well be a repeat of the 1980s and developing countries will need to be prepared for the challenges that might lie ahead.

Finally, a short research note examines the use of anti-dumping measures by the European Union against imports from China in the three-year period 1995-1998. The author suggests that there is significant evidence that anti-dumping measures have tended to be misused and makes the disquieting allegation that they are in effect trade-restricting devices. If countries are to be won over to the benefits flowing from free trade, such apprehensions are highly damaging and more effort needs to be put at WTO, and bilaterally, into preventing resort to anti-dumping measures on anything other than the most stringent grounds.

Shahid Ahmed