DO YOU KNOW?

What is Phillips Curve?

The Phillips Curve tells us the relationship between inflation and the unemployment rate. It is inverse relationship between the rate of unemployment and rate of inflation in any economy. In simple words, this curve indicates that lower the employment, higher the rate of inflation.

William Phillips, a New Zealand born economist wrote a paper in 1958 titled, The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957. It was published in Economica. Philips said that there was an inverse relationship between wages and unemployment in the British economy in the aforementioned period. Similar patterns were found in other countries. This drew the attention of other economists in other countries who had also dealt with the relationship between inflation and unemployment. This theory has also come under criticism. During 1970s, the United States experienced periods of high employment and high inflation at the same time. Many countries experienced high levels of both inflation and unemployment known as stagflation. Phillips Curve had suggested that this could not happen. The curve theory came under attack from a group of economists headed by Milton Friedman. According to the Hoover, Phillips conjectured, the lower the unemployment rate, the tighter the labour market, the faster firms must raise wages to attract scarce labour. At higher rates of unemployment, the pressure abated. Phillips curve represented the average relationship between unemployment and wage behaviour over the business cycle. It showed the rate of wage inflation that would result if a particular level of unemployment persisted for some time. Modern macro economics models often employ another version of Phillips curve in which the output gap replaces the unemployment rate as the measure aggregate demand relative to aggregate supply. Over the years, the theory has faced many opponents, yet it remains key to relating unemployment to inflation in macroeconomic analysis.

What are Special Drawing Rights (SDRS)?

Special Drawing Rights (SDRs) are designed to augment international liquidity by supplementing the standard reserve currencies. SDRs are assigned to the accounts of International Monetary Fund members in proportion to their contribution to the fund. This international monetary reserve currency was established by the International Monetary Fund. It operates as a supplement to the existing reserve of member countries. Responding to the concerns about the limitation of gold and dollars as the sole means of settling international accounts, SDRs are meant to augment international liquidity by supplementing the standard reserve currencies. The International Monetary Fund uses SDRs for internal accounting purposes. SDRs are allocated by the IMF to its member countries.

Special Drawing Rights were created by the IMF in 1969 and were intended to be an asset held in foreign exchange reserves. It has been felt that the role of SDRs are limited now as the developed countries who hold more SDRs are unlikely to use them for any purpose. Developing countries are more likely to use them as rather cheaper forms of credit. SDRs carry an interest. However, interest is not paid if any member country maintains the amount of SDRs allocated to it. The allotment of SDRs depends on financial resources contributed to the fund. All IMF member countries are represented in the SDR department. SDR is used by some international organisations as a unit of account. It helps cope with exchange rate volatility. The objective of creating this reserve asset was to supplement the official reserves of member countries. A country participating in this system needed official reserves – government or central bank holding of gold and widely accepted foreign currencies. It can be used to purchase the domestic currency in foreign exchange markets as required in order to maintain exchange rate. After the collapse of "Bretton Woods System" major currencies shifted to a floating exchange rate regime. Apart from this, the growth in international capital markets facilitated borrowing by creditworthy governments. Both these developments lessened the need for SDRs. The SDR is neither a currency nor a claim on IMF. Rather it is a potential claim on the freely usable currencies of IMF members. There are two ways in which the holders of SDRs can obtain these currencies in exchange of their SDRs. First through the arrangement of voluntary exchanges between members and second by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions.. ❑

(Compiled by Hasan Zia, Editor, Yojana, Urdu)