Hots (Higher Order Thinking Skills)

Q. 1. Briefly explain the two key lessons which economists and politicians draw out from interwar economic experience.

Ans. First

(i) An industrial society based on mass production cannot be sustained without mass consumption.

(ii) But to ensure mass consumption, there was a need for high and stable incomes.

(iii) Incomes could not be stable if employment was unstable. Thus stable incomes also required steady, full employment.

(iv) But markets alone could not guarantee full employment. Therefore the government could have to step in, to minimise fluctuations of price, output and employment.

Second

(i) It is related to a country's economic links with the outside world.

(ii) The goal of full employment could only be achieved if governments had power to control flow of goods, capital and labour. Thus the main aim of the post-war international economic system was to preserve economic stability and full employment in the industrial world.

Q. 2. How does a multilateral settlement system work?

Ans. (i) By 19th century, British manufacturers flooded the Indian market. Food grain and raw material exports from India to Britain and the rest of the world increased.

(ii) But the value of British exports to India was much higher than the value of British imports from India. Thus Britain had a 'trade surplus' with India.

(iii) Britain used this surplus to balance its trade deficits with other countries—the countries from which Britain was importing more than it was selling to.

(iv) This is how a multilateral settlement system works — it allows one country's deficit with another country to be settled by its surplus with a third country.

Q. 3. How were floating exchange rates introduced?

Ans. Despite years of stable and rapid growth, not all was well in this post-war world.

From the 1960s, the rising cost of its overseas involvements weakened the US's finances and competitive strength.

The US dollar now no longer commanded confidence as the world's principal currency.

It could not maintain its value in relation to gold.

This eventually led to the collapse of the system of fixed exchange rates and the introduction of a system of floating exchange rates.

Q. 4. How did the international financial systems lead to periodic debt crisis in the developing countries?

Ans. From the mid-1970s, the international financial system also changed in important ways.

Earlier, developing countries could turn to international institutions for loans and development assistance.

But now, they were forced to borrow from western commercial banks and private lending institutions.

This led to periodic debt crisis in the developing world, and lower incomes and increased poverty, especially in Africa and Latin America.