Size levels of safety and return. therefore, any

**Size of the Economy:**

More precisely, it is the proportion contributed by the originating economy in international economic transactions and the nature of these transactions. By way of examples of this phenomenon, we can consider countries which have a large share in short-term capital flows or in energy sources like petroleum products, etc. and countries whose currencies are used as foreign exchange reserves, such as the US and the UK.

**Intensity of the Initial Disturbance:**

Other things being equal, a disturbance of higher initial intensity is likely to cause a correspondingly greater damage to the interconnected open economies.

**Degree of Integration:**

This factor is self-explanatory. Economies with greater restrictions on international economic transactions tend to suffer less when a disturbance originates in some other country. When a number of South East Asian economies suffered heavily on account of a severe financial crisis in 1997-98, India could escape this disaster. This was because Indian rupee was not freely convertible on capital account and short term capital funds could not leave the country on a large scale. 2. Footloose Funds: Currently, large amounts of “ footloose” (that is, short term and/or speculative type) funds are moving around the world in search of places where they can be “ parked” (that is, invested temporarily) within acceptable levels of safety and return.

Therefore, any change in one or both of these determining factors can lead to a large scale international movement of these funds. 3. Import Dependence: Certain varieties of imports can expose a country to undue political, economic and cultural risk. Examples are imports necessary for defence, health care, energy needs, food needs, and the like.

4. Indebtedness: Large scale increase in international capital flows has resulted in problems like heavy indebtedness of certain countries and their inability to repay their debts. Starting with 1970s banks and other financial institutions, in search for better returns extended huge loans to some countries. Their borrowers, however, could not use these loans for increasing their export earnings out of which to service them.

Some of them could not “ absorb” these loans productively for promoting their economic growth. This resulted in frequent bankruptcies of the borrowing governments and associated financial crises. 5. Growth Bringing Poverty: There are instances where an expansion in international trade of a country has resulted in what is termed “ immiserising growth”. It happens when international trade adds to the productive capacity of a country, but its terms of trade deteriorate so much that there is a net decline in its economic welfare.

In addition, it is also possible that while there is an overall increase in economic welfare of the country, some sections happen to be net losers. 6. Constraints on Resource Use: It is possible that a country is forced to adopt certain production technologies which do not let it make an optimum use of its factor-endowment. Alternatively, it may have to face restrictions on its exports. Such a state of affairs may be thrust upon a country which has a weak bargaining strength or which is facing balance of payments difficulties. For example, the USA and several other industrially advanced countries (with abundant capital resources) are interested in weakening competition from imported goods from labour-surplus countries like India.

They are insisting that imports should be totally banned (or at least severely restricted) if they are produced by “ exploited” or “ sweat” labour (that is, by labour which is paid at rates lower than those in rich countries like the USA) or by child labour. The flaws in this logic are quite easy to see. Wage rates are expected to be lower in a labour-surplus economy. And it is this fact which makes its labour-intensive products competitive. Similarly, it is a fact that child labour is extensively used in India in the manufacture of carpets and other handicrafts. It is also admitted that it would be better if these children, instead of working, were attending schools.

But that happy situation can be attained only if our economy grows and income levels of the parents rise. Till then, if these children are prevented from taking up jobs, their families would become still poorer. 7. Problems of Foreign Exchange: These days, currencies are on “ paper standard”.’ And historically, some leading currencies of the world (the most prominent being the US dollar) are being held as “ foreign exchange reserves” by countries of the world for financing their trade and other international economic transactions. Moreover, a rapid expansion in these transactions has added to the need for ever-increasing volumes of foreign exchange reserves. This need for international liquidity is being met by countries by holding ever-increasing balances of US dollars and the US economy is running into ever-growing “ current account deficits” against rest of the world.

A view is gaining ground that it is impossible to sustain this state of affairs forever.