To Our Readers

Now that Globalization has come to be a reality in almost all countries of the world, there is perhaps a need to see the effect of it on the financial systems of the participating countries. In various studies done on several countries - and over several years - it has been found that at least as far as the developed countries are concerned, there has been a general convergence of financial systems along the dimensions of patterns of sources and uses of funds. This convergence has also generally been towards lower levels of investment and in more volatile options. And, in general, the movement has been towards exit-dominated models rather than otherwise.

The implications of these must be seen in the context of the past. For decades, monetary authorities and central banks controlled monetary policy by controlling either the price or the quantity of credit, or both. This was accomplished through interest rate controls, credit ceilings, and directed credit. Over the years, the effectiveness of these policy instruments has been questioned by economists and financial specialists. Major reasons include the reduction in the use of bank credits as source of funds, increased purchase of assets and reduction of investment in manufacturing in many developed countries, increased turnover of financial markets, and the growth of financial intermediaries which are not within the control of the central banks. The response to all these changes by the monetary authorities has been along traditional lines - indirect controls and the dismantling of institutional mechanisms for credit allocation. In the end, the monetary authorities have been left with much less control over the flow of financing than previously.

Obviously then, regulatory changes and new policy instruments are needed to increase the effectiveness of monetary policy, and to help allocate credit to productive investment while damping speculative pressures in the new financial environment. But what are these to be? An obvious answer would be to bring the financial intermediaries - of all kinds- under the control of the monetary authorities. This is important because this would give control back to the central banks so far as channeling of credit is concerned. Secondly, one could recommend the use of differential asset reserve requirements as an indirect policy tool, to guide credit to more potentially productive investment options. A tax on financial transactions working together with these differential asset requirements could then be used to further curb speculation. These three policies could in fact be used as an integrated package by the fast emerging countries like India.

The Indian problem in this context is that too many authorities (although, to be honest, there are rather fewer of them these days than earlier) have a finger in the pie. This has led to occasion where market players making merry while the authorities sorted out their respective acts. What is necessary at this stage is an approach that, as we have said, not only integrates the tools of monetary policy - the newer ones developed in the context of globalization - but does the same to the overall approach of the monetary authorities. In short a conceptual integration is called for, one that is dominated neither by traditional banking vision, nor by a traditional corporate control orientation, or even by a traditional economic perspective. What is needed is a combination of all, with the imperatives of financial globalization forming the binding cord.

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