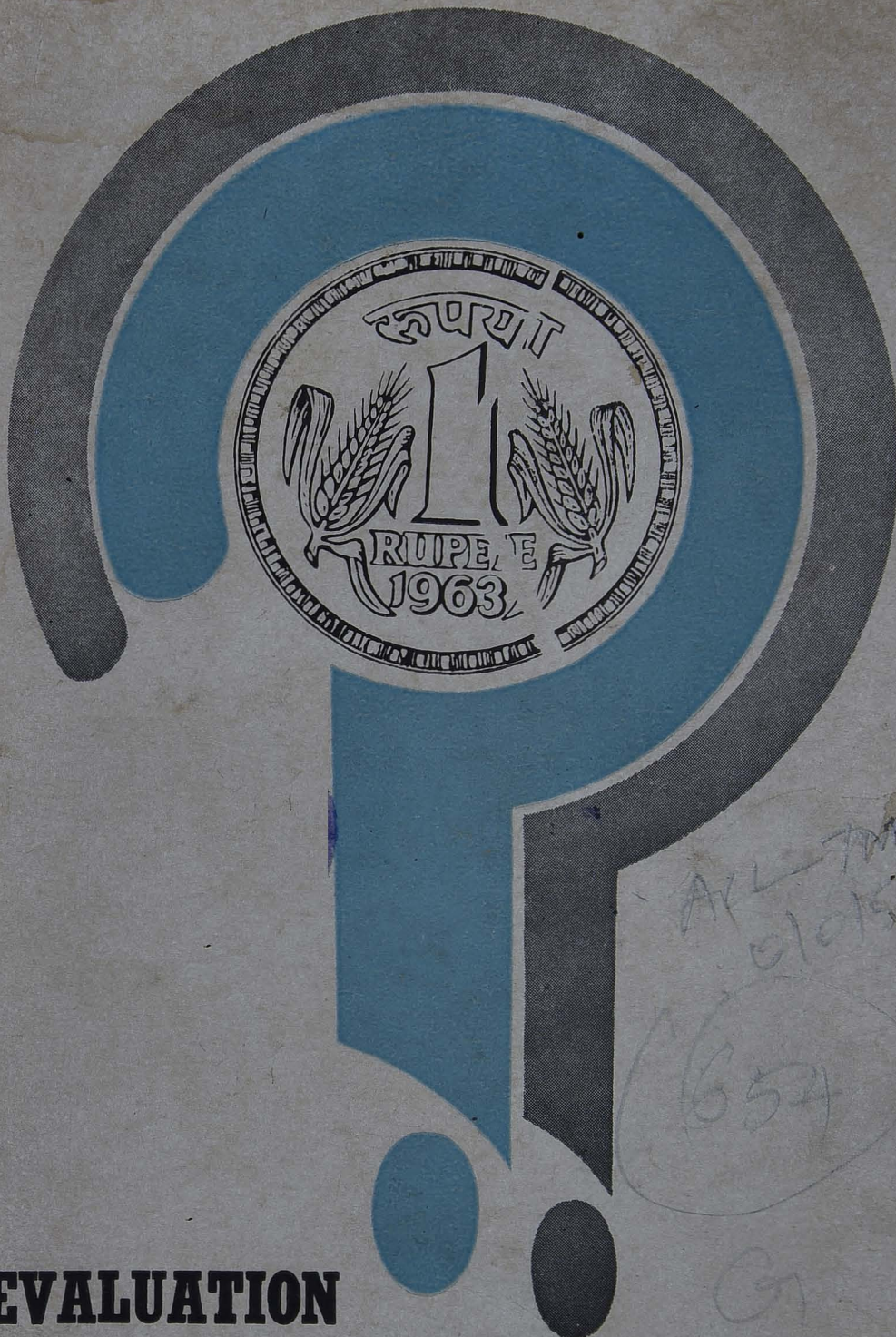




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With the Compliments
of

Dr. L. M. Singhvi, M. P.,

Executive Chairman,

INSTITUTE OF CONSTITUTIONAL

and

PARLIAMENTARY STUDIES

DEVALUATION OF THE RUPEE AND ITS IMPLICATIONS

THE INSTITUTE OF CONSTITUTIONAL AND
PARLIAMENTARY STUDIES

Vithalbhai Patel House,
New Delhi

PREFACE

The present publication seeks to set forth the background and analyse the implications of the recent devaluation of the rupee with a view to promote an informed public discussion and assist legislators in the study of the subject in all its manifold aspects. It is an objective monograph as well as a symposium of different points of view on this subject of vital significance. The Institute's purpose is neither to applaud nor to decry the measure ; its object is only to cull and compile materials and to present the pros and cons objectively in a single, readily accessible volume. I need hardly reiterate that the Institute does not offer any opinion on the subject, and that the views expressed in the symposium are those of the respective authors.

The quintessence of democratic government and of parliamentary discussion lies in a free and informed debate leading constructively to a sound formulation of policies. The Institute is committed to a continuous strengthening of this process. The Institute was established *inter alia* to disseminate democratic values, to strengthen and facilitate our constitutional system and the working of parliamentary institutions, and, as part of those objectives, to provide research and reference services for the benefit of all interested members of the Union Parliament and State Legislatures irrespective of their party affiliations. The Institute is thus an amalgum of a research organisation and a vehicle for popular dissemination of democratic values. It was in this perspective that Dr. S. Radhakrishnan, President of India, had expressed the hope while inaugurating the Institute (on 10th December, 1965) that the work of the Institute would be helpful to the country and its leaders in formulating their path and in guiding them

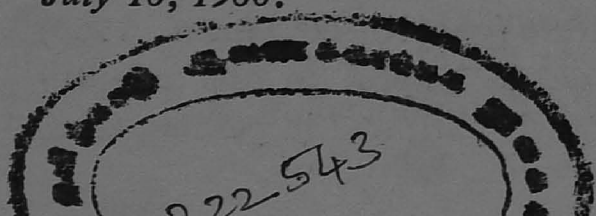
in the future. As Sardar Hukum Singh, the Speaker of Lok Sabha and President of the Institute, pointed out on that occasion: "A democratic welfare state can never succeed in achieving its objective unless its common citizens are enlightened and awakened and are strong, vigorous and vocal in their views and attitudes towards the policies of the State." He emphasized in this context "the need to educate public opinion so that the democratic process may be assisted by the spontaneous cooperation of all the citizens of the country at every stage." He also expected the Institute "to contribute in raising the standard of parliamentary debate by arranging specialized studies for legislators and focussing their attention on the more important problems." The present publication is the first in the series of studies and symposia which the Institute proposes to bring out from time to time, and it is hoped that it would serve the twin purposes of assisting legislators and policy-makers and of educating and informing public opinion on a fiscal measure of far reaching consequences.

The present publication had to be prepared under severe limitations, particularly the limitation of time. But for the prompt response from our contributors to the symposium, most of whom have written specially for this volume, the publication would have been greatly handicapped. I take this opportunity to express the grateful appreciation of the Institute to the distinguished contributors to the symposium.

NEW DELHI,
July 16, 1966.

L M SINGHVI
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The Institute of Constitutional
and Parliamentary Studies



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Note on Devaluation

The Union Finance Minister, Shri Sachindra Chaudhuri, took the entire nation by surprise on June 5 with his midnight broadcast on devaluation. The par value of the rupee, the Finance Minister announced, had been changed, effective from 2 A.M. on June 6, from 18.66 grams of gold per hundred rupees to 11.85 grams of gold, representing a reduction in the external value of the rupee by 36.5 per cent. In practical terms, the U.S. dollar was henceforth to cost Rs. 7.50 instead of Rs. 4.76, and the pound sterling Rs. 21 instead of 13-1/3. Along with this, Shri Chaudhuri also announced a number of other economic measures, all flowing from the devaluation decision.

This major monetary announcement, coming in the wake of repeated earlier official denials and contrary to known Government policy in the immediate past, caused considerable initial bewilderment (and resentment in some quarters) and has since touched off a nation-wide debate in which almost every point of view has found expression. It is appropriate now to take a composite view of the situation before the subject comes up for debate and appraisal in Parliament. This is what is attempted here.

WHAT IS DEVALUATION ?

Starting with the fundamentals, the first question that arises naturally is: What is devaluation ?

Devaluation may be defined simply as the lowering of the external value of the currency of a country. This external value (known as the *par value*) of a currency is the rate at which that currency normally exchanges for the currencies of other

countries. When a country's currency is devalued, what happens is, because, of its diminished external value, one now pays or receives more in the devalued currency than before in exchange for the same amount of foreign currency.

The immediate effects associated with devaluation are, in the main, a stimulation of exports and a reduction in imports—'in the main', because its effects are not confined to exports and imports alone but extend to every transaction in which exchange of currency is involved e. g. travel and tourism, repatriation of profits by foreign investors, servicing of debt charges, remittances by Indian nationals from abroad, etc. These consequences however actually flow only when, upon devaluation, while the external purchasing power of the currency has been lowered, its internal purchasing power itself against goods and services in general remains unchanged within the country, at least for the time being. This is a basic assumption which it is not easy to fulfil and is indeed seldom fulfilled. There are, besides, other counterwailing factors, such as duties etc. levied by Government as also the realities of world trade, which have to be taken into account and which tend to substantially qualify the assumed absolute results.

BACKGROUND TO DEVALUATION

An immediate reaction to the devaluation decision was that it had been done under "political pressure" from the United States and the international monetary authorities. Certain reports in the foreign as well as Indian Press seemed to lend substance to this. The Government, however, have denied this and have been pleading economic compulsions as the justification for the measure. It is therefore worthwhile to get in perspective the economic and political background in which the decision came to be taken,

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Although the news of devaluation came with an element of surprise, implicit probably in any monetary announcement of that nature, the forebodings had been there for some time past. Early in 1965 our foreign exchange reserves touched an 'uncomfortably low' level. Our foreign exchange reserves, which stood at Rs. 951.4 crores at the end of 1950-51, had fallen to Rs. 228.55 crores at the end of January 1965—a figure which after some recovery again fell further to Rs. 184 crores.

Table 1

India's Foreign Exchange Reserves*

(Rs. crores)

<i>End of</i>	<i>Assets</i>
1950-51	951.4
1955-56	824.6
1956-57	681.1
1957-58	421.2
1958-59	378.9
1959-60	362.9
1960-61	303.6
1961-62	297.3
1962-63	293.1
1963-64	305.8
Jan. 65	228.6
1964-65	249.7
December 1965	285.4

Several factors have led to a steady deterioration of our balance of trade position. While our exports had risen from Rs. 600.64 crores in 1950-51 to a mere Rs. 802.85 crores in the year 1965-66, our imports had

* Source : Government of India Economic Survey 1965-66, Appendix Statistical Table No. 6, 1,

more than doubled in the same period from Rs. 650.22 crores in 1950-51 to Rs. 1350.45 crores in 1965-66. This is reflected in the ever-widening trade deficit, which in the year 1950-51 was only Rs. 49.58 crores, but was of the order of the Rs. 547.7 in the year 1965-66.

Table 2
India's Foreign Trade
(Merchandise)

(In crores of rupees)

Year	Merchandise		
	Imports (—) (c.i.f.)	Exports (+) (f.o.b.)	Balance of Trade
1950-51	650.22	600.64	— 49.58
1951-52	943.13	732.99	—210.14
1952-53	669.88	577.37	— 92.51
1953-54	571.93	530.62	— 41.31
1954-55	656.26	593.54	— 62.72
1955-56	774.25	608.90	—165.35
First Plan Total	3615.45	3043.42	—572.03
1956-57	902.91	619.62	—283.29
1957-58	1036.40	635.14	—401.26
1958-59	903.64	572.64	—331.00
1959-60	961.45	639.65	—321.80
1960-61	1121.62	642.07	—479.55
Second Plan Total	4926.02	3109.12	—1816.90
1961-62	1091.63	660.58	—431.05
1962-63	1131.48	685.32	—446.16
1963-64	1222.85	793.24	—429.61
1964-65	1270.34	813.26	—457.08
1965-66	1350.45	802.85	—547.60
Third Plan Total	6066.75	3755.25	—2311.50

As can be seen from these figures, while the impact of development on the balance of payments was not very significant during the First Five Year Plan, probably because of its stress on agriculture which did not involve large imports of machinery and capital goods, in the Second Plan period these imports had increased substantially so much so that at the beginning of the Third Plan the country was left with a reserve of only Rs. 303 crores—barely a hundred crores over the minimum statutory requirement of Rs. 200 crores. Additional import of foodgrains, fertilizers and defence items during this period only added to an already difficult situation.

The Third Five Year Plan ended with an outstanding foreign debt estimated to be about Rs. 2,700 crores. Debt servicing charges were mounting steeply and foreign exchange outflow on account of repatriation of returns on foreign investment and other invisibles such as travel, transportation etc. was showing all round increase.

The diagram that follows gives an idea of the rising crescendo of our debt servicing payments.

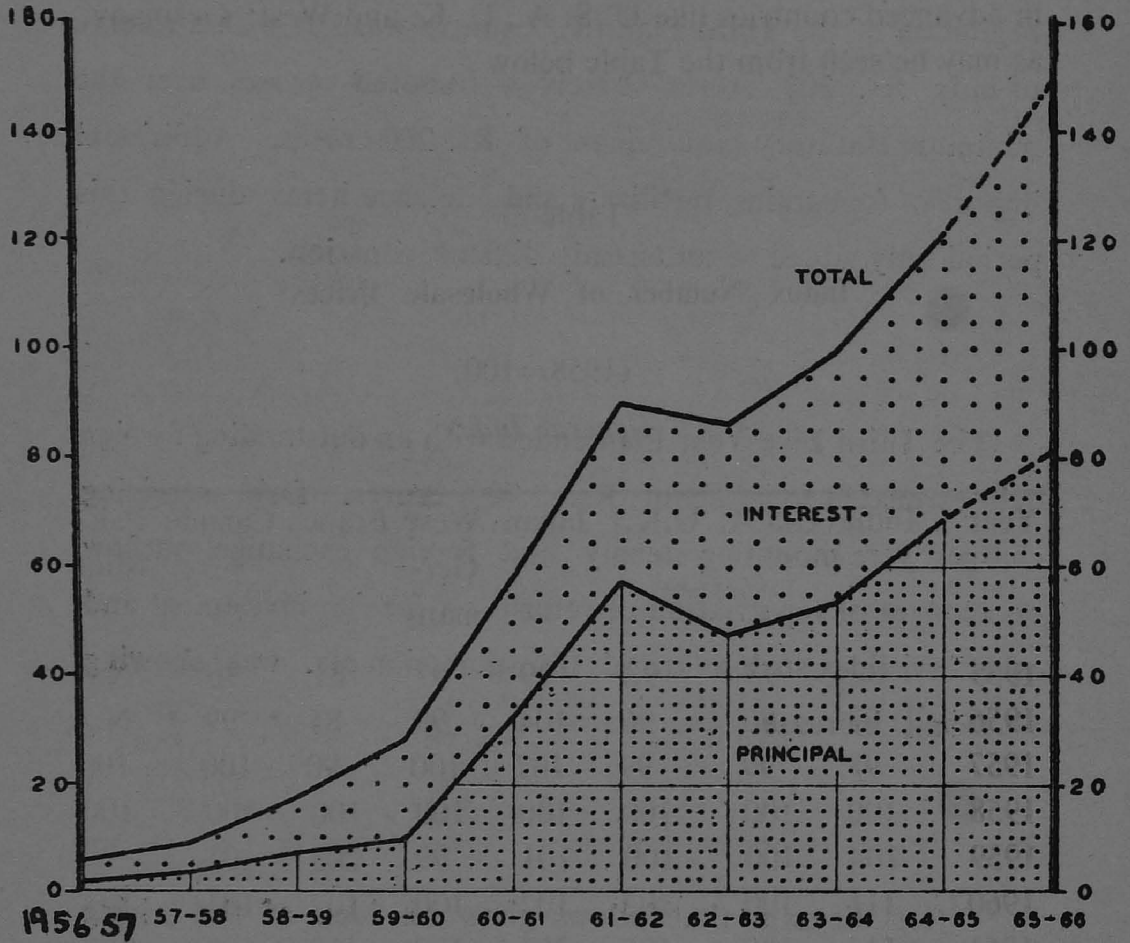
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DEBT SERVICING PAYMENTS*

(In Foreign Currencies)

Rs.
crores

Rs.
crores



* Economic Survey 1965-66

The abnormal rise in prices within the country, following deficit financing under developmental pressure, was fast getting Indian prices out of alignment with world prices and rendering the par value of the rupee unrealistic. Over the decade Indian prices had risen by as much as 80 per cent (from 82 in 1955 to 141 in 1965) as compared to a rise of between 10 to 20 per cent in advanced countries like U. S. A., U. K. and West Germany, as may be seen from the Table below :

Table 3

Index Number of Wholesale Prices*

(1958=100)

General Index

Year	India	U.S.A.	U.K.†	Japan	West Ger- many	France	Canada	Pak- istan
1955	82	93	92	99	97	81	96	N.A
1956	93	96	96	104	99	85	99	N.A
1957	98	99	99	107	100	90	100	100
1958	100	100	100	100	100	100	100	100
1959	104	100	100	101	99	205	101	98
1960	111	100	102	102	100	107	101	103
1961	113	100	105	103	102	110	103	108
1962	115	100	107	101	103	113	105	111
1963	119	100	108	103	104	117	107	110
1964	134	100	112	103	104	119	108	109
May								
1965	141	102	115	104	107	122	109	120

*By courtesy of the Indian Institute of Public Opinion,

†Refers to all manufactured products.

The heavy erosion in the purchasing power of the rupee, reflected in the inflationary price spiral, has also been accompanied by under-invoicing of exports and over invoicing of imports, diversion of incoming remittances through non-banking channels, smuggling etc.

In the early part of 1965 the country began to witness a virtual foreign exchange crisis. It was about this time that the Bell Mission came to India to study the state of Indian economy. As has since become public knowledge, one of the major recommendations of the Bell Mission was the devaluation of the rupee.* According to one writer, thinking on devaluation had set in in the Finance Ministry long before Mr. Bernard Bell's celebrated report.† At that time, the Government was of the view that a palliative in the nature of a selective approach was worth trying to set right the economic ills before yielding to a remedy of the magnitude of devaluation. This perhaps explains the former Finance Minister, Shri T. T. Krishnamachari's August 1965 budget, which was actually in the nature of a holding action, and his recent reported statement that "there was no other way than what they (Government) have done." Before the new schemes had a chance to operate, there followed the agricultural collapse of the later part of 1965, the economic drain of Indo-Pakistan conflict and a pause in foreign aid. These developments again only served to strengthen the inflationary pressures and stall the export drive and the foreign exchange reserves began to display a new phase of instability.

It appears that it was in this situation that the Government of India sounded the World Bank and the IMF for help early

*See Vishnu Dutt's article "How We Got There: Downhill March to Devaluation," Times of India, June 18, 1966.

†For excerpts from the Bell Mission's Report, see Appendix IV.

this year. Reports have it that while the World Bank met with some success in persuading creditor nations to consider re-scheduling or refinancing the debt payments falling due, the IMF strongly urged a reassessment of the international value of the rupee. In the meanwhile, crisis again loomed large in the month of May when the foreign exchange reserves were getting depleted while the prospect of foreign aid from the Consortium was still distant.

The Government were now faced with a serious situation. According to an official source "Our foreign exchange position at present is so difficult that *unless aid begins to flow soon in adequate quantities*, there is every danger of the economy receiving a serious setback Lastly, *action could not be postponed as all further negotiations* hinged on it (devaluation)"* (emphasis supplied).

The position was this : The rate of industrial production was becoming sluggish owing to paucity of raw materials and imports were urgently needed to keep the wheels of industry moving. Success of the agricultural programmes again depended upon substantial import of fertilisers through aid. The commitments on account of debt repayments had also become so heavy that the country was at a stage when it had to incur debts to repay old ones. The fate of the Fourth Plan was also linked with the prospect of aid. In the Government's view, it was extremely doubtful whether adequate and immediate aid would be forthcoming "without demonstrable evidence of our determination and capacity to push up our exports and improve the external viability of our economy".† This, then, was the context in which the decision to devalue was taken.

* See "Devaluation of Rupee: Some Questions Answered", 7 June, 1966 pp. 14-15.

† Ibid p. 15.

IMPLICATIONS OF DEVALUATION

Devaluation and Exports

The aid aspect apart, the main argument for devaluation advanced by the Government is that it will boost exports and help improve the balance of payments position. Their thesis has been that the abnormal rise in internal prices in recent years as compared with other countries has been pricing out our exports in the world market and devaluation would stimulate exports both by increasing the competitiveness of our goods and by providing incentive to exporters in the shape of larger export earnings.

With reference to the plea that our goods were getting priced out, it has been pointed out that the argument loses much of its weight in the face of the Government's own statement (in the annual report of the Ministry of Commerce for 1965-66) that about 80 per cent of our exports move out at international prices. The validity of the comparison made in this connection of wholesale price indices in different countries is also questioned on the ground that what should matter really is the prices of commodities actually traded in rather than the wholesale price levels.* The argument that devaluation is meant to increase the competitiveness of our goods is again questioned on the ground that, in respect of our traditional export items constituting the bulk of our export trade, export duties have been imposed following devaluation to prevent any appreciable decline in their international prices.†

As for the prospect of increased foreign exchange earnings on exports, it depends upon several factors such as the elasticity of demand abroad for Indian goods, our exportable surplus or surplus potential and the Indian-foreign price differential of our exportable goods. Nearly 75 per cent of our

* See Dr. S. R. Mohnot's Views in the Symposium.

† See Dr. D. K. Rangnekar's views in the Symposium.

exports admittedly consist of traditional items, the demand for which is stated to be inelastic. The view of the trade is that the levy of export duties on these items with a simultaneous withdrawal of all the earlier export incentive schemes has the affect of practically nullifying the incentive implicit in devaluation. On the other hand, at least one economist comes to the conclusion that notwithstanding the high export duties levied to skim away some or most of the creamy profits of devaluation, exporters will be left everywhere with sufficient margins of gains at stable world prices and this might even make room for manipulating the world demand for our products by reducing the prices in the case of the more elastic commodities*.

Any expansion of exports in appreciable measure must obviously come from the non-traditional sector. Before the prospects of export earnings in this sector can be gauged, a detailed examination of the items, industry by industry, would be necessary to ascertain (a) the domestic-foreign price differential (b) capacity constraints and raw material shortages inhibiting production (c) sensitivity of unit cost of production to fuller utilisation of capacity and (d) the likely impact of increased exports on domestic prices. Such an analysis of the situation in depth is yet to be made.*

Devaluation and Imports

The immediate consequence of devaluation on imports is the rise in the value of imports in rupee terms by 57.5%. The general apprehension is that this drastic increase would be reflected in an increase of production costs and of prices. The

*See Eric P. da Costa "Devaluation and India's Foreign Trade", Supplement to the "Monthly Commentary on Indian Economic Conditions" published by the Indian Institute of Public Opinion, Vol. VII No. 11.

†See Dr. Samuel Paul in the Symposium.

Government however do not seem to take such an alarming view of the situation. Their argument is that with articles of food and other essential commodities like kerosene oil etc. either subsidised or their prices suitably controlled, the workingman's cost of living should not go up appreciably. As for production costs, the official argument is that where no import component is involved the price of a product should not go up; and where some element of imported component enters, the rise in price should strictly be proportionate to the actual percentage of the import component in the product. The logic of this argument does not command general acceptance because it leaves out of account burden^{of} replacement of capital machinery, debt obligations in foreign countries already incurred and now enhanced by devaluation, and similar other factors. Price mechanism in any economy, it is pointed out, does not function in an insulated manner, and sympathetic and psychological rise in prices^{to be} is a common enough phenomenon everywhere.

It is claimed that high import costs would encourage import substitution. Since any programme of import substitution involves technical know-how and research, the results in the nature of things cannot show up immediately. It has also been pointed out that the very process of import substitution can give rise to demand for new products which are not available from indigenous sources. The process of import substitution can therefore only help in bringing about a further change in the character of import trade and not necessarily a reduction in the volume of goods imported from abroad.†

Devaluation and the Balance of Payments Position

The official claim about improving the balance of payments position through increased export earnings as a result

†See Shri Ramnath A. Podar's view in the Symposium. Also, see Shri Manubhai Shah's speech "Development without aid", occasional Paper of National Council of Applied Economic Research, 1965.

of devaluation is received with scepticism. It is pointed out that the present state of the balance of payments position is not to be attributed so much to the poor export performance as to an economic policy which tries to force the pace of growth beyond the capacity of the available internal resources. The huge gap in the trade balance, it is asserted, cannot be bridged in the near future by any spurt in export performance. With further large—scale aid in view and the increased rupee burden on account of devaluation, the situation, if at all, may further worsen.

The Aftermath Devaluation

The implications of devaluation are complex and controversial. Its impact on our economic development would hinge, however, on the follow-up measures initiated by the Government. It is on this aspect of the matter that policy-makers in the country would have to concentrate, if devaluation has to confer any lasting benefits for the country's economic progress. As Prime Minister Shrimati Indira Gandhi herself put it, devaluation is not a magic cure. From the point of view of the Government, it offers a corrective to some of the distortions which had crept into the economy. The question which is being posed by some is, whether devaluation will be followed by other measures of liberalisation of imports, of controls and of industrial policy generally, whether it would pave the way for a substantially higher level of industrial activity and a consequent improvement in the nation's economic health and whether there would be a substantially increased inflow of foreign aid and foreign private investment. The question is whether this represents a change in the socio-economic philosophy to which the Congress Party has been wedded since its Avadi Session, i.e. whether devaluation and the follow-up measures are merely tactical adjustments or a

basis for the redefinition of the country's economic strategy. Above all, the immediate question is whether we would be able to arrest the rising spiral of prices and achieve agricultural self-sufficiency. Time alone will provide the answer whether devaluation was a capitulation to outside pressures or a venture of volition on the road to self-reliance.

Symposium on Devaluation

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The Devaluation of the Indian Rupee

P. C. Bhattacharyya

With effect from June 6, 1966, the Government of India devalued the rupee by 36.5 per cent, by reducing its par value from 0.186621 gramme of gold to 0.118489 gramme. As a result, at present Re. 1 is equivalent to 13.33 cents (U.S.) or 11.43d. (sterling), as against 21 cents and 1s. 6d., respectively before the devaluation. Conversely \$1 (U.S.) is now equivalent to Rs. 7.50, as against Rs. 4.76 before the devaluation, and £1 (sterling) is equal to Rs. 21 instead of Rs. 13.33. In view of the momentous nature of the decision to devalue, I propose to discuss here briefly the reasons which prompted Government to devalue and the economic implications of the devaluation.

It may be mentioned at the outset that, although the official external value of the rupee was maintained unchanged since the preceding devaluation in September 1949 until the present devaluation, its internal value in terms of purchasing power went down substantially over the same period as a result of inflation. It is true that the value of the currencies of countries that are our main trading partners also declined at the same time, but the extent of the decline was far less. For instance, between 1949 and 1966, the price level in India rose by more than 75 per cent, as against less than 30 per cent in the U.S.A. In other countries too the price rise was considerably less than in India. Consequently, the rupee was out of alignment with the currencies of our main trading partners. This served to discourage exports, by making them costlier to the foreign buyer in terms of foreign currencies, and to encourage imports, by

making them cheaper in terms of rupees than their domestic substitutes, the prices of which had risen because of internal inflation. The gap between receipts of, and payments in foreign currencies was further widened by the growing volume of developmental and maintenance imports and the mounting burden of repayment of foreign loans and payment of interest on them. The situation was further aggravated by the dwindling of the flow of remittances from Indians abroad, who began to transfer funds through unofficial channels, where they could obtain more rupees for their foreign currency, which was in great demand for buying gold and luxury goods, to be smuggled into India and sold at a very high profit.

All these factors were together responsible for the steady deterioration in India's balance of payments, particularly since 1957, and the recurring foreign exchange crises. In spite of the growing volume of foreign aid the foreign exchange reserves of the country dwindled to a precariously low level. In this situation, the pause in foreign aid, which occurred after the Indo-Pakistani conflict last September, made self-reliance more imperative than ever before. Our earnings from exports had to be enhanced and our expenditure on imports had to be curtailed. But, in order to achieve these objectives, it was felt, it would be necessary to encourage exports from and discourage imports into India, by lowering the external value of the rupee and bringing it in line with the currencies of our trading partners. This uniform, all-round adjustment was preferable to other measures, such as further tightening of import restriction and heavy import duties and import entitlements, tax credit certificates and subsidies for exports, which had lead to uneconomic allocation resources and served to distort the structure of the economy. On the other hand, devaluation would bring about export promotion and import substitution without adverse effects on the economy. This will be evident from the following examination of the implications of the recent devaluation.

EXPORTS

Although India's exports tended to rise in the earlier years of the Third Plan period, they were stagnant in 1964-65 and actually declined in 1965-66. The stagnation in exports was brought about mainly by inflation, which reduced not only the *ability* to export by raising the cost of production of our export commodities, thus making it difficult for them to compete in foreign markets, but also the *willingness* to export by enabling producers to secure a much higher price by selling their goods within the country than by exporting them. In order to promote exports, the Government of India took several steps, such as import entitlement schemes, the tax credit certificate scheme and even straight subsidies. Import entitlement schemes enabled exporters to compensate their losses on exports by profits on imports, which were high because import restrictions were tight. Their success thus depended upon continuance of such tight restrictions. On the other hand, if existing idle capacity of industries was to be fully utilised to boost up production, it was necessary to liberalise imports. To that extent, the profits from import entitlements would have declined and the scope for exporting at a lower price would have diminished. Import entitlement schemes could not, therefore, be continued indefinitely. As regards the tax credit certificate scheme and straight subsidies, both of them involved heavy burden on the exchequer, while the latter also carried the danger of retaliation by importing countries. For these reasons, when devaluing the rupee, Government withdrew the import entitlement and tax credit certificate scheme and direct subsidies.* Devaluation of the rupee would be more beneficial to exports because an exporter earning a given amount in foreign exchange would earn 57.5 per cent more in terms of rupees. Thus, for example, \$ 1,000 would fetch Rs. 7,500 after the devaluation, as against Rs. 4,760 before it. By increasing

*In order that exports may not suffer as a result, arrangements have been made for exporters to secure their import requirements on a priority basis.

the profitability of exports, devaluation will encourage the flow of investment into export industries.

Following the devaluation, export duties were imposed on traditional items of exports, which were not difficult to export without any special incentive even before the devaluation. The export duties were introduced with a view to preventing a sharp fall in export prices in foreign currencies, which would have resulted in a fall in our export earnings, as the foreign demand for these commodities would not have increased sufficiently to make up for the fall in price. At the same time, however, care has been taken to ensure that exporters have a margin which would enable them to reduce their prices to some extent in order to compete in foreign markets. Apart from export duties, the prices of our exports in terms of foreign exchange are not likely to fall in respect of most commodities because India's share in their world imports is small. In the case of tea and jute, however, where India's share in world imports is large and world demand is relatively inelastic, there is the possibility of a fall in the export price in foreign exchange terms. But this is likely to be checked by the export duties. As regards exports of non-traditional commodities, devaluation would confer greater advantages than the previous incentives. So, the general effect of the devaluation will be to encourage exports and increase foreign exchange earnings. But, where the devaluation might have reduced foreign exchange earnings, export duties will ensure that they do not.

IMPORTS

So far as imports are concerned, it was found that, in spite of progressive tightening of import restrictions and raising of import duties, imports continued to grow, due mainly to the fact that the cost of imports in terms of rupees was much lower than that of comparable goods manufactured at home. This discouraged import substitution and meant large profits for

importers. As a result of the devaluation, the c.i.f. value of imports in rupee terms has gone up by 57.5 per cent. This will reduce to a considerable extent the large profit margins of importers, which they enjoyed because of the tight foreign exchange situation and strict import licensing, and encourage substitution of imports by domestic products. Entrepreneurs will find it more profitable to invest in industries manufacturing import substitutes.

Following the devaluation, import duties have been lowered. But the reduction in import duty does not offset the rise in the c.i.f. cost of imports in rupee terms to the full extent. This has been done with a view to minimising the adverse effect on the budget of the reduction in import duties and ensuring that import costs are not out of line with domestic costs. By increasing the rupee cost of imports, devaluation will make it possible to simplify import controls, without detriment to domestic industries. Steps are also being taken by Government to reduce procedural delays associated with import controls.

PRICES

Apprehensives have been expressed that the higher rupee prices of imports are likely to be transmitted to domestic commodities in which they are used, resulting in internal inflation which, by discouraging exports and encouraging imports, would nullify the benefits of the devaluation. Logically speaking, however, internal prices should not rise except to the extent of the rise in the prices of import contents. Secondly, even before the devaluation, the prices of many imported commodities were far higher than their landed cost plus import duty, due mainly to their scarcity. There is no justification for a rise in the prices of such commodities because the increase in the rupee cost as a result of the devaluation could be absorbed by the excessive profit margin. Thirdly, a number of measures have been taken by Government to minimise the impact of the

devaluation on the prices of essential commodities that enter into the cost of living. Thus, it has been decided not to raise the issue prices of imported foodgrains and fertilisers (by subsidising them) and the prices of petroleum products including diesel oil and kerosene (by making adjustments in import and excise duties). Fourthly, the introduction of a realistic rate of exchange has prompted lending countries to resume the grant of aid on a large scale, particularly for maintenance imports. This will enable Government to set up maintenance imports, which are essential for utilisation of idle capacity in many industries. Greater utilisation of capacity will lower the cost of production, thus encouraging exports. The increased output will act as a check on rising prices.

INVISIBLES & CAPITAL TRANSACTIONS

So far, I have dealt with merchandise transactions, which are the major constituents of our balance of payments. Now, I shall refer to invisibles and capital transactions, which have been growing in importance in recent years.

The relatively high rate of exchange for the rupee before the devaluation meant a larger drain in terms of foreign exchange in respect of remittances of profits and dividends from foreign investments. It was also responsible for the dwindling of remittances by Indians abroad through official channels because the unofficial market offered a larger number of rupees for a given amount of foreign exchange. As a matter of fact, the National Defence Remittance Scheme, which enable the recipients of remittances from abroad to obtain, in addition to the official rate, an import entitlement which they could sell for a consideration, led to a spurt in the inflow of remittances from abroad. Over-valuation of the rupee also encouraged the smuggling of gold and luxury articles, by widening the margin between their landed cost in rupee terms and the prices prevailing within the country. It also encouraged under-invoic-

ing of exports and over-invoicing of imports, with a view to retaining illegally foreign exchange abroad.

The lowering of the exchange rate of the rupee will stimulate the flow of remittances from abroad into India and dampen that of remittances out of India. The foreign exchange burden of remittances of profits, dividends, royalties etc., will be lowered. Foreign private investment is likely to be encouraged, as the foreign private investor will now secure a larger amount of rupees for the same amount of foreign exchange. Foreign tourists will be attracted to India by its cheapness in terms of their own currency. On the other hand, foreign travel by Indians would be discouraged because it would be costlier in rupee terms. Smuggling of gold and luxury articles, as also under-invoicing of exports and over-invoicing of imports, would become less profitable.

EFFECTS ON THE BUDGET

The impression of some, that the burden of servicing of (i.e. repayment of principal of and payment of interest on) foreign loans will go up in terms of foreign exchange, is not correct, as these obligations are fixed in terms of foreign exchange. The burden will, however, rise in terms of rupees. The Budget will also have to bear the higher cost of Government imports and expenditure abroad. But, as against this, the export duties will yield substantial additional revenues. Although the rates of import duties have been lowered, the revenue from them is not likely to fall, in view of the rise in unit value of imports in rupee terms and the decision to liberalise the flow of imports. The rupee value of foreign aid will also go up as a result of the devaluation. For these reasons, the devaluation is not likely to have an adverse effect on the Budget.

CONCLUSION

To sum up, the recent devaluation of the rupee will prove

to be a more efficient method of reducing India's adverse balance of payments than the various export promotion and import substitution measures that preceded it. In spite of the lowering of the exchange rate, export earnings would be maintained with the help of export duties. Higher rupee costs of imports, coupled with only limited reduction in import duties, would encourage substitution of imports by domestic goods. The rise in prices within the country would be checked by large maintenance imports that would be made possible by resumption of non-project assistance after the devaluation. On invisibles and capital account, there is likely to be a reduction in payments and an improvement in receipts. Although the Budget will be strained by the increase in the cost of servicing of foreign loans in rupee terms, it will benefit from the simultaneous rise in the rupee value of foreign aid and the introduction of export duties; the revenue from import duties may not fall despite a lowering of their rates.

DEVALUATION

Causes and Consequences*

H. V. R. Iengar

A great many things have been said about this momentous change—Devaluation—both by Government spokesman, politicians, economists, businessmen and lay citizens. Some of the comments are purely polemical and may be dismissed as part of the continuous battle of words that goes on between the ruling party and the opposition. As men who are engaged in industry and commerce, we should forget polemics and take a cool and dispassionate view of the situation. Within the brief compass of these remarks I propose to ask myself the question as to why a situation arose in which devaluation was considered necessary; whether it could have been avoided; and what are likely to be the consequences of this step. I am well aware of the argument that devaluation is like a major surgical operation; and once it has been carried out, there is no going back on it and, from this point of view, a discussion as to whether the step was right or wrong has only academic interest. But from the long-term interest of the country it is important that we do carry out a post-mortem so that if any mistakes have been committed in policy or administration which have led to this situation, those mistakes are not repeated in future and lead to further bouts of devaluation which would be ruinous to the country.

I have read with great care the statements issued by Government spokesmen, and I heard, the other day, a defence

* Text of speech delivered by the author at the Golden Jubilee of the Mysore Chamber of Commerce on June 19, 1966.

of devaluation by two very able Ministers of the Union Government who visited Madras. The Ministers talked about imbalances that had developed in the economy and of the need to cure these imbalances and distortions. I submit that this is merely an explanation of the technical aspects of the problem. The fundamental question in which we ought to be interested is: Why did these imbalances and distortions occur? Did they arise for reasons beyond our control, or are they the consequences of errors of policy and administration?

In dealing with this question, it might be useful to set out certain essential facts. These facts are that till the Chinese invasion took place in 1962, our economy was, on the whole, going smoothly enough. The official wholesale price index before the Chinese invasion was 125 on the base 1952-53 = 100. In other words, prices had gone up by about a quarter in ten years. Considering that a substantial amount of developmental expenditure had been financed by what is euphemistically called deficit financing but what, in reality, is the printing of currency notes by the sovereign authority without the backing of real assets, this was not a bad performance. Even so, the Reserve Bank had been issuing warnings that pressures were developing which, if not corrected, might lead to rising inflation. To-day, some $3\frac{1}{2}$ years after the Chinese invasion, the wholesale price index is 183. In other words, in $3\frac{1}{2}$ years there has been an increase of 50 per cent in the price level. In comparison with the rise in price level in other countries with whom we trade, the rise that has taken place in India is exceptionally high. We have been pricing ourselves out of the international markets, and it is basically this which economists and Government spokesmen have been describing as imbalances in the economy. Why did this situation arise?

The fact of the matter is that Government indulged, and have been indulging till very recently, in a degree of bravado that can only be called astonishing, to say the least. When the

Third Five-Year Plan was conceived, they were well aware that there had been an over-estimate of resources and that, as matters stood, the plan was not likely to be achieved without a further rise in prices. After the Chinese invasion took place, there was a sudden and large scale increase in Defence expenditure. When this took place, it was quite obvious that any attempt to carry out the Third Five-Year Plan as originally conceived was bound to lead to serious inflation. Quite a number of people pointed this out to Government. I regret to say that in our country there has hitherto been a tendency for people in authority summarily to dismiss opinions which do not conform to official doctrine. These warnings were disregarded, Ministers talked of Development with Defence; and the consequence has been a large scale increase in the price level which has already caused a great deal of misery to large number of people.

I think it is specially important at this time to be clear in our minds about the basic factor leading to a situation in which Government have considered devaluation as unavoidable. In simple terms, we have attempted to live wholly beyond our means, including therein the assistance who have been getting from abroad. The compulsions of development were, of course, great, and the spectre of poverty touched the hearts of Government, but it was necessary to preserve a sense of balance and realism. I myself am one of those who accepted the need for deficit financing in the circumstances in which we were placed. Nor did international organisations take a rigid or obstructive attitude to the use of this instrument. But this instrument, while legitimate enough, is a dangerous one, and what has happened in the last few years has been an excessive recourse to it at a time when pressures had already mounted up. It is the political failure to recognise the need for reducing expenditure that has led to the present distortions. It is vital that we do not commit the same mistake in future. I draw particulars attention to this point because already there is evidence that

there are those who are not learning from our past mistakes. Just as there are supposed to be "doves" and "hawks" in various administrations, there are in India some planners who are mesmerised by the need for large plans and those who take a realistic view of planning development with a reasonable degree of stability. A controversy between these two groups which has going been on ever since planning was accepted in our country seems again to be simmering. The common citizen should not allow himself to be confused by technical jargon. He should appreciate the fact that if we try once again to rush our economy too fast by extravagant plans, leading to illegitimate use of deficit financing, we shall, devaluation or no devaluation, once again be in jeopardy and run the grave risk of further devaluation.

It is not with a view to indulging in a merely academic exercise that I pose myself the next question as to whether devaluation could have been avoided. The late Finance Minister, Mr. T. T. Krishnamachari, attempted to avoid this step by a recourse to very heavy import duties and a system of export subsidies and other export incentives. His measures could have been successful provided two conditions were fulfilled. It was necessary for the success of these measures that Government should take steps to see that the distortions in the economy were not further aggravated by heavy recourse to deficit financing. This involved bold political decisions which, unfortunately, were not forthcoming. Further it was necessary that the administration concerned with the operation of a whole battery of controls and incentive schemes should be prompt and efficient. This also was not the case. Thirdly, it was necessary that the trading community who were the beneficiaries of incentive schemes should behave with a reasonable degree of decorum and honesty. Unfortunately, even this was not the case, and there have been gross abuses by certain sections of the private sector, leading to serious leakages of

foreign exchange. In other words, as a purely technical proposition, devaluation could well have been avoided provided a certain degree of basic discipline, integrity, and efficiency had been exercised by everybody concerned. Where this failed, the remedy of import duties and export incentives was obviously futile.

The Prime Minister has realised that while devaluation may have been necessary, it is not solution of our problems but merely the beginning of a series of steps that have to be taken to put the economy back on the rails. The first effect of devaluation is likely to be an increase in the price level. This is because we would still, for some years, have to import substantially in excess of our export earnings, and the price of imports in rupee terms would go up as a result of devaluation. As a necessary holding action, it would be essential to hold the price line in regard, at any rate, to basic commodities. But it would be futile to expect that this can be done by the mere issue of ordinances or by a belief in the efficiency of consumer societies or Government Departmental Stores. I fear that, whatever steps Government take, it would be impossible to prevent some rise in the general price level. The policy should aim at reducing its extent and duration to the maximum extent possible. In the meanwhile, production must be got going as quickly as possible to catch up with the demand. In so far as agricultural production is concerned, it is, unfortunately, to some extent, a gamble on the rains, and one can only pray that the country will be fortunate enough in the monsoon this year. So far as industries are concerned, devaluation would have no meanings if Government were unable to organise a massive degree of external assistance which will enable industrial raw material, components and spares to be imported in quantity so that the existing industrial apparatus is exploited to its maximum extent. Concomitantly, fiscal policy and the credit mechanism would have to be refashioned to provide the

necessary rupee resources to enable this to be done. But even if this were done, basic disciplines have to be maintained, both by Governments and the public. Certain State Governments have been notoriously guilty of indiscipline in running up large unauthorised overdrafts with the Reserve Bank, and the Central Government have shown an inability in the past to take unpopular decision regarding the size of the plans. Too many people in private business have shown a tendency to exploit the situation for making cheap profits by illegitimate means. Government have said that they will take a strong line with unsocial elements. They have said this in the past without really meaning it. Fortunately, there is evidence that the Prime Minister has grasped the basic lessons of past experience. She has been speaking with refreshing candour, sincerity, and understanding. While devaluation has been forced on us largely because of our own mistakes in the past, and it is still a gamble as to whether it will restore the health of the economy, it will have served a useful purpose if it has pointed out to us the need for some poise and balance in our thinking, for courage in taking unpopular decisions, and generally, for the exercise of self-discipline all round.

Some Post-Devaluation Problems and Policies *

Dr. V. K. R. V. Rao

It is not my intention to discuss the merits of the decision on devaluation. Obviously, there are two sides to the case and it is possible for people honestly to hold different views on this controversial subject. But what we are all concerned with is the national interest, the welfare of the common man, and the acceleration of our economic development. Now that devaluation is an accomplished fact, we have all to work together and seek the best ways of getting the maximum national dividends from this decision.

Devaluation means that the rupee prices of imported goods and services go up. The extent to which they will go up depends upon the import content in their cost of production and not the percentage rise in the cost of the imported item. Thus, for example, if a commodity has an import content of 10 per cent, its cost would go up only by 5.7 per cent even though the cost of the imported item may go up by 57 per cent. Even this is subject to certain important qualifications. Thus, we must remember that a good proportion of our imports consists of machinery and equipment or what are called project imports for the installation of new units of productive activity, whether in the private or public sector. While the rupee prices for their imports have now gone up, these units are still in the process of establishment and have not yet started producing

*Broadcast talk reproduced by courtesy of the AIR.

goods for the market. When they actually start producing the price of their output would be higher than what would have been the case before devaluation unless countered by increasing efficiency; but this is in the future. For the time being, increase in their capital costs should have no effect on prices, for they are not selling any goods. If producers or stockists of goods similar to those which would be produced in the future by these concerns, now raise their prices, it only means that they are making abnormal profits by taking undue advantage of the current situation. I know that there is the argument of replacement cost, but replacement comes later, and there would be no objection to their raising their prices when they start expanding or replacing their capacity. When this situation arises, it could be taken care of by appropriate fiscal or other measures, when these are considered socially necessary. For the time being, however, there is no case for existing units charging higher prices just because the cost of establishing new units has gone up because of devaluation.

But we may be told that imports also include basic consumption goods like foodgrains, kerosene, and adjuncts to agricultural production like fertilisers, pesticides etc. But in the case of these Government have already given the assurance that they will maintain their rupee prices at the pre-devaluation level by fiscal adjustments in import duties and excise duties, and by subsidisation where needed as in the case of imported foodgrains and fertilisers. There is therefore no justification for a rise in these prices and as their distribution is largely handled by a governmental or semi-governmental machinery, it is also possible to enforce this decision.

Then there is the question of maintenance imports which enter into the current cost of production and may therefore be expected to bring about a rise in prices on account of devaluation. But we must not forget that the Indian prices of the imported maintenance item was not equivalent to the landed

cost of the imported item in most cases. A certain proportion of the imported items were sold at prices much above their imported cost as they were being brought in the black market from persons who sold their import licenses or did not use them in their own manufactures. Even in the case of those who used their import licenses legitimately in their own business, they sold the final product at prices that gave them a substantial margin over the cost of the imported component because prices were determined by supply and demand and the current climate of shortage in the economy. This meant in turn that the prices of goods with an import content were already high and were yielding an abnormal profit even to those who did not have to pay a black market price for purchasing these import components. Under the circumstances, there is absolutely no reason why they should raise the prices of their goods simply on the ground of devaluation.

Moreover, independent of the devaluation, the import of a number of maintenance items is being liberalised. This should result in larger availability of raw materials, spare parts, and components for Indian industry. This, in turn, should lead to a larger utilisation of existing industrial capacity and a sharp decline in the extent of unutilised capacity. It is well-known that where there is unutilised capacity, costs per unit increase because overheads have to be spread over a smaller output. When more capacity is utilised and the output increases, the cost per unit comes down as now the overheads can be spread over a larger output. This is what will happen to the bulk of Indian industry which depends upon imported raw materials or spare part and components and is working with a great deal of unutilised capacity because of shortage of foreign exchange. With liberalisation of imports, not only will there be increased production, but there will also be a reduction in unit. Prices of such industrial goods are therefore bound to decline as soon as the liberalised imports have reached the hands of the relevant

producers and they have been able to increase their utilisation of capacity. But this will take some time, probably from about five to six months; and in the meanwhile there may be tendency to raise on psychological grounds.

There are three ways of resisting this tendency. One is for Government to take the most stringent measures to punish traders who raise prices above the pre-devaluation level, using only not the Essential Commodities Act, but also arming themselves with further powers by issuing the necessary Ordinance for the purpose. It is however important that these powers are actively exercised even if it means the incurring of a certain measure of unpopularity among the trading classes. These measures will not succeed, however, unless the public also expresses its strong disapproval of traders or manufacturers who take advantage of the current situation to exploit the vast masses of their fellow citizens.

Another measure is for Government to play an active role in the distributive system either directly or through consumer cooperative stores. Power must be taken to acquire a given proportion of current output of various kinds from the producers and these must be sold at the departmental or co-operative stores at such prices as will serve as a deterrent to profiteering on the part of traders and manufacturing who want to take advantage of the situation created by devaluation. Government has already announced its decision to undertake such a policy and some measure of socialisation of distribution is expected to result from this decision. But all this will take some time. Departmental or cooperative stores cannot be started in a day or nor can they be either staffed or filled with stocks within a week. At least several months will elapse before such a distributional machinery can be brought into existence on a wide enough scale or put into effective operation. Meanwhile the danger remains of an immediate and unjustified

rise in prices because of the anti-social activities of unscrupulous persons who want to profiteer at the expense of the national emergency.

The third and, in fact, the immediately most effective way of dealing with the problem is organised consumer resistance. Consumers have to make up their minds that they will not buy goods the prices of which have been raised above their pre-devaluation levels, except to the minimum essential extent that is necessary. It would be best if the nation went on a consumer strike as it were and postpone all purchases of goods for which traders want to charge higher prices. Such organised consumer resistance proved successful in Calcutta in preventing high prices and profiteering by traders in fish. Here, in Delhi, the payment coffee shop played an important role in arresting the move for sharp rise in the price of coffee. In situation where traders fail to respond to the call of social duty, consumers have to step into the breach and persuade them to do so by non-violent abstention from purchasing at their shops. Apart from such action on the part of individual consumers, it is necessary for consumers to organise themselves into clubs, associations, and cooperatives in order to see that price regulations are not violated by widely disseminating information on legally chargeable prices, identifying traders or producers who raise prices and the commodities of which they raise the prices, and bringing the pressure on articulate public opinion to make them change their ways and function in a more socially responsible manner.

The measure I have spoken of so far are all for the immediate present and the short period. It is here that the greatest danger lies of defeating the purpose of devaluation by the emergence of immediate and unjustified rise in prices. Devaluation has not increased the cost of commodities already produced and stocked by either manufacturers or traders.

If this is recognised and an immediate rise in prices arrested by concerted governmental and public action supplemented by the voluntary restraint of public spirited traders and manufacturers, then time would have been gained for the new harvest of agricultural commodities to come to the market, for the liberalised imports to result in increased industrial production and at lower unit costs, and for the departmental and cooperative consumer stores to come into operation. It is this gaining of time which is most essential for holding the price line; and it is the consumer and their concerted action that can play the most effective role in securing it.

LOW PRIORITY GOODS

Having said this, I must hasten to add that holding the price line cannot be expected to apply to all commodities irrespective of their essentiality or the proportion of the population that buys these commodities. Devaluation will fail of its purpose if it does not discourage the consumption of low priority or luxury goods with import content or result in the speeding up of the production of indigenous import substitutes even if they are more expensive than the imports. Undoubtedly, the prices of commodities of basic consumption must be held in the future as well. But prices of luxury commodities or of commodities used by the small number of well-to-do people or of low priority goods with import content, even if used by large number of people, must be allowed to rise and restrict consumption, if devaluation is to fulfil the fundamental purpose of reducing imports and improving our balance of payments.

I would now like to refer to some of the more basic and less short period aspects of the problem of getting the maximum advantage out of devaluation. Devaluation is bitter medicine, and unless complementary and follow up action is taken both by Government and the people, it will not succeed in solving our balance of payments problem or permanently

maintaining even the reduced value of the rupee. For this purpose, an all-out attempt must be made to increase our export earnings by increasing the volume and diversifying the content of our exports. Increase in exports cannot be secured merely by price competitiveness, and even here devaluation needs to be accompanied by a policy of subsidisation of selected exports which have a high price elasticity of demand. The more important condition for increase in exports is the availability and continuity of larger supplies. For this, supplies for exports have to be built into our production planning and temporary restraints in consumption accepted when necessary for securing surplus for export. Liberalisation of imports has to be directed to this end, and exports crops have to be given prominence in the new strategy for increasing agricultural production. Prompt action has to be taken to step up the mining of iron ore and other exportable minerals, while simultaneously action has to be taken for their quicker and more economic handling for export from our ports. Higher priority attention needs to be paid to our output of fish and other marine products as also of fruits, as these have a high potential for increase in exports. This has to be accompanied by complementary action for cold storage, refrigerated transport, processing, and scientific packaging. Indian exports can certainly be increased in significant measure but only if the necessary supplies are made available, apart from price competitiveness and marketing efficiency. Advantage should be taken of devaluation to step up our invisible exports, especially in terms of tourist traffic which has been a major instrument for improvement in balance of payment in the case of other countries that had resorted to devaluation.

To get the maximum advantages out of devaluation, import substitution must proceed at a faster pace than has been the case so far. This requires a greater swadeshi spirit not only on the part of our consumers but much more so on

the part of our manufacturers and handlers of projects in both the public and the private sectors. Vainly to seek for the best in the form of imports is to deny the good in the form of indigenous substitutes; and such a policy will be suicidal from the point of view of preventing the pressure on our balance of payments or the tendency of short supplies of imports producing a black market and profiteering economy. If imports increase in spite of devaluation, it will worsen our balance of payments and threaten the stability even of the devalued rupee. If imports are cut and rationed to serve our balance of payments, it will lead to shortages, black markets, and profiteering in the Indian economy, apart from acting as a deterrent to export promotion. There is no way out for country except to go in for import substitution on a massive scale. This may lead to an initial rise in costs and some shortfalls in quality, but in the long run this will get rectified as our economic development gathers speed and the domestic market widens in terms of effective demand. Consumer's patriotism, manufacturers' enlightened self interest, and scientists' talent and enthusiasm have all to be harnessed in this task; and Government has to function as a stimulant by its own behaviour in the public sector and by suitable fiscal and other incentives and expedients. Only by export promotion and import substitution can we turn to advantage the higher rupee prices of imports and the lower foreign exchange prices of our exports that are the result of devaluation. Only by this two-pronged approach to our international trade can we rescue it from its balance of payments crisis and ensure the future stability of the Indian rupee.

May I conclude by an appeal for greater understanding by the public of both the advantages and the disadvantages that devaluation brings in its train for the national economy. There is no use expending time and energy on the 'why' of devaluation except for the purpose of knowing what should be

done to prevent any possibility of its recurrence in the future. What is needed is a firm and clear policy by Government, understanding and cooperation from the public spirited action by our manufacturers and agricultural producers, all directed towards increase in production, larger supplies for exports, more effective exports promotion, and a firm determination and intelligent action for import substitution. If we do this, we will give a new start to our economy. Our domestic production will increase, our balance of payment will become favourable, our need for foreign aid will diminish, and our economy will achieve self-reliance. It is up to us, both people and Government, producers and consumers, to see that this gets done by the way we function in both our producing and our purchasing activities.

Implications of Devaluation

M. R. Masani, M.P.

What is Devaluation ? Let us say that it is a recognition of reality. It faces the fact that the value of a particular currency in terms of other currencies is at a certain level. Just as everything has a price, so the Dollar, the Pound, the Mark and the Franc also have a price in terms of the Rupee. When the value of the Rupee goes down, then just as all other prices go up the value of the foreign currencies which we can buy with our Rupee also goes up. Similarly, if the value of our currency were to go up, all prices would come down and the price of the Dollar, the Pound, the Mark and the Franc would also come down.

What happened a few days ago was therefore nothing new. It was not something that was contrived, something that was done by our Government. It was simply that our Government at last decided, for reasons which we shall go into presently, to accept that the Rupee was no longer worth 20 Cents of the American Dollar, as was the official theory. Till last week 4.75 Rupees made a Dollar; that is what our school children were being taught. But even the brighter school children knew by this time that this was not so. Our Ministers had not discovered it, but they discovered it last week !

Actually, for some months now, the value of the Rupee in the free markets of the world (which was published every week in *Newsweek* in a little box in case anyone wants to check up on them) was round about 10 U. S. Cents, when this development took place, half roughly of what the Rupee was

purporting to be. What the Government of India did with the approval of the International Monetary Fund a few days ago was to peg the Rupee at about 14 or 15 American Cents. In other words, the Devaluation is partial.

What is the case for devaluation ? The case for devaluation was put, probably at its best, by the Finance Minister, Mr. Sachin Chaudhari, in his broadcast. He said there was a rise in prices over the last ten years of 80%. In other words the Rupee's value at home had gone down by 80% during the last ten years. Secondly, just as the home value had gone down, similarly the foreign value of the Rupee had gone down also. This meant that the official rate of exchange was not being practised over large areas of commercial transactions. So the Finance Minister explained that this was not making sense any more. It was better to face facts.

The third reason he gave was that India's exports were being priced out of the world market. Our prices were so high, our cost of production had soared so much that India had become a very expensive country to buy in or from. The result was that even products which we were accustomed to export to the world we could not sell because we were not able to offer a competitive price in the world markets. Fourthly, he said our reserves abroad had declined to zero. The British had left us with a large sterling balance and our Congress Government during the last 18 years had completely dissipated it. And since there were no reserves, we were unable to meet our foreign obligations. We could not repay our debts, we could not pay the interests on our debts anymore. This was the picture he presented. And he said that devaluation would act as a corrective to this distortion.

Was he right ? Devaluation in certain circumstances, accompanied by certain other measures, could correct certain distortions. But, as we know, it also creates new hardships,

new inequities. Innocent people get hurt in the process. People who were not at all responsible for creating this situation are the ones to be hit most. Students who want to go abroad. People who want to travel abroad on legitimate business, medical or other grounds. People who had contracted to buy machinery abroad and had not yet paid for it. This is very unjust. It means that innocent citizens of India have got hurt through no fault of their own. It is the Government that had misbehaved, but the people have to pay the price.

Devaluation is like the filing of a petition of bankruptcy. Today India has become bankrupt. And this bankrupt country now goes to the World Bank and the International Monetary Fund and says : "We made a mess of it ; if you will forgive us now we will start again with a clean slate and, as an earnest of this, we agree that our currency, our credit, our prestige has gone down by 57.5%".

Now there are two kinds of insolvents. There is the honest insolvent and there is the dishonest one. The result is that at the end of the process there are those who are honourably discharged from bankruptcy and there is the undischarged insolvent who remains like a ghost fleeing around the courts and the civil prisons. Now, the honest insolvent declares his assets, discards his bad habits, his extravagance, his attempt to live beyond his means and tries to live an honest life. The dishonest insolvent secretes his wealth, pretends that he is more bankrupt than he is, and tries to cheat his creditors. And then he goes on again, having got out of the mess, with the same bad old ways. The question before us is whether our Government today is an honest insolvent or a dishonest one.

Trying to be judicious and objective, I would say that perhaps it is too early to pass a final judgement, but certainly the indications from Delhi are not very encouraging. Let us consi-

der, for instance, what the real reasons for this action might have been. Now, I have given accurately and fairly Mr. Sachin Chaudhari's explanation. He is a good friend of mine, and I have no desire to be unfair to him. The question that arises is ; are the reasons he has given the real reasons why this step was taken ? Let us consider what he said. Did he tell us anything new ? Did he say anything in his broadcast which I had not said 15 months ago. Well now, if that is so, if these same people ignored all the warnings which were given to them, pretended that everything was all right and everything we said was nonsensical, if then they suddenly adopt our arguments and make to us the same speech that we have been making to them, then certainly it begins to make one wonder whether these could be the real reasons.

Now here, for the record, is what I said in my Budget speech in Parliament on 22nd March, 1965, fourteen or fifteen months ago, when Mr. Krishnamchari was sitting opposite :

“When foreign aid starts drying up (which has happened) there will only be two alternatives left to this country. It can shamelessly go bankrupt (as it has) or it can put its house in order. If it is going to put its house in order there are two ways of doing it again. One is to stop these inflationary policies and to scrap the Fourth Plan as it is at present devised and two, create a stable measure of value in this country, an honest rupee. If you do not do this, I will tell what you will have to do, and what you won't like to see the Finance Minister of your Party doing in the next two years (we didn't have to wait that long, only fifteen months), and that is to devalue the rupee. It is a very painful expedient to cut down officially the value of one's currency. If you do not listen to our warning today and stop this inflationary, reckless way in which you are doing things, you will yourself have

to come to this House and this country and say : 'Let us face the facts. Our rupee is worth only half of what it was, let us pretend that it is $\frac{3}{4}$ th of what it was before' (this is exactly where Mr. Sachin Chaudhari has now pegged it — $\frac{3}{4}$ ths of what it was before). That is what is called devaluation. I am not advocating it. It is a very painful remedy. It will hurt rich and poor, honest and dishonest alike. And I would like to avoid it. But as things are developing today, with this Budget and the proposed Plan, I can say that devaluation is round the corner and even my honourable friend opposite will one day have the courage and the honesty to come forth and admit it."

Luckily for him, he was thrown out of office. But the successor has to carry the baby.

The Sunday Standard said last Sunday something very interesting. It said that the Reserve Bank now say that if they had devalued the rupee in March 1965, when I spoke in Parliament the rupee could have been pegged at Rs.6 to the Dollar instead of Rs. 7.50. In other words, by not listening to our warnings, not listening to what the Swatantra Party had to say in the last two years, they had to peg the rupee further down.

Now I mention all this to ask the question: how convincing is this sudden concern for fiscal rectitude? How genuine is this repentance? Can people who have flagrantly defied or denied the facts—(as the Congress Party has done over these years saying: No, no, no, the rupee is all right, where did Mr. Masani get his facts from?) Mr. Krishnamchari pretended two years running that the rupee had only one value—Rs. 4.75 per dollar, everything else was nonsense)—can such people be taken seriously when they come and repeat our arguments to us and ask us to accept them?

Than what can be the real motive ? Here we do not have to guess too much because the cat was let out of the bag on the 6th of June. The Finance Ministry put out a note entitled: "Devaluation—Some Questions Answerd" supposed to have been issued to all M.P.s. I have not got my copy. But the Congress M.P.s got theirs and the Press got them from the Congress M.P.s, and I learn from the Press that what the note says to the M.P.s is this :

"This action could not be postponed as all further aid negotiation hinged on it."

It is very clear than that devaluation came not because of the very high and noble reason given by the Finance Minister but because the foreign loans and the aid they wanted were not forthcoming on any other basis. To put it clearly, it was a bargain. It was a bargain struck between our Government and the World Bank and the other Governments that, if we devalued our rupee, they would make massive foreign aid available.

It is very intresting that this bargain seems to have been arrived at by none other than our Minister of Planning. It was on his return that this discussion on whether or not to devalue started. The amusing thing is this that the Minister of Planning, Mr. Asoka Mehta, while he was discussing devaluation in Washington, issued a statement for our benefit through *the Indian Express* of the most valient and courageous kind. He said "I have not travelled 10,000 miles in order to discuss the exchange value of my currency. What we do with our rupee is a matter for the Government of India to decide. We shall not discuss it with anyone." Now, is it not perfectly clear that among the things he was discussing, and probably more than anything else he was discussing, was precisely the value of the Rupee ? When I spoke in Parliament after this vainglorious speech, I said: "What impertinence ! You ask people to take a rupee and say : 'This is 20 cents; give us 20 cents worth of goods', and they say

to you: 'But this is not 20 cents; your paper rupee is worth only 10 cents.' Therefore, let us discuss what is to be done about the fact that you have by your inflationary policies brought your rupee to half its value. You can answer them; you can say; 'we do not believe in devaluation', nor do we. But you can not say that you will not discuss it." So I said it was an impertinence on his part to take this line. Well now it is proved he was trying to throw dust in the eyes of the Indian people. It was precise y because he was discussing devaluation that he was striking this posture of mock heroism. And these are the people whom we are now told are to be trusted with seeing this country out of the woods.

The Government had two alternatives last week. One, as you know, they have taken. The other would have been a much better alternative. It would have been the alternative of not taking massive foreign aid, of cutting our coat according to our cloth, of cutting out this wretched Fourth Plan and going about it in a decent, democratic, civilised manner with what ever resources we have. That was a better alternative than devaluation. They could have said: All right, no devaluation, no aid. We accept that. 'You can give us what little you can, we shall manage. We shall manage by cutting our coat according to our cloth, by balancing our budget, by putting our house in order. May be after a year or two, you feel like giving us more aid.' That would have been a self-respecting, decent alternative. But than of course, the Fourth Five Year Plan would have had to be scrapped. Perish the thought ! That can never even be thought about ! So, in order to save this wretched Plan, this country had to go through devaluation. The real motive of devaluation is thus to save the Fourth Five Year Plan.

The Fourth Five Year Plan, as you will remember, was to be one of Rs. 21,000 crores. One would have thought, ashmed with their own enormity, the Planning Commission would have

been agreeable to cut it down. But, oh no! Mr. Asoka Mehta and his colleagues now want to increase it to Rs. 28,000 crores on the ground that the rupee is worth less. And they are right. In real value, a Rs. 21,000 crores Plan which will be carried out now will cost Rs. 28,000 crores. At present, as you know, the Finance Minister is fighting with his back to the wall to prevent this further disaster. So devaluation was brought in to save this wretched, disastrous Plan.

Now there are two possible difficulties we face. One is that the World Bank and the others concerned, seeing that our Government does not seem to have learnt anything and is talking of a bigger plan, will not give the massive aid that our Government thinks they are getting. In other words, the bargain will fall through. This will be a minor disaster. But the much bigger disaster will be if that aid really comes through, and if the World Bank and other Governments are unwise enough to underwrite this Fourth Plan.

Let us consider why we are in our pitiable condition. Why did we go bankrupt? Why did we have to devalue? What are the wrong policies of Government which have brought us to this pass? The first, undoubtedly, was living beyond our means; spending what we did not earn or possess, importing more than we exported, spending more than we produced. The Second and Third Plans were the vehicles by which this was done. Each had deficit finance as a necessary part of it, and only last week it was announced that the deficit financing or created money was twice that what was budgeted under the Third Plan document. In other words, the Third Plan had said so much deficit financing is legitimate. Nothing is legitimate. But they said that so much cheating would be legitimate. Well they cheated twice as much on their own admission last week!

The second thing wrong with the Plans was that these plans were Stalinist, communist Plans. They are taken from the Stalinist phase in Soviet Russia when the obsession was with steel and heavy industry and starving people of food and consumer goods. Our Second and Third Plans were obsessed with heavy industry and steel and left very little money for spending on agriculture, water, road and consumer goods. The third thing wrong with the Plan was heavy indebtedness depending too much on foreign loans which we are now unable to repay.

The fourth thing was over-taxation, both direct and indirect. Now what is wrong with over-taxation in terms of inflation is that when people have money in their hands, banks or pockets, they spend it fairly productively, they invest where they get a good return. They entrust it to good businessmen, entrepreneurs and industrialists who give them a good dividend. But when Government takes the money away from the private people into its own coffers, it is incapable of investing it productively. It wastes it either on the civil service or in big steel works where the country losses crores of rupees as in Bhilai, Rourkela and Durgapur. Fourthly, these Plans devised a system of controls which has created a massive amount of corruption—because every control means more corruption.

Now the Fourth Plan is just as bad and worse. There is nothing in the Fourth Plan document as now proposed which is basically different from this Second and Third Plans. In fact, it is worse than the Third Plan because it is bigger, with no more money to show for ourselves. It would be an inflationary plan. It is as much biased in favour of heavy industry as the last Plan, and it is as much biased in favour of State enterprise as against the people's enterprise, as the Third Plan.

You don't have to take my word for it. I shall quote Mr. Asoka Mehta and Mr. Sachin Chaudhari. On 17th May,

the last day when Parliament adjourned, Mr. Asoka Mehta told Parliament that of the foreign loans they were negotiating 70% would go to State enterprises. Mr. Sachin Chaudhari repeated this on 8th June when he said: "To the extent larger foreign aid is available, the prospects of a larger Public Sector Plan will improve."

Now, I fear our Prime Minister does not quite know her facts yet. She said on 11th June that Soviet Russia was helping us to build the public sector and America was helping us to build the private sector. I wish it were so: But the fact is as I pointed out—and she should learn it from her own colleagues, the Planning and the Finance Ministers—that 70% of Western aid is going into the coffers of the State to spend on these wasteful State projects.

Now, this, if I may say so, it is utter madness. If a man has gone insolvent and asks to be forgiven, and then resorts to the same measures which were responsible for his plight, then he cannot be a responsible person. If this Fourth Five Year Plan in its present shape and dimensions is imposed on this country, our Rupee, which is today 10 U.S. cents in the free market, will sink to 5 cents of the American Dollar. What will we do then ? 'Again devalue', some body said. But at that time it won't work, because people won't trust us a second time. Mr. Sachin Chaudhari has described devaluation as the ultimate remedy. Now, when you try the ultimate remedy, nothing is left except complete collapse and chaos. What I am worrying about is that this will prove to be in the hands of these people only a short time stimulant. And when the effect has faded away, we shall be worse off than we were before.

Devaluation is like a strong drug. It is like a surgeon's knife. There is a disease, you are in a horrible state and you

have to resort either to a very strong drug or to get a surgeon's knife to operate on you. Now a surgeon's knife or a strong drug is neither good nor bad. It is neutral. It is a remedy for your condition. You have got to accept it. But it makes all the world of difference whether you put that surgeon's knife or that drug in the hands of a qualified surgeon or physician or in the hands of a quack. I consider the present National Planning Commission and the Cabinet to be a set of quacks. I have said on the floor of Parliament last year that they were a group of charlatans, playing ducks and drakes with the people's well-being, their money and their credit.

Rajaji other day gave a very good analogy. He said, "I had a doctor. Under his kind care my leg got worse and worse and festered more and more until it got gangrene, which was poisoning my whole body. So a surgeon was sent for and the surgeon said: I am very sorry, Rajaji, but I shall have to amputate your leg. It is beyond repair now, it has been neglected very badly. And at that stage, he said my doctor chimed in and said: Yes I will listen to the surgeon, I will have the operation. But you get out. You have brought me to this mess and you are not going to look after my leg after the amputation, otherwise my other leg will get gangrene".

This is exactly the position. If the charlatans of the Planning Commission are going to be in charge of this operation, then a nothing good can come of it. There will be a further disaster for this country. *The London Economist* of last week carried an excellent article on the Shah of Iran. The Shah's advice to developing countries, as reported in the *Economist* is: "Listen to what the economists say and then do the opposite." If only the Prime Minister would listen to me, I would advise her to listen to the Planning Commission and then do just the opposite. She can't go wrong.

And now, what are we going to do about it? The elections are still far away. If the Government were prepared to listen to our advice, what would be advise them to do now that they have done this?

The important and fundamental thing is that the basic economic policies of this country and the Government have to change. First of all, we must learn to live within our means. This means that all kinds of inflationary policies so far followed must be eschewed. There can be no more deficit finance for the Central Government, no more overdrafts from the Reserve Bank for State Governments. They must earn what they want to spend. This will involve a drastic reduction in civil, non-developmental expenditure. All further recruitment to Government services will have to stop for two or three years at least, so that those who are on the job can be dispersed over the whole field, in place of those who retire, or die.

The second thing will be to postpone and recast the Fourth Plan which, as I said, would be a bigger disaster than the Third and the Second Plans. This can be done by dropping from it all new capital projects in the State sector, because they are generally wasteful. The first that should be dropped from the Fourth Plan is the Bokaro Steel Plant, the biggest of the white elephants we are asked to feed! When it was discovered that the Bokaro project was more expensive than anything we had gone in for and even the Government was forced to admit it, the reason given for not dropping it was a very peculiar one. It was said: "We must not be ungracious to the Russians!"

Then again, Government to Government loans, which are a drain on the country's resources, should be restricted to only two things. In the immediate, they should be used for importing the raw materials, the spare parts and the fuels which are needed and which are called maintenance imports. It is a

desperate necessity. Otherwise the wheels of our industry will grind to a halt. Many of us will go unemployed and the whole country will go down. For this particular emergency which has been caused by the misdeeds of Government, certainly maintenance imports should be obtained.

The other fundamental, long term purpose for Government to Government loans should be accepted is what is called the infra-structure, which in plain language means the foundation of our economy. The supply of water for drinking and irrigation purposes, of roads, transportation and communications, the supply of electric power to make our oil pumps in the villages and the machinery in the factories run. Beyond that we should not go in for foreign Government to Government loans at all, because these loans come at our risk. Even if our Government spends those loans badly and unwisely, this country has to repay capital and interest. They are bad for the country and those who give us these advances and loans, except for these limited purposes, are doing us no good. All the rest of foreign capital should come in as risk capital at the risk of the men, the industrialists, who bring it in. If they make a profit in India, then they can take away their profits. If they make a loss, let them go empty handed. Let not this country bear the loss. These are some of the anti-inflationary measures of which we should demand that the Government announce their acceptance.

The next thing should be a sharp education in direct and indirect taxation. No amount of foreign aid will save the country unless there is rupee finance to develop this country. Today, there is no rupee finance. The capital market has had its bottom knocked out. The only way to put rupee finance in the hands of those who can produce is by cutting down direct taxation and the excise duties, so that there is more

money in the hands of the people which they can invest. When it is invested, there will be more goods and when there are more goods, prices will come down.

Finally, just as important as any thing else, this mass controls with which this country has been fettered will have to be discarded. The entire structure of import licensing and foreign exchange controls will have to be dismantled. I know there are people who get shocked at this. There are reasons for it. There are some people who get so used to fetters and slavery that they forget what it is to be free. There are others, politicians and officials who sell these licences and take bribes and there are those who buy these licences and make huge profits of several hundred per cent by selling these licences to others who really need the goods. Prof. Shenoy, one of our finest economists, has described import licencing as the biggest portfolio of political patronage in this country. There are too many ministers and too many civil servants and too many businessmen involved in this racket. The real test of the sincerity of this Government will be as to whether or not they abolish exchange controls and import licences. If they don't, then I shall be convinced that devaluation has been brought in not to make India an honest country, not to have clean hands, but only to get foreign aid, so that this Government can tide over the next twelve months and somehow tide over the next General Elections. When I say that decontrol must come, I mean that Gold Control must go, restrictions on foreign travel must go, exchange control must go, and import licencing must go if the vital energies of the Indian people are to be released, if they are to be harnessed to the productive needs of this country. If these things are done, then production will go up. It is only then that prices can be stopped from rising, if we produce more and sell more abroad.

It is only when you do this that you have a right to go to the rest of the world and say : "Now I am an honest insolvent,

please forgive me and my debts.” The future of the country has been hopelessly mortgaged by the Congress Government. We can’t go to the rest of the world and ask to be forgiven if we don’t put our house in order first. I have tried to indicate the steps which are necessary to make us honest insolvents. If we do that then I think, as Rajaji has suggested, our Government will have a right to go abroad and say : “Look, we have done all the hard things, now will you forego part of the interest of the capital on these debts or will you allow us a postponement for a few years ?”

The 64,000 dollar question is—will the present Government do all this ? I do not think I am being unduly cynical or sceptical when I say that I doubt it.

Somebody once wrote rather aptly that “the most under-developed territory, in the world lies under the hats and caps that men wear”. And of all that territory, the most under developed territory is that which lies under the White Cap in our country.

Therefore, one sadly comes to the conclusion that it is very doubtful whether this Government has either the integrity or the courage or the capability to carry through this very difficult operation. It may be that we shall once again go through disaster, that the rupee will sink to five cents, and that the only solution to this problem of our economy may, after all, turn out to be political one—a change of government.

June 15, 1966.

Devaluation—A Move Based on a Myth

Dr. Gyan Chand

Devaluation has given a shock to the country, and the circumstances under which it has been introduced indicate very clearly that the step has been taken under pressure by U.S.A., World Bank. etc. This pressure had been growing for the last three or four years. It started with the report of the Bell Mission in which recommendation for devaluation definitely is known to have been made. Mr. Krishnamachari, who was then the Finance Minister, resisted and was not prepared to accept the recommendation of the Mission. Since then, however, the pressure had been continuously exercised and our important political leaders and highly placed senior administrators have, it is clear, not only given in to it but actually taken active part in mounting the pressures. Devaluation had to be a snap decision, but on purpose an atmosphere was created by the men in authority in which the advent of devaluation was given the appearance of being inevitable. This atmosphere was created in order to make devaluation look like a compelling necessity and was, as stated above, made effective with the collusion of political leaders and administrators in very strategic position. Information bearing upon this process is being withheld from the public, but the country has been let down badly by these men because they became willing instruments of the policy laid down by U.S.A. and World Bank.

Now, devaluation is an accomplished fact and the country has to take consequential measures to deal with a very difficult

situation which has arisen on that account. Its most important consequence is that reaction in the country has become stronger, forces arrayed against socialism have got a clear signal to consolidate themselves and economic philosophy of the World Bank which, I need not say, is completely contradictory to our economic policy and social objectives, is being made the basis of the economic programme which has been prescribed for us and which we are duly carrying out according to agreed time schedule as a pre-condition for the grant of aid of U.S.A. and the Consortium. This creates a real threat to the future of our country, which has to be met by a clear understanding and awareness of its nature and strength by our people. Devaluation is a beginning, but only a beginning, of what is to come; and if our people do not realise its real meaning and gather the necessary strength and determination to combat it, the outlook for the country will become very disturbing indeed. This is the first and the most important consequence of devaluation. History will judge the men in authority who have let down the country badly as real tools of foreign dictation and policy. They are, however, to be arraigned now before the bar of public opinion and made to see themselves as others see them i.e., guilty men who in a crisis have done great disservice to the best interests of the country and undermined the strength and determination of the people to cultivate and exercise self-reliance. Devaluation is really a retreat from all our basic commitments and a stride towards economy of the country moving in the reverse gear.

The main argument in favour of the case for devaluation rests on the view that the Indian rupee was, as they say, overvalued. Our exports on account of the inordinate rise of prices in the country were being "priced out" of the world markets and the outlook for the country therefore was very gloomy indeed. India's balance of payments position is very difficult. In 1964-65 adverse balance was well over Rs. 500

crores and our imports had reached their peak but it has to be remembered that one of the most important factors in creating this really difficult situation is our defeatist and unjustified policy of food imports. In the last 10 years, the authorised imports under PL 480 have amounted to Rs. 2,200 crores and actual imports Rs. 1,465 crores. Ever since the Foodgrains Inquiry Committee under the chairmanship of the present Planning Minister reported and forecast that India had to face chronic deficit in food supply and therefore rely upon PL 480 imports, we have accepted this policy as our basic premise and our incapacity to tap and develop our own agricultural potential is its direct result. When in 1964-65 we had internal production of over 88 million tons, our food imports were the highest since 1956 and amounted to the value of Rs. 307 crores for which neither there is any explanation nor any justification. There are other causes for our adverse balance but food imports are very important among them. 1965-66 has been a specially bad year but the decline in our production had been purposely exaggerated and though our scarcity conditions are acute and we need food imports from abroad, this situation would not have arisen if we had built up our own reserves earlier and been in the position to meet the present crisis with comparative ease and confidence. This situation can be radically altered. We, with the means at our disposal, can bring about complete stoppage of food imports and meet our future requirements with our own resources. This is admitted even by the Food Ministry, and yet the assumption to which I have referred and which we have acted on since 1956, is that we cannot avoid chronic food deficits and have to depend upon the PL 480 imports which, it has to be clearly realized, have impaired national integrity and economic independence.

The core of the argument, to which I have just referred, is that India's exports are being "priced out" in world markets

and devaluation became unavoidable in order to hold our own. This is a myth which has been created purposely in order to promote and implement defeatist and anti-national policies. Our exports have, broadly speaking, been rising since 1961-62 to 1964-65 and we not only have maintained our position but the value of our exports has gone up during this period and there are no indications from whatever information is available that a decline in exports is imminent and unavoidable. Our exports in 1965-66 were about the highest since 1951 and as I have said the view that we were being under-sold in world markets has no factual basis. Our general price level has risen disproportionately because of the radically wrong policy which government had followed all those years but this inflationary pressure, which had brought about this rise of prices in the country, had not undermined our export position and generally the unit values of our most important exports, with one important exception, have been stable and not shown any significant rise. Jute is our most important export and its unit values have increased during the last two years. The value of exports in 1965 reached the peak of Rs. 184 crores and were the highest on record. Our traditional exports are not capable of rapid expansion. The demand for them, as is well-known, is, to use the economist's word, "inelastic" and though we have to do what we can to push their sales, a realistic view of the matter clearly shows that even in spite of devaluation there is not much scope for their rapid expansion. This view is accepted and was fully supported by the two Committees which specially reported on the problem of export promotion. The Export Promotion Committee of 1957 and the Mudaliar Committee of 1962, both stated that there is real scope for exporting engineering goods; but they are now a little over 2 per cent of our total exports and even if the Fourth Plan target of Rs. 50 crores is realized, which is not at all likely, their proportion will be less than 5 per cent. Any exaggerated hopes built upon devaluation

regarding expansion of exports will only lead to disillusionment and real political set back. If we want to reduce the trade-gap the first obvious thing to do is to stop food imports. This is the most important import substitution project which we have to pursue and if we do it with success there is no doubt that we can face the future with greater self-confidence. But if we take supplementary measures, stop, for instance, import of super-fine cotton and by fully utilizing our resources, materially reduce the import of fuel and steel, the trade-gap of 1965 can not only be narrowed but completely overcome. The alarm that we are in a perilous state has been invented by the World Bank and their collaborators in high places in India to create an unnecessary scare and justify the adoption and implementation of a policy of relaxation and retreat.

Now, it is necessary to rationalize controls and permit freer imports of raw-materials and spares on a strictly selective basis. But the view which is being deliberately promoted is that our controls have been our undoing and have to be very largely removed and abolished. If we really plan to have a socialist economy, an apparatus of integrated controls is absolutely essential and unavoidable and the atmosphere in favour of decontrolled economy, which is being created is meant to introduce a policy of free play of market forces in, of course, negation of planning and can only bring disaster to this country. We have to stop the rot that has set in, but not by giving free play to the unregulated working of the price mechanism but by honest fidelity to our objective of socialism and basing our whole economic policy on its values and its sincere implementations. We are taking a completely wrong view of what is called a "mixed economy". Giving private sector a place in our economy does not mean that its values have to be supreme. It has to be integrated with socialist economy, the essence of which is predominance of socialist sector and acceptance of values according to which the public sector has to be a predominant factor and the economy

has to be steered in the right direction and develop new norms of economic management and behaviour. This is the sense in which private sector had to be given an assured place in our economic policy, but at present private sector in collusion with giant businesses in U.S.A and other countries is working against the implementation of our basic policies and creating severe and increasing stresses.

In conclusion the whole question of foreign assistance may be dealt with briefly. We have received assistance of over Rs. 4,000 crores since 1951 and 86 per cent of it had been an assistance from U.S.A. and the countries and institutions which follow its lead. The U.S.A. itself has given authorised assistance of nearly Rs. 3,000 crores of which nearly 2/3rd is the assistance under P.L. 480. The aid by Soviet Union, though only 14 per cent of the total, has meant real contribution to building up our key industries, self-reliance and economic independence. The aid given or approved by U.S.A. has, however, meant political penetration of the country, economic intervention, deliberate building up of the private enterprises in collaboration with foreign cartels and dissipation of our resources on objects of low priority or no priority. The whole position has to be reviewed. The devaluation is the price which we have had to pay for this aid and it is a very high price indeed. Foreign assistance is not bad. We should receive it if needed, if it can come to us without compromising our future; but, if it cannot, we should receive aid only from such sources and on such conditions which are in accord with our social objectives, national honour and economic independence. U.S. aid is a tainted aid. If we develop and rely upon our own resources, make radical changes in the working of our economy and refuse to bend to the pressures within and from outside, we can go ahead and in essential matters be the better for it without it. That is the view which we should adopt and act upon and one of the lessons of devaluation, and the most important one, should be that this will be done and we should do it.

Devaluation : Economic Implications and Consequences

Ramanbhai B. Amin

The decision to change the par value of the rupee which came into effect from the early hours of 6th June, 1966, is one of great importance to our future economic development. It also casts reflection on the economic management of the country in the last 15 years of our planned economic development. The significance of the decision compared to the one taken in September 1949 is that while the earlier decision followed the devaluation of the pound sterling, we have now been obliged to take a unilateral decision. The declared objective of the measure is "to put our economy on a sounder footing and pave the way for future progress and development".

I

STRESSES AND STRAINS IN THE ECONOMY

It is indeed somewhat futile to debate as to whether such a decision should or should not have been taken, since it is a *fait accompli*, or to discuss at this stage about the timing of the decision or the extent of devaluation. But one cannot look at the post devaluation economic scene without casting a glance at the economic policies followed in the last 15 years or more and the efforts put in by the nation as a whole in bringing about a better standard of living for the Indian people.

The central point which needs to be underlined is that we as a nation have been living beyond our means. This broad statement may be analysed with reference to a few major developments :

A. Large Plan : The requirements of economic development as viewed by governmental authorities have thrown a very heavy strain on our internal resources specially in the Third Plan period. The slow rate of economic growth resulted in lack of real resources; yet we endeavoured to implement a large plan.

B. Public Sector Industrial Projects : There has been a good deal of investment specially in the public sector industrial projects of over Rs. 2,000 crores which has not yet started yielding dividends not merely in the economic sense but in the sense of making goods and services available for investment or consumption by the community.

C. Growth in Defence and Civil Expenditure : The growth of defence and civil expenditure has been phenomenal. For example, at the beginning of the First Plan i.e. in 1950-51 our defence expenditure was Rs. 168 crores and civil expenditure about Rs. 250 crores, on revenue and capital accounts. The defence expenditure increased to Rs. 312 crores and civil expenditure Rs. 1036 crores in 1961-62. After the Chinese invasion in October 1962 there has been a tremendous increase in both defence and civil expenditures. In 1965-66 the defence expenditure on revenue and capital accounts was Rs. 888 crores and civil expenditure Rs. 1970 crores. In the Budget for 1966-67 the expenditure in respect of defence will increase further to Rs. 918 crores and civil expenditure to Rs. 2204 crores. All this represents the expenditure incurred by the Central Government alone. If one were to look at the picture of State finances the position would appear to be even worse in as much as they have been resorting to over-drafts from the Reserve Bank of India.

D. Foreign Exchange Reserves : Our foreign exchange position has been even less satisfactory. The foreign exchange reserves excluding gold have declined from Rs. 785 crores in

the beginning of the Second Plan to the low level of Rs. 184 crores at the end of March, 1966. We have also borrowed heavily from foreign agencies and friendly countries. The total utilisation of external assistance from the commencement of the First Plan until the end of September 1965 was of the order of Rs 4,156 crores. The fact that in the last few years we have been obliged to use a part of our aid for maintenance imports also indicates that our economic development has not been along right lines.

E. Trade Deficit : The position on the foreign trade front has not been reassuring and in the calendar year 1965 we had an all-time high adverse balance of trade of Rs. 575 crores.

F. Special Problems : The year 1965-66 presented some special problems because of the conflict with Pakistan and the serious drought which led among other things, to a sharp decline in the production of foodgrains to 76-77 million tons as compared to 88.4 million tons in the previous year. The decline in agricultural production was also responsible for loss in exports to the tune of Rs. 80 to 90 crores in 1965-66.

G. Price Spiral : In the last ten years, prices have risen by about 80 per cent. It is known that in the First Plan period there was a slight decline in the index number of wholesale prices. The index rose by about 28 per cent in the Second Plan period, and stood at 127.5 at the end of March 1961. In the next two years, the prices remained somewhat stable and the index was almost at the same level at the end of March 1963 as at the end of March 1961. There has, however, been a fairly sharp rise in the last three years and the index increased to 167 at the end of March 1966 i.e. nearly 31 per cent more than what it was towards the end of March 1963. In the financial year 1965-66 alone the rise was of the order of about 15 per cent. There was somewhat alarming rise in the months of April and

May 1966; the index rose to 184.2 on 4th June 1966. No doubt, prices have increased in other countries also. But the extent of rise has been much smaller. For example, in the last decade prices rose by only 5 per cent in Japan, about 9 per cent in USA, 10 per cent in Germany, and 20 per cent in U.K. Our prices have been rather out of balance with world prices.

The above factors clearly indicate that the health of the Indian economy has not been particularly good. It was in this context that there has been a talk for some time that devaluation of the rupee might provide a corrective. It is well known that the International Bank for Reconstruction and Development and the International Monetary Fund have been making suggestions for breaking the economic stalemate in our country. Specifically with reference to our serious balance of payments position suggestions have been made that devaluation would have advantage over any alternative technique for exploiting more fully the potential for export which was partially done through export incentive schemes.

In a way we have been having a system of selective devaluation in our economy ever since the evolution of the export assistance schemes nearly a decade ago. The form of export assistance underwent a number of changes last year. Fresh, or in some cases additional, assistance was extended in the form of tax credit certificates and in some cases cash subsidies. Obviously these did not help promote exports to the desired extent. On the import side also there was an attempt made to restrain imports by the levy of high accross-the-board duties in the supplementary Budget of 19th August 1965. However, the outbreak of the conflict with Pakistan soon after created new problems. Aid was frozen. It is in the context of all these circumstances that one has to view the decision to devalue the rupee.

II

IMPLICATIONS OF DEVALUATION

The implications of devaluation on the economy are manifold and affect almost every aspect of our economic development. It is proposed to deal here only with the likely consequences on our imports, exports and prices.

IMPORTS

One of the important consequences of devaluation is to restrain imports and to promote exports. However, the decision to devalue the rupee was taken in a situation where a large number of industries were working with low inventories and the rate of growth of industrial production was adversely affected due to the inadequacy of imports. As a result of devaluation and the receipt of large aid—especially non-project aid—we can step up imports. A few major decisions for a liberalised policy of imports specially with regard to 59 priority industries were announced on 21st June. This policy will help plan imports and production on a continuous basis and lead to fuller utilisation of existing capacity. At the same time there is a greater impetus for import substitution in as much as the cost of imported goods has been increased by 57½ per cent. This should give greater scope to our ability to innovate and improvise and to make fuller use of indigenous talent and know-how.

In addition to the direct increases in costs due to devaluation, readjustments in import duties that were announced simultaneously with the decision to devalue the rupee on June 6, will further increase cost to some extent, excepting in the case of machinery and capital equipment where the effective duty has been decreased from 45 per cent to 27½ per cent. It is important to note that even this represents a fractional decline in the total incidence of import duty inasmuch as the import

duty would now be calculated on the new c. i. f. value which would be higher by 57.5 per cent. The other changes in the levels of import duty such as on raw materials and intermediate products and consumer goods would increase the total incidence of duty.

Devaluation along with the changes brought about in the rates of import duty has thrown up a number of problems :

- (a) Sharp increase in cost of new projects.
- (b) Increase in costs as a result of increased duties on raw materials and intermediates which might have a snow-ball effect.
- (c) The problem of financing of imports and finding additional rupee resources.
- (d) Difficulties in respect of foreign loans and import of capital equipment on deferred payment basis inasmuch as the repayment liability has increased in terms of rupees.

However, since the industries have been experiencing a tremendous problem in obtaining imported materials, and as non-project assistance of the order of \$900 million is likely to be made available, it is to be expected that there will be a better utilization of our national resources and that this will pave the way for strengthening our foreign exchange position. The maintenance needs of the economy would be met more fully. There will be some encouragement to import saving activity specially in respect of items where local raw materials are used. Above all, even the selective measure of liberalisation that has been announced should go some way in importing a degree of competitiveness to the economy.

EXPORTS

One of the primary reason for bringing about devaluation is to devise a more enduring and reliable way of restoring and indeed increasing the competitive power of exports. The stimulus of export effort has however been moderated, to some extent, by the imposition and enhancement of export duties, withdrawal of tax credit certificates (exports) scheme, abolition of export assistance schemes and generation of high costs as a result of higher prices of imported equipment and raw materials, etc.

The total exports of items on which duties have been levied constitute between 55 and 60 per cent of our total exports. Without going into the details of the levy on different items and the revisions that have been subsequently made in some cases it may be stated that it is only through an active policy of export promotion that the nation can reap the advantages of devaluation. In other words, the success of devaluation would depend to a large extent upon the continuing effort that we can make successfully in bringing about substantial increase in export earnings.

Apart from giving the highest priority to agricultural development, greater attention needs to be placed on the development of our mineral resources. The export of ores, minerals and scrap amounted in 1965 to about Rs. 75 crores, but the potentialities in this regard are considerable. Exploitation of mineral resources can be pushed ahead by following a flexible policy in allowing the private sector to do exploratory work and to augment production by grant of necessary facilities. Yet, another aspect of the importance of mineral development which needs emphasis is the considerable potentialities it offers for import substitution.

PRICES

The maintenance of the internal price level at a reasonable level is extremely important for bringing about a better balance

in the economy. There is, however, a great deal of confused thinking concerning the impact of devaluation on prices. It has to be explicitly recognised that some element of price rise is inevitable since all imported goods will now cost in terms of Indian rupees 57.5 per cent more and, in some cases, the rise will be higher because of the larger incidence of import duties. Even if one were to recognise that under conditions of scarcity, that is at the pre-devaluation stage, the actual prices paid by the consumers were higher than the landed cost, the impact of devaluation on raising costs would be there, although it may get moderated to the extent that there will be fuller utilisation of capacity and consequential reduction in overhead costs, etc. Further, this rise would be restrained as a result of certain measures that have been taken by Government. Prices of commodities like foodgrains, fertilizers, kerosene and diesel oil will not rise as a result of subsidies and or reductions in import and excise duties.

Government are also contemplating to set up a number of departmental stores to distribute essential commodities. This experiment has been tried before and the achievements have not been encouraging. It is strange, therefore, that Government should repeat this experiment rather than devise means for closer working between trade and Government. The proposal to set up such stores will involve large investment, impose additional burden on the tax-payer, give rise to undesirable practices and deprive the consumer of the facilities he expects and obtains from normal trade channels. Therefore, Government have to take the existing trading agencies into confidence and evolve some method by which the objective of preventing unwarranted price rise can be achieved without dislocating normal trade channels.

III

SUPPLEMENTARY MEASURES

Devaluation has to be looked upon as a drastic remedy

for our economic ills. Its objective to put the Indian economy on a sounder footing and to pave the way for future progress and development can be achieved only by higher production and greater productivity. All our efforts to hold the price line, to increase exports, to develop indigenous substitutes for imported materials and to make economic growth self-sustaining cannot succeed without stepping up production to the maximum extent. Larger production is the only test by which must be judged the success of our policy. Devaluation can become an important instrument of economic policy only if it releases productive forces in the agricultural, industrial, mineral and every other sector of economic activity.

An all-round increase in production is the surest way of restraining the rise in prices. However, the objective cannot be to insulate all prices against the effects of devaluation; for, that would prevent the operation of its self-acting mechanism. In this context, the following observations made by the Prime Minister at her Press conference on June 15th are significant :

The rupee cost of imported articles will certainly go up. This is a part of the logic of devaluation. But the incidence of this on items of mass consumption need really be quite limited. The Government is not committed to holding the prices of all articles with an import content. But it is committed to holding the prices of essential commodities such as food grains, vegetable oil, sugar, kerosene, cloth and fertilizers and to preventing profiteering elsewhere.

Increase in production is imperative. The success of devaluation will also depend upon the manner in which it helps to restore market mechanism and to reduce administrative delays and other obstacles which stand in the way of larger production. For this purpose, a number of supplementary measures would require to be taken to bring about a smooth

functioning of the Indian economy. These should include the following :—

TO RESTRAIN PRICE RISE

- (a) effort should be concentrated on increasing agricultural output particularly by providing the necessary inputs like fertilizers, minor irrigation, pesticides and improved seeds ; and
- (b) non-productive civil expenditure, expenditure on prestige projects and on projects with long gestation period should be curtailed.

TO PROVIDE LARGER FUNDS TO INDUSTRY

- (a) credit controls on scheduled banks have to be removed ;
- (b) financial institutions have to be provided with larger funds ; and
- (c) taxes on corporate and individual incomes have to be reduced.

TO RESTORE MARKET MECHANISM

- (b) the area of the operation of the industrial licensing system should be minimum ; and
- (b) all price and distribution controls should be relaxed.

TO STIMULATE FOREIGN EXCHANGE EARNINGS

- (a) export assistance schemes have to be re-framed ;
- (b) foreign investment has to be encouraged ; and
- (c) tourist facilities have to be extended.

The experience of the countries which have devalued their currency clearly indicates that the measure can succeed only if it is accompanied by a higher degree of economic discipline. All our energies must now be directed towards avoiding unproductive expenditure, securing the best use of resources—whether in the public or private sector—and bringing about a continuous and rapid increase in production.

Devaluation—A Challenge

Babubhai M. Chinai

It is difficult to recall an economic measure in recent times full of implications and consequences greater than those implicit in the decision to devalue the Rupee. It must have been a very difficult decision. Spokesmen of Government, who all along had continued to deny vehemently any intention to devalue the Rupee, were apparently overtaken by a developing situation which forced their hands to decide to devalue.

COURAGEOUS DECISION

Devaluation is acclaimed as a corrective to balance of payments difficulties. But there are genuine misgivings about its success in a developing economy such as ours. If one were to examine the merits and demerits of devaluation in the context of the state of our developing economy, actually one could perhaps make out a more than convincing case against devaluation, although there is, at the same time, a school of thought which honestly believes that devaluation will by itself assist the economy in regaining its equilibrium, solve its foreign exchange problem and thus be an instrument of further economic progress. Anyway, the fact remains that it was not easy to come to a quick decision and it must have been obvious that announcement of the devaluation decision was sure to give rise to sharp reactions. One could have understood a tendency, if it was shown, of avoiding or postponing such a fateful decision. The nature of the decision heightens its importance, and, whether you agree with it or not, you cannot but show your appreciation of the high degree of courage and determination of the Prime Minister, Smt. Indira Gandhi, that went into making

this decision. I feel the country must consider itself lucky to have, at this crucial stage, as its Prime Minister a person who does not shy away from taking difficult decisions.

BACKGROUND TO DEVALUATION—IMBALANCES IN THE ECONOMY

It is well-known that since a long time imbalance and distortions have persisted in our economy—(a) all our efforts at stepping up agricultural production have not produced the required results ; (b) the rate of growth of industrial production has slowed down ; (c) inflationary pressures have continued to persist ; (d) the foreign exchange resources have reached a very low level ; (e) the external debt has increased ; (f) the burden of taxation has been stepped up from time to time ; (g) a good part of the resources which are scarce and which are raised through taxation of a very high order are diverted to non-productive and wasteful expenditure ; (h) capital has since become shy and industries find it difficult to raise resources for new enterprises and those required for running the day-to-day activities ; and (i) the difficult food situation has only served to accentuate the imbalances present in the economy.

INDO-PAKISTANI CONFLICT—A FURTHER DRAIN ON OUR LIMITED RESOURCES

The Indo-Pakistani conflict last year created a further strain on the economy. Necessarily large amount had to be spent on imports for defence purposes.

STOPPAGE OF ECONOMIC AID

In the wake of this conflict the economic assistance was abruptly stopped. Naturally, that had a tremendous adverse effect on the foreign exchange resources. Cumulatively, therefore, all the factors worked to highlight the many weak spots

in the economy. It is against this background that Government took the decision to devalue the rupee.

WAYS OF GETTING OVER POSSIBLE ADVERSE EFFECTS OF DEVALUATION

Since devaluation is a *fait accompli*, the only rational approach and attitude that could now be taken is to consider fully and completely all the implications of devaluation, examine their impact on the economic problems confronting the country and find out what steps could be taken to secure fully the benefits expected of devaluation.

EFFECT ON EXPORTS

One of the objectives of devaluation is to stimulate exports. Our exports are static. Export incentive schemes have not been successful in achieving a breakthrough. Our exports are priced out from the world market. Devaluation will, no doubt, provide a price-edge to our export products in the foreign markets ; but, in respect of a number of export products, the demand is inelastic. In respect of others, it is doubtful whether, in the near future, it would be possible to have additional supplies for being released for exports on an increasing scale. While the decision has had the immediate effect of slowing down the flow of exports or even bringing it to a standstill, it would be too early to say what actual effect devaluation will have on exports. It is very likely that there may be some improvement over a period of time, but whether devaluation can help to make a substantial improvement will depend on a number of imponderable factors.

COST OF SERVICING THE EXTERNAL DEBTS

Cost of servicing external debts will be increased ; that cannot be avoided and will have to depend entirely on the goodwill of the aid-giving countries for any relief that may be extended to us.

FOREIGN INVESTMENTS

It is claimed [that devaluation will give a fillip to the flow of foreign private capital into the country. While one hopes that this would be so, it has to be remembered that devaluation will mean reduced off-take in terms of dividends and repatriation of capital and this fact is likely to act as a disincentive to the further flow of foreign private capital into the country.

STEPS NECESSARY TO HELP ACHIEVE THE EXPECTED BENEFITS OF DEVALUATION

When we examine the measures that are necessary for reaping the full benefit of devaluation, a number of steps suggest themselves.

Some of them are :

- (a) Larger and freer imports of essential industrial raw materials and components should be allowed. In one group falls those basic and vital raw materials such as sulphur, mercury, copper, special steels, etc., which cannot be obtained or are available to a very less extent from indigenous sources. In the other group falls raw materials which [have to be imported to supplement indigenous production such as raw jute, cotton, rayon yarn, etc. The raw materials falling in the first group should be allowed to be imported freely. Adequate quantities of imports should be allowed of items falling under the second group.
- (b) Larger imports of components, if necessary by raising import duties, should be permitted so as to encourage indigenous production. At the same time, this should not shut out imports of components although they will be more costlier.

- (c) Import of capital goods should be allowed duty free.
- (d) The procedure re: import licences and others should be streamlined so as to obviate delays in import of essential raw materials.

THE NEW IMPORT POLICY WELCOME

Government, no doubt, have given an indication that they are determined to take the necessary corrective measures. As a positive indication, Government have since announced certain measures to ensure regular flow of raw materials, components and spares for specified priority industries to enable them to work to their full capacity for six months. Import liberalisation measures reflect an accent on exports and basic items like raw hides and skins, tanning substances and cashew-nuts which are primarily intended for exports after processing are put on Open Licences valid for shipment upto 31st March, 1967. The requirements of small scale industries have also received consideration. These various measures of liberalisation of imports are expected to give a boost to production. But the problem, however, before the country is not only of increasing production but also of lowering the cost of production particularly from the export angle. It is from this point of view that a reduction in the rate of import duties has been suggested, so that the adverse effect of devaluation on import costs could be off-set. Government have also taken some action in this direction. But the reduction in the rates of import duties as announced is not adequate for the purpose of bringing about a lowering in the cost of imports. More particularly if establishment of new industrial undertakings has to be encouraged, capital goods have to be imported on a liberal basis and their costs have to be reduced by lowering the import duty applicable to their imports. It is hoped that Government will take early action in this direction.

CRUCIAL PROBLEMS AWAITING SOLUTION

The crucial problems which have to be tackled are : holding the price line, stepping up of exports, developing indigenous substitutes for imported materials and making the economic growth self-sustaining. These problems have to be satisfactorily solved, and solved urgently, not only for preventing a further pressure on prices consequent on devaluation but also for generating in the economy forces of self-sustaining growth which would help bring the inflationary situation under control.

DEVALUATION—A CHALLENGE

Creation of such a helpful environment is a challenge to the ingenuity and resources of one and all—the Government, the business community and the people at large. All have to play their role with a high sense of responsibility, urgency and dedication. In fact, everyone has to be prepared to bear this strain implicit in the effort to free the economy from the shackles of inflation and enabling it to draw sustenance from increased production, both in agriculture and industry.

MEASURES TO BE TAKEN BY GOVERNMENT

As far as Government is concerned, I have already indicated some of the measures which require to be taken on an immediate basis. It is good to note that Government have already taken action in the direction of implementing some of the suggestions such as liberalisation of imports. Other measures have necessarily to follow.

LONG RANGE MEASURES

But one has to recognise that however energetically Government may act in minimising the adverse effects of devaluation, that by itself is not going to help place the economy on an even keel. Devaluation is not a panacea for all

our economic ills. Other measures are necessary to stimulate the economy, strengthen its agricultural and industrial structure and bring down the prices and make the life of the common man bearable.

PROBLEM OF INFLATION

The main problem before the country, as I said, is of containing prices. Inter-play of many factors has brought about a steep increase in price and the common man groans under the burden of the high cost of living. He finds it difficult to maintain himself and even to secure for him and his family the bare essentials of daily necessities. The situation is explosive enough. The other day, we were shocked to learn that a crowd of 25,000 persons mobbed a passenger train near Gulbarga. Immediate and direct provocation for this atrocious behaviour may be intense regional loyalties. But I for one believe that the root cause of the trouble has to be traced to economic malaise, the problem of food shortage and the problem of high prices of essentials of life. This situation, no doubt, has to be tackled on an immediate basis and I will come to this aspect later.

In the long run, the situation has to be improved only by increasing the goods and services in the country. Now, this is possible only with increased production—production in agriculture and production in industry. And, if production is the be-all for solving all our difficulties, it goes without saying that no extraneous consideration should be allowed to come in the way of achieving these objectives. If controls come in the way of increased production, they have to be removed. Raw materials have to be supplied to industries on a continuous basis and in an adequate measure. Industries have to have funds required for carrying on day-to-day activities and what is more, these funds have to be at a reasonable cost. In short, all steps have to be taken to enable

existing industries to utilise their installed capacity fully. Together with the established industries, the setting up of new industries has to be encouraged, which means that capital goods have to be allowed to be imported in adequate quantities and at comparatively lesser cost. Term finance has to be adequately ensured. All these measures have to be taken. In other words, a great deal of liberalisation, as opposed to rigidities, requires to be breathed into the economy. Government would do so if a sense of realism is to permeate their thinking and ideological considerations are not allowed to act as a brake on the actions deemed necessary for giving a push to the economy. An objective and realistic assessment of the situation suggests that Government must (i) avoid scrupulously non-productive expenditure and recourse to deficit financing, (ii) endeavour to closely relate the planning effort to the availability of resources, both in terms of finance and organisation, (iii) recognise that devaluation is really reflective of the failure of economic policies followed in the past, and (iv) avoid living beyond our means in trying to do too many things in as short a time as possible, resulting in the existing chaos through which the economy is passing. Will the Government learn from its past mistakes? Will it be realistic enough to eschew all that is not really effective in terms of strengthening the economy and concentrate only on those measures which steadily take us further along the road of economic millennium? That, really speaking, is the challenge posed by devaluation to the Government.

ROLE OF THE BUSINESS COMMUNITY

If devaluation is a challenge to Government, it is as much a test of resourcefulness of the business community. The increase in the import costs of capital goods, machinery and raw materials must necessarily give an impetus to the task of import substitution. It lies with the business community to take full advantage of the opportunity presented by devaluation

and harness all its capacities for hard work, ingenuity and determination to the task of finding out import substitutes. I quite recognise that import substitution has its own limits. The very process of import substitution creates a demand for imports in other directions. Be that as it may, at least the country will have the benefit of strengthening or broad-basing its industrial structure. That is a challenge that is posed before the business community.

EXPORT SURPLUS SHOULD BE BUILT AND COST REDUCED

Apart from import substitution, the business community can play an important part in assisting the efforts at export promotion. So far as exports are concerned, the first essential is to have adequate supplies which could be released for exports. Government are already endeavouring to create suitable climate for increased production through liberalised imports. But an equally important task is one of bringing about a reduction in the cost of production. Only so would it be possible to enable our products to find an outlet in the export markets. The field of action is essentially limited for the factors which impinge on the cost of production are largely beyond the control of the entrepreneurs. While therefore they must endeavour to ensure that these factors are either removed, or made to reduce their impact on cost of production, they must on their part help bring about a reduction in cost by pressing into service a greater degree of efficiency in the day-to-day handling of the problems of industry, avoid all wastes and effect utmost economies without in any way sacrificing efficiency. These are the challenges confronting the business community and I have no doubt, given the necessary environment, it will not lag behind in meeting the challenge of devaluation.

CHALLENGE TO THE COMMON MAN

I talked about the responsibility of Government and the business community in the present situation. Some responsibility also attaches to the common man, the consumer, in helping the country to regain its composure or in any case not allowing itself to go under the weight of the adverse repercussions of devaluation. In saying so, I am quite aware that the lot of the common man is already difficult and to ask him to bear any greater burden would be something like adding insult to injury. What I am, however, suggesting is that he must try to understand the forces that are at work in the economy, the forces that have been released by devaluation and which may lead to increase in prices inevitably and unavoidably, however much a businessman may try to hold the price line. In saying so, I am not holding any brief for those in the business community who resort to anti-social activities such as hoarding or profiteering and rigging up the prices under any pretext. They must be dealt with sternly and without any mercy. What I am suggesting is that the common man, as I said earlier, should show a greater awareness of the economic forces at work and endeavour to understand that there is an essential difference between profiteering and profit, there is a difference between an increase in price dictated by economic considerations and a price rise for which there is no rational explanation, and resist a tendency to go in for these supplies for the fear that prices would rise or supplies may not be available at least in respect of consumer goods, particularly such of them the demand for which is capable of being postponed. In any case, they must not create a situation which will prompt Government to take panicky measures designed to hold the price line. As an instance, I would like to refer to the proposal for consumers stores. I have personally nothing against consumer co-operative stores excepting for the fact that the experience of the working of these stores so far has been far

from satisfactory and this is no time for attempting to switch over to a different distributive economy on the plea that the same will make it possible for consumers to have goods at fair prices. The experiment would be costly. The existing distributive machinery would be disorganised and confusion will become worse confounded.

CONCLUSION

This then is the story of the devaluation and the challenges that it has posed to Government and to all sections of the community. Devaluation provides a turning point in our economic history. Its turn in one direction may mean a refusal to learn from past experience, persist in rigidities of mind and refusal to recognise the need for a pragmatic approach to the problems of the day. That road will lead certainly to continuous stagnation and economic confusion and chaos.

A turn in the other direction presupposes that we accept the realities of the situation as our guideline and plan our future progress accordingly. In such a course of action emphasis must necessarily lie on increased production and increased exports and a change in the fiscal and economic policies in a manner as would help achieve these objectives.

I am a person who has a deep abiding faith in the country and its progress. Even when I see difficulties coming in the way, I refuse to get unnerved by them and I am hopeful that all sections of the community in and out of office will rise as a single man and meet the challenge of devaluation and do everything in its power not only to prevent a return to the *status quo* but to help usher in an economy pulsating with vigour, in which the common man is able to have a measurable relief from the strains of life and is able to look forward with zest to the prospects for further improvement in living standards.

Whither Since Devaluation ?

C. C. Desai

I was abroad, actually in America, when devaluation of the Indian rupee came like a bolt from the blue. People abroad generally felt that the Indian Government had shown great courage and sense of realism in recognizing the true value of the Indian rupee in the international market and fixing the exchange rate on that basis. There is no gainsaying the fact that for some time now, indeed for some years now, thanks to the gross mismanagement of our economy by the ruling clique, the Indian rupee has been going down in its intrinsic worth and this was amply demonstrated by the various steps taken by the Government of India from time to time. For instance, all the export incentive schemes smacked of the devaluation of the rupee. Heavy import duties and regulatory import duty which was imposed by Shri T. T. Krishnamachari told the same tale. The National Defence Remittance Scheme with 60% foreign exchange certificates fetching sometimes as high a premium as 200 per cent had no other meaning. Refusal of Air India International, the show-piece of Government of India in the public sector, to accept Indian rupees on their planes during international flights could have no other meaning. While this was the state of affairs of the Indian rupee in the unofficial market, Indian Government had clung on to the original value and this had become a bone of contention between the Indian Government on the one hand and the world financing bodies, such as, the International Bank for Reconstruction and Development or popularly known as the World Bank and the International Monetary Fund in Washington, on the other. Whenever we had difficulties about foreign balances, we had to approach

International Monetary Fund for stand—by credits and these were given sparingly and grudgingly, and every time the question was raised of correct valuation of the Indian rupee in the international market. A situation arose when we had to submit to the obstinacy of the International Monetary Fund in favour of devaluation of the rupee in order to qualify for further stand—by credits from that organisation as also for the World Bank aid, without which the Indian economy was grinding slowly, but surely, to a halt. It is futile and dishonest to say that there was no pressure from either the World Bank or the International Monetary Fund. Basically, the pressure came from the essential weakness of the Indian economy. It is not the business of the World Bank to go into the value of the Indian rupee ; but they pointed out that they could not get the governments of financing countries to agree to any substantial aid unless there was understanding between the Indian Government and the International Monetary Fund in regard to the correct value of the Indian rupee. That is how devaluation, the spectre of which was looming large before the country for the last so many years, descended on us on Sunday the 5th June, 1966.

This devaluation was very different from the devaluation of 1949 when I happened to be Secretary in the Ministry of Commerce in the Government of India. At that time there was a general devaluation of the sterling and although it was not absolutely necessary for us to devalue the Indian rupee we followed suit in order to maintain the unity and integrity of the sterling area. On this occasion, we are the only sterling country which has been required to resort to devaluation and it is a matter of shame that we should have had to take a step which has not been found to be necessary by the other adjoining countries, such as, Pakistan, Ceylon, Nepal and Burma. That only shows how far we have sunk in the management of our economy as compared with the

other countries, notwithstanding our size, our resources, our traditions, our banking growth, our industrial development and our opening sterling balances in 1947. Some people have regarded the decision about devaluation as a far greater blow to Indian economy and Indian prestige than our ignominious defeat during the Chinese war in 1962 and the Indo-Pakistan war of 1965 with all its success in the field. To my mind, it is a disastrous decision inevitable and unavoidable because of the past misconduct, but nonetheless extremely disastrous in its effects on our economy, now and for a long time to come.

Even the supporters of Government and staunch party men have no more than an apologetic justification for the decision of Government. For Shri Morarji Desai to say that the decision is irreversible clearly shows that he is not in agreement with it and he is not happy about it, but he feels that as it has happened we have to make the best of it and we have to live with it. This surely cannot be regarded as either approval of the decision of devaluation or as payment of a compliment to the Government who made this decision. Shri T. T. Krishnamchari, former Minister of Commerce and Industry and Minister for Finance, who must surely accept substantial blame for the present state of affairs, is reported to have said that he would not have allowed devaluation. That is not approval of the decision of devaluation nor payment of a compliment to the Government run by a party of which he is an important member. Shri B.R. Shenoy, the well-known high priest of devaluation, while welcoming the decision for devaluation, has warned the country against inadequate devaluation and has foretold that a further dose of devaluation may become necessary before long. Some people consider the devaluation of the order of 36.5 per cent as a terrific devaluation; but Mr. Shenoy, the economist knowing the state of the country, does not think so and fears that we may have to devalue still further. I could go on quoting

leading Congressmen, economists, industrialists and businessmen, all of whom have been staggered by the suddenness and severity of the decision of devaluation; but it would serve no useful purpose, particularly against a Government blind to public opinion and believing in the philosophy: "Let the dogs bark, the caravan will go on."

From all accounts and reports, the devaluation decision was based upon certain assumptions, most or none of which seems to be coming true, at least so far. It has been assumed that devaluation will appease or mollify International Monetary Fund and the World Bank and in consequence the flow of aid would become larger and would be sufficient to bridge the yawning gap between imports and exports until the new rate becomes stabilised and economic equilibrium is reached. I have it on unimpeachable authority that we were going to get \$ 900 million as non-project aid through the World Bank consortium *with or without devaluation*, and I find that the same figure, if not less, has stood even after devaluation. People in the Government thought or fancied that they would get something like 1700 or 1800 million dollars, at least in the first two years, to embark upon a programme of liberal imports and relaxation of controls; but they forget that it is the Government of different countries which give the aid and these countries are not bothered about Indian devaluation, Indian balance of payment difficulties or Indian economy. They have their own budgets and they have their own parliaments which have to approve of these aid commitments. They just cannot increase the aid to twice or thrice the original figure simple because India has obliged the World Bank and the International Monetary Fund by swallowing the bitter pill of devaluation. Other countries such as Pakistan are getting the same aid as promised earlier but without devaluation. Even with devaluation we are not getting a dollar extra. By devaluation we would be widening the gap between imports and exports substantially, and where is the

foreign exchange to come in to bridge this gap? We would again have same difficulties as faced before devaluation and we would be once more on the slippery road of devaluation unless we tighten our belts and live within our means, which the present Government is in no mood to do. Thus, from the point of view of volume of foreign aid, devaluation has done us no good at all.

The second assumption is that with devaluation the volume of exports should go up so that ultimately what we lose in value, we make up by volume. This means that we must have substantial surplus production after meeting the indigenous requirements. There is no symptom of such surplus. Ceylon, a tiny little country, exports more tea than India where tea is cultivated in the north and in the south. In respect of our traditional exports the benefit in price competitiveness due to devaluation is sought to be set at nought through export duties, thus bringing the position to where it was prior to devaluation. In non-traditional goods prices are rising, thus negating the benefit of devaluation. For a sizable export surplus, production must be stepped up considerably and this requires not only import liberalisation of raw materials and components but also additional finance for which again there is no sign on the horizon. On the other hand, whatever indications or point to the continuance of the credit squeeze and lightness of rupee finance. Meanwhile, population is increasing and with it the demand; thus whatever little increase in production there may be would be mopped up by increased consumption within the country, leaving no additional surplus for exports. Because of devaluation we would be getting less foreign exchange for our exports and thus there would be a substantial fall in the foreign exchange earnings through exports. Devaluation has thus done no good to our export situation.

I have already touched on the factor of increased production which is said to be one of the benefits of devaluation. It is true that Government has announced import liberalisation of raw materials and components and this would certainly help increase production and activate some of the idle capacity that was a sorry feature of our economy ; but mere raw materials are not enough for increased production. Wage line has to be maintained and there has to be the necessary bank finance to sustain increased production. There is no sign of increased bank finance and therefore industries are not likely to take full advantage of increased or liberalised imports of raw materials and components. The hope of increased production is thus not likely to be realised. This assumption leading to devaluation is also unlikely to come true.

Devaluation should normally help the tourist trade ; but tourists not only want cheaper places to go to, but they must also have their comforts ; and here we would fail again. There are some countries like Spain which receive as many as 18 million tourists per year where as a vast and ancient country like India with all its romantic past does not attract or receive even a million visitors. We would not have sufficient or good hotels. Our customs regulations do not encourage tourists. Our prohibition laws inhibit visitors who are accustomed to drink. Our monolithic air services carry on in their old ways in the absence of competition and do not care whether tourists are happy or not. While we would like to have more and more tourists, we do everything to keep them away. Cheaper rupee is not likely to have any effect in the face of the disincentives. Devaluation is not likely to help the tourists trade, at any rate, materially.

Devaluation is supposed to reduce imports and to encourage indigenous production. To some extent devaluation will certainly have this effect. But there are areas where no matter how costly the imports are they have to be resorted to

in the interest of maintaining economy. Foodgrains, non-ferrous metals, alloy steels, fertilizers, sulphures, pesticides, tractors, certain types of petroleum products and capital goods for our expanding industries, are some of the items which we have to import no matter how costly the imports are, and that is where the import bill will go up, thanks to devaluation. There may be some impetus to import substitution; but, for instance, if non-ferrous metals are not to be found in the country, no amount or slogan of import substitution could be of any help. I have no doubt that because of devaluation the import will, go up substantially notwithstanding the high and almost prohibitive import cost. In any case, it would be a long time before import substitution becomes effective and its effect beginning to be felt on the balance of payment position of the country.

Comparison is sometimes made of the benefits due to devaluation accruing to French economy and hopes of similar benefits from recent devaluation to the Indian economy. But the Government spokesmen forget that the circumstances of the two countries are so very different. France is a country with surplus agricultural production, being in no need to import foodgrains or meat. The industry is highly developed in France and the surplus production could benefit from devaluation through increased exports, volume overtaking the value. On the other hand, Indian agricultural production is below our consumption and the deficit in foodgrains is widening every day, thanks to rapidly increasing population. Our engineering industries are not so highly developed as to feel the pinch of competition through over valuation of the Indian rupee. It is misleading to compare the conditions of the two countries without appreciating the circumstances prevailing in the two countries, and that is how Government has fallen into the error of feeling that what was good for France must also be good for India.

Then there are certain correctives which Government has to adopt in order to maintain the effective value of the Indian rupee. Will the present government take these steps? Judging from the past experience, the answer is definitely in the negative. For instance, first and foremost, we must learn to live within our means. There should be no deficit financing. There should be economy at every level of expenditure. The grandiose plans should be pruned so as to keep within the available resources. The habit of overdrafts on the part of state governments has to be ruthlessly checked. The public sector which is not bothered as to how the resources are raised would continue to get the lion's share of resources regardless of how they are spent or what return they yield. The public sector, even though it may be inefficient, has to be encouraged and expanded in the name of Socialistic pattern of society, a slogan left to us by the late Prime Minister. The price line has to be held, not by speeches and slogans, but by increased production, free distribution and natural application of the law of supply and demand. Price controls will fail miserably to hold the price line but our Government can only think in terms of control rather take the steps enumerated above. The Congress government has learnt nothing and will learn nothing. There is no discipline in the Congress. The dictates of the Finance Ministry fall on deaf ears in the spending ministries. New posts are created to suit individuals regardless of the cost involved. Redundant posts are confirmed to suit favourites. Ministries are grouped and regrouped to suit the whims and fancies of ministers regardless of considerations of efficiency or unity of work. State governments go on spending merrily insisting on overdrafts on the Reserve Bank of India and neither the Reserve Bank nor the Finance Minister nor the party in power is in a position to enforce discipline on state leadership. The Planning Commission is there not to prune the plan so as to keep within the resources but to expand it so as to go down in history as authors of substantial and imaginative planning. It

is impossible for the present government constituted as it is and with all the inheritance of the past to resort to economy, to enforce discipline and to insist on efficiency as the sole criterion of expenditure. That being so, devaluation would have lost its possible chance of correcting the economy of the country. It would have been much better for the Congress party to have recognized its own weaknesses and to have taken a practical view and carried on with the old valuation of the rupee as was done by the late Prime Minister Shri Lal Bahadur Shastri on whom also the pressure for devaluation was no less than on the present Prime Minister. It would go down to the eternal credit of Shri Lal Bahadur Shastri that he saw the unwisdom and unnecessary of devaluation and resisted it while he was alive. It is a tragedy for the country that he is no longer alive. I have a feeling that if he were alive he would not have agreed to devaluation and that the country would have been saved from the present hopeless mess in economy and irreparable damage to our international prestige.

Devaluation : Submission to the Forces of the Market

V. M. Dandekar

Devaluation is advocated on grounds that it encourages exports, discourages imports and thus helps in overcoming a deficit arising out of the normal import and export trade of a country. However, even in economic theory, this proposition is hedged with several qualifications relating to the nature of the commodities involved in the import and export trade, the reactions of the international competitors in the export market and also the reactions of the importing countries. Consequently, it is recognised that devaluation cannot help more than bridge comparatively small deficits in the balance of payment of a country.

In the Indian context, the balance of payment difficulties arise, primarily not because of an imbalance in the normal exports and imports, but because of the extraordinary capital imports required by our development programmes. As our development plans are at present constructed and the manner in which they have been executed over the past three Plan periods, it is obvious that they have come to depend more and more on capital imports from abroad. There is little chance, with or without devaluation, of our realizing an export surplus large enough to finance capital imports on the scale contemplated in the present plans. These will have to be financed by foreign aid in the form of loans and grants. In the circumstances, the purpose of devaluation can not be to create an export surplus so large that such foreign aid will not be required. Its purpose can only be

to facilitate securing the foreign aid on a scale which appears to be unavoidable in the present juncture. The arguments and fine calculations regarding the possible effect of devaluation on our exports and imports are, therefore, ideal speculations. The devaluation can be justified only on grounds that it facilitates securing of necessary foreign aid.

This is the principal reason for devaluation, though there is reluctance to admit it in so many words. It will greatly facilitate understanding the reason for and the pros and cons of devaluation if this fact is simply and explicitly stated; namely, that the Western block countries and the international financial institutions dominated by them told us that without devaluation, no foreign assistance would be forthcoming and, helplessly dependent as we were on this assistance, we decided to devalue.

There appears to be yet another reason for undertaking devaluation which, again, has not been explicitly stated, but which appears to be a dominant theme in the several justifications that have been put forward for devaluation. It is this. Over the past fifteen years, we have found it impossible to operate import controls, import restrictions and import allocations. We have also found it impossible to promote exports through extra-monetary measures such as export subsidies and the like. The reason for this failure may be spelt out in several ways. In the final analysis, they amount to no more than the proved incompetence of the Government to control and regulate the handful of powerful interests in the export and import fields. It is this political and administrative failure on the part of the government which is another and possibly a more basic reason for resorting to devaluation. In fact it was this failure on our part to conserve and use economically and purposefully the foreign exchange resources earned through exports and obtained through foreign assistance, that led to a situation where we were told that without devaluation, no further assistance would be forthcoming.

Thus, the failure to manage our own affairs and the consequent vulnerability to pressures from abroad, are the two principal reasons for making devaluation inevitable and unavoidable. These simple grounds have not been made explicit and, in fact, have been concealed in complicated and sophisticated arguments, creating an impression that the grounds for devaluation are too technical to be understood by the common man. It is necessary to rid the whole debate of this overbearing impression.

The debate may be divested of much of the mystery in which it is shrouded if we consider an analogous problem. There is a simple analogy between the foreign exchange situation and the food situation. The foreign exchange is scarce in the sense that we do not have enough of it or we can not earn enough of it to meet our needs. In the same way, food is scarce in the sense that we do not have enough of it and we can not produce enough of it to meet our needs. The food problem is universally understood and there is little mystery about it. It is understood that we do not have enough food, and, therefore, with or without food aid, we must use our food supplies rationally by regulating their distribution. Over the past twenty years, we have gone through the debate regarding the control and decontrol of food. We have tried both and, presently, at any rate, it is generally accepted that on balance we have got to control and regulate the distribution of food. The situation in respect of foreign exchange is exactly similar. It is scarce and, therefore, its use has to be regulated.

Consider now a hypothetical situation which, unfortunately, is not entirely hypothetical. Suppose over the next few months or over the next one or two years, we again find it impossible to control and regulate the distribution of our food supplies in a rational manner, that is to say, in an equitable manner. Various explanations may be put forward. In the ulti-

mate analysis, they amount to no more than incompetence on the part of the Government to control the powerful interests in the field. Suppose, this happens. Then several arguments will be put forward, as they have been in the past, advocating decontrol. It will be argued, for instance, that controls lead to corruption, malpractices, bureaucratic mismanagement and waste. It will also be argued that control of foods' prices leads to production disincentives. A case can then be made that decontrol of food, even though it may lead to somewhat higher food prices, will rid the country of all the corruption, malpractices and waste attending food controls and at the same time it will offer incentives to increase production. Thus it will be argued that food decontrol will lead to increased production and better distribution if they are left to the market mechanism.

These familiar arguments are exactly analogous to the arguments that devaluation will lead to increased exports, reduced imports and an improvement in the balance of payments; that devaluation will make the management of foreign exchange easier and that it will lead to a more efficient allocation of foreign exchange resources. It will be easier to understand the principal grounds of devaluation if this analogy is borne in mind.

The analogy may be carried further by considering another hypothetical situation. Let us suppose that other countries which are in a position to give us food aid, begin to sense that the government of this country is incapable of controlling and regulating the distribution of food. Let us suppose further that these countries have either philosophical, political or economic interests in establishing in this country a pattern of economy in which distribution of food is left to the market forces. It will then be opportune and natural for these countries to tell us that food aid will be available only on condition that the distribution of food is not regulated but that it is left to the

mechanism of the free market. If and when this happens, it will provide another powerful and urgent reason for advocating decontrol of food. We do hope that such a situation does not arise; but if it does, it will be exactly analogous to the present situation regarding foreign exchange where we have become vulnerable to such pressures from abroad.

If this analogy between foreign exchange situation and the food situation is borne in mind, the real reasons for devaluation will be more simply understood. It will also make clear that devaluation is a step in the direction of making the market forces more active and thus handing over the economy step by step to the forces of the free market. If this has become inevitable or unavoidable, the only grounds can be our incompetence to use our scarce resources more purposefully than dictated by the market. Devaluation has been variously described as a bold step. It is certainly a bold step in the sense that it amounts to a public acknowledgement of this failure to control the forces of the market.

The basic reason for devaluation and food decontrol are thus similar. There is however, an important difference between the two situations. Food administration is basically an internal matter. We may, therefore, continue to debate the merits and demerits of control or decontrol and experiment with one or the other periodically, even if with disastrous consequences. Management of foreign exchange is, however, tied up with international relations. It is not, therefore, possible to continue to debate the merit or demerits of devaluation and experiment light-heartedly with the rate of exchange. Devaluation is an irreversible process, at least in the short run. Once done, it is an established fact. Therefore, it is now necessary to turn attention to the future rather than engage ourselves in idle discussion regarding the merits of the step already taken.

Thus viewed, the more serious problem that we must now address ourselves to, is how to prevent a repetition of the situ-

ation where further devaluation will be necessary and may have to be justified as even a bolder step. To do this, it is necessary to contemplate and seriously ponder over our policy and administration in the past which led us to the present situation where devaluation became necessary and had to be applauded as a bold step.

As mentioned above, the reasons for the present state of affairs are our failure to operate foreign exchange regulations and use our exchange resources purposefully. If repetition of the same situation is to be avoided, we must consider how we may make the foreign exchange regulations more effective than in the past. The root cause of all troubles, both in the field of foreign exchange and in the field of food distribution, is the failure on the part of the Government to control and regulate powerful interests in these fields. In the field of food distribution, the logical conclusion which has been put forward on several occasions, by several bodies, both expert and political, is the socialisation of trade in food. On this analogy, if the Government is incapable of controlling and regulating the powerful interests in the field of imports and exports, there is no alternative except to abolish all such private interests and nationalise the import and export trade if further deterioration of the situation is to be prevented.

Devaluation : Implications for the Indian Economy*

Professor S. Paul

In recent weeks, there has been a great deal of public discussion on whether or not devaluation was a wise policy decision on the part of the Government. It is not my intention to attempt a *post mortem* of this event. Instead, I shall briefly examine the likely consequences of the decision and suggest certain policy measures by way of follow-up action.

There are three major questions which have been raised time and again in public discussions on devaluation. We shall analyse them briefly in the following pages. The questions are :

- (1) Will devaluation increase our foreign exchange earnings significantly ?
- (2) Will it accelerate the pace of import substitution ?
- (3) Is a general price rise inevitable in the wake of devaluation ?

I. DEVALUATION AND EXPORTS

It is often said that devaluation will make Indian exports cheaper to foreigners and imports more costly to Indians. As a result, exports will go up and imports will decline, thus reducing the deficit in the country's balance of payments.

*The views expressed in this article are the personal views of the author and are not to be taken as in anyway reflecting those of the Indian Institute of Management, Ahmedabad, where Shri Paul is Professor of Economics.

Whether, in fact, exports will expand and earn more foreign exchange will depend also on a number of other factors such as the nature of demand abroad for Indian goods, our ability to increase the availability of goods for export and the difference between the Indian and international prices of our exportable goods. Let us examine these factors.

Assume that prior to devaluation, an Indian exporter was willing to sell an item in a foreign market for \$10. After devaluation, he could reduce his foreign price by 36.5% and still get the same price in rupees. If he gets \$6.40 now, he can obtain Rs. 48 at the new exchange rate which is what he would have received prior to devaluation also. This shows, then, that for any item the maximum price reduction an exporter will be able to make in a foreign market as a result of devaluation is 36.5%.

If, however, an exporter reduces his price abroad, he will certainly have to export more to earn a given amount of foreign exchange. For instance, if he reduces his price by 36.5%, he must increase his quantum of exports by 57% to maintain the level of his foreign exchange earning. It is only if the foreigners' demand for our products increases considerably more than in proportion to our price reduction that we can hope to augment our earnings from exports. In other words, Indian exports will gain through devaluation only if our goods have an elastic demand abroad.

Government spokesmen have said from time to time that nearly 75% of our exports consist of items the demand for which is inelastic. Thus traditional items like tea and jute have a more or less stable demand and are not price elastic. The decision to impose export duties on them is based on this diagnosis. Expansion of exports must, therefore, come primarily from the non-traditional sector.

What are the prospects of non-traditional exports ? A meaningful answer can be given only after a detailed examination of items, industry by industry, to ascertain :

- (a) the Indian-foreign price differential,
- (b) capacity constraints and raw material shortages inhibiting production,
- (c) sensitivity of unit cost of production to fuller utilisation of capacity, and
- (d) the likely impact of increased exports on domestic prices.

As we have seen earlier, non-traditional items most of which are manufactured goods will be exported only if the relevant Indian-foreign price differential falls within the range of feasible price reduction (36.5%) which has been referred to above. So far, one has not come across any Government assessment or analysis of this question in depth. However, a sketchy survey of several industries indicates that for a majority of exportable products of the engineering, chemical, textile and electrical industries, the price differential is well above 40%. A number of these items used to be exported prior to devaluation simply because the incentive schemes and import entitlements had more than made up for the price differential. An important conclusion, therefore, is that unless special subsidies are provided, exports of many manufactured items will decline.

In spite of the price disadvantage, claims have been made that as we utilise capacity more fully, unit cost will come down, thereby facilitating price reduction and narrowing of the price differential. First of all, this assumes excess capacity across the board. Secondly, it assumes that unit costs will vary inversely with capacity utilisation. Both assumptions can be

challenged. Many process industries in the chemical sector have no idle capacity. Further economies in cost through increased production are therefore hard to come by. There is, however, considerable scope for generating economies of scale through the installation of large size plants. But this is a long term proposition.

In other industries, idle capacity is a widespread phenomenon. But it is by no means certain that unit costs will come down as a result of increased capacity utilisation made possible through import liberalisation will invariably augment costs of production through its effect on import prices. Imports are likely to cost 30—40 % more depending on the reduction in import duties affecting different products. Since most items have some direct or indirect import content, unit costs will invariably receive an upward push. My judgment, based on discussions with technical experts in industry, is that economies arising from fuller capacity utilisation may not fully offset the cost push emanating from enhanced import prices. In fact, for many manufactured exportables, the price advantage made possible by devaluation will to some extent be eroded by the import cost hike. The larger the proportion of direct and indirect import content in a product, the greater the degree of erosion.

An equally important factor to consider is whether increased exports will tend to raise the level of domestic prices. Given the shortages in the system, domestic consumers will tend to bid up prices as exports are stepped up. To the extent that this happens, industry's incentive to export will be smothered. It is important, therefore, to expand production substantially first and export a share of the growing pie.

II. IMPORT SUBSTITUTION

An important consequence of devaluation is that it leads to a rise in the price of foreign exchange. A rise in price is

normally to be expected whenever the demand for an item persistently exceeds its supply. Such an excess demand for foreign exchange has been in existence in India for nearly a decade. Premiums and black markets in foreign currencies were external symptoms of this imbalance. Heavy import duties and export incentive schemes had already raised the cost of imports in subtle ways before devaluation. This explains why the operation of these schemes has been termed "selective devaluation".

The peculiarity of devaluation is that it has raised the cost of all imports by 57%. Downward adjustment of import duties will no doubt lessen the magnitude of its impact on many items. Nonetheless, indigenous substitutes for imports will get a substantial boost as a result of devaluation. Generally the higher price of foreign exchange will encourage buyers to turn their eyes from imports to import substitutes.

A good example is the encouragement devaluation is likely to give to the cultivation of long staple cotton in India. Prior to devaluation, mills found it profitable to use imported cotton even though indigenous substitutes were available. At the new rate of exchange, the textile industry will turn increasingly to indigenous varieties. This shift will encourage the farmer to grow more long staple cotton, although in spite of his best efforts, the country will have to depend on imports for extra long staple cotton for a long time to come.

It is important, however, to remember that the protection afforded by devaluation may not always lead to effective import substitution. To take the example of long staple cotton again, not only should the farmers receive a price incentive, but special efforts will have to be made to remove other obstacles which are impeding progress. Thus, timely supply of adequate inputs, proper storage and ginning facilities, and appropriate measures of quality control and grading are as important

ingredients as a reasonable price for the farmer in a programme for import substitution in long staple cotton. It is clear that devaluation by itself cannot effectively tackle all aspects of the problem.

A major objective of raising the price of foreign exchange is to facilitate a more rational allocation of scarce resources. The single largest user of foreign exchange in India is the Government. If devaluation is to be effective in relation to the Plan and the growth of the economy, increasing attention will have to be given to the efficiency and profitability of government projects. The high price of foreign exchange must be a signal to policy makers to economise the use of this scarce resource and to insist on maximum returns from projects using scarce resources, both foreign and indigenous. If this lesson is not learnt, devaluation will have been in vain. Devaluation involves an economic judgment and calls for the use of economic criteria in resource allocation.

III DEVALUATION AND INFLATION

The question of price rise has already been referred to above. To the extent that import costs go up, there will set in an upward pressure on prices. If, for instance, import costs account for 20% of the total cost of production of an item, there is likely to be 10% increase in its price. This reflects the direct effect on internal prices of devaluation through its impact on import prices. Even if an item is manufactured solely from indigenous materials and components, its price may tend to go up if the indigenous materials in turn have an import content. The magnitude of this indirect effect may not be significant in many cases, although there is no doubt that the effect will be inflationary.

Price rises may occur even in the absence of a cost push. Thus if exports are in fact stepped up and the domestic market

is starved, demand pressures may tend to generate inflationary pressures. Once such a price spiral gathers momentum, it will be difficult to maintain our competitiveness in foreign markets, unless steps are taken to ration at least all essential goods. It remains to be seen whether import liberalisation will help increase the supply of goods so that in spite of increased exports the price level could be maintained at pre-devaluation levels. A programme for subsidising essential goods will go a long way to contain the inflationary pressures in the economy.

In summary, a rise in the general price level appears inevitable in the wake of devaluation. Industry will for the most part, succeed in passing on higher import costs to the consumer in the form of higher prices. A subsidy programme for essential goods is urgently required to minimise the hardships of the common man.

IV. SOME POLICY MEASURES

The major objective of devaluation is to correct the chronic disequilibrium in the balance of payments by making exports more attractive and imports more costly. We have seen, however, that the nature of the problem is such that other follow-up measures are required to reinforce the effects of devaluation. Such measures are called for on the export and import substitution fronts as well as to combat inflationary pressures in the economy. Delays and indecision on the part of the Government in following up will nullify whatever competitive advantage devaluation could bring in the present context of the economy. Some important follow up measures are summarised below:

(1) It seems that the price advantage provided by devaluation will not fully offset the difference between the Indian and international prices of many of our new non-traditional

exports. Depending on our need for additional foreign exchange, subsidies must be given to encourage items which are most promising. In the pre-devaluation days, a variety of indiscriminate export incentives were given to many items the cost of which to the economy was hard to compute. It is possible now to plan subsidies such that an additional unit of foreign exchange is earned at the least possible cost.

(2) Import substitution will no doubt be stimulated by devaluation. But to speed up the process, it is essential to remove all other bottlenecks in the path of import substitution through a better planning and coordination of its requirements. Devaluation may, at best, have provided an incentive on the price front only.

(3) In spite of the Government's determination to hold the price line, the price level will go up irrespective of whether an article has direct import content or not. A realistic approach is to plan to contain the price rise in essential goods to the maximum possible extent. If required, rationing must be extended to cover more items. Setting up one or two department stores in large cities will be both inadequate and inefficient and is hardly the way to facilitate a fair distribution of goods in a shortage economy. Mere price control without rationing seldom works where shortages are severe.

(4) It should be clear by now that our ability to export and compete in foreign markets will depend solely on our internal competitiveness and efficiency in the use of scarce resources. Devaluation can give us only a temporary advantage over others. Our competitors abroad are also capable of providing export subsidies and incentives and protection to their domestic industries. In the final analysis, then, India's competitive position abroad will be determined chiefly by her ability to produce goods at low cost and sell them at low prices.

It is in this context that the planning and execution of projects, especially in the public sector, assume significance. If we ignore the importance of location, size of plant and proper management practices in choosing and operating our projects, they will invariably turn out to be high cost and inefficient units. Whether such decisions are taken on the basis of social and political considerations or out of ignorance, there is no doubt that the country is now paying a heavy price for such uneconomic decisions. If we want to enhance our competitiveness, we must be willing to adopt policies that encourage efficiency and profitability.

Devaluation is like opening up an ulcer in the body. Opening up is an important step, but must be followed immediately by other steps in the operation. The process is no doubt painful. The alternative may be fatal.

Devaluation : Its Implications

K. Rangachari

Devaluation of the rupee is an accomplished fact. The decision is final and irreversible. While we have to concentrate our attention on how best its disadvantages can be mitigated and its benefits maximised, the public cannot be asked to refrain from discussing its merits even at this stage. Serious public discussion is not possible before devaluation and, as in this case the Government had been denied competent advice except from a small body of its own officials or foreign experts: not to discuss the need for or manner of devaluation even after the step is taken would amount to surrender of the right to criticise the exercise of a far-reaching power by a small inner group of the Government.

Even if we have to concede that devaluation was justified because foreign aid would not have been available otherwise, it is possible to question the timing and the rate, and the preparations made before, and the consequential measures taken after, devaluation.

For some year now, the World Bank and some foreign advisers have been suggesting devaluation in view of the inflation in India in recent years and the steady erosion of the internal value of the rupee. The Government has also partially accepted this view; to discourage imports by raising their prices (in addition to import licensing restrictions) import duties have been raised. To promote exports subsidies in the form of tax credit certificates and import entitlements have been granted; to attract remittances now passing through currency black markets, the national defence remittance scheme was introduced. All these

amounted to a selective devaluation of the rupee but they involved expensive and dilatory administrative procedures. There was therefore something in the view that a straight forward devaluation would simplify this system, even if it implied some unnecessary hardship in some sectors.

On the other hand, there is also substance in the view, held by many competent observers in India, that this selective devaluation, with all its drawbacks, could have been continued for some more time because the Indian problem was not a textbook example of the case for devaluation. Ultimately, however, the issue was decided by the Government on the basis that aid would not be forthcoming without devaluation. Such pressure was the wrong reason for this step. The Government could have tried some of the alternatives; it could have held on in the hope that ultimately the Western countries having an interest in the economic and political stability of India would relent. Or we could have improved and perfected the system of selective devaluation by reducing the number of regulations or by the adoption of multiple exchange rates. This latter method has been tried in some Latin American countries and Indonesia: it is normally disapproved as unorthodox and the IMF could not have been expected to bless it particularly when it has been exhorting the Latin American countries to eliminate such practices. But Pakistan has had a special rate for remittances of its nationals from abroad, which gave 30% more in Pakistan currency, and is none the worse for such deviation. There is nothing to support the Government's claim (made in its pamphlet on devaluation) that a floating exchange rate for the rupee was the only alternative which it had rejected—and quite rightly too.

The Government seems to have been too ready to accept the oft repeated theory that because of internal inflation, the rupee was grossly overvalued and that the black market rates were a true reflection of this depreciation. So long as certain

transactions involving foreign exchange are banned, there will be a thriving black market and even in future we cannot expect it to disappear. There will be people willing to buy smuggled gold, watches, transistors or cameras at fancy prices and it pays the smuggler to get the foreign exchange for them by paying more in rupees. The existence of this feature doesn't in any way settle the international value of the currency.

On the other hand, we have been too ready to accept the theory of a fall in the value of the rupee without scrutiny. The fact that a certain rupee income—Rs. 100, Rs. 500 or Rs. 1,000—can go a much longer way than the corresponding amount of foreign currency, before or after devaluation, is incontrovertible and provides proof that the rupee was not too much overvalued. One can buy more shoes, cloth, food and groceries, living accommodation and personal services in India for the rupee than its old or new equivalent in or a shillings, franc or marks. Mass produced goods—cars, man-made fibres, household gadgets and some consumer durables—are much cheaper abroad, but that does not alter the fact that the rupee goes a longer way in providing the goods needed for maintaining living standards prevailing in India.

On the question whether in the internationally traded goods, the rupee has been relatively lower or higher in value, we can only cite the exported duties now levied on many exported items to support the view that over two-thirds of our export rupee costs were competitive enough. In new lines like steel, overhead costs of projects made the final product costly: in old industries like textiles and sugar, agricultural price supports inflated costs. Even now, because of restrictive import policies in these commodities in the advanced industrial countries, especially in textiles, there is no assurance that rupee devaluation will act as a sure device for exporting more. Subsidies

cannot be eliminated even now, and are not necessarily undesirable since even advanced countries like Japan resort to this method of export promotion.

The case of devaluation is therefore not a straight or a convincing one. But if the Government had to do without aid for another six months, industrial production might have fallen sharply at a time when the general elections were due. Also the Fourth Plan would have had to be postponed indefinitely. Finally, however misguided the Washington's advice and pressure might have been, no improper motives could be attributed to it. The US and World Bank's interest in the progress and stability of the Indian economy has been shown so keenly and consistently in the past that we cannot say that they advised a policy knowing that it would complicate India's problems. Some academic and text-book arguments, which orthodox monetary experts like to believe in, were probably carried too far. The pressure was certainly not justified; some of the hopes about liberalization of imports and controls had doctrinaire overtones and may not be fulfilled. It is becoming obvious that we will have to exchange old controls for new ones; introduce new subsidies in the domestic field and face some difficult adjustments as in the rupee trade. But the Indian Government did nothing earlier to get light on these aspects. It sat on the World Bank recommendations for several years without even discretely allowing it to be discussed by Indian experts in respect of its practical implications for trade, payments, aid and prices. And finally it threw up its hands and yielded without even planning beforehand the many consequential measures to be taken to make devaluation can become a success.

Devaluation of the rupee is not an end in itself but only the first step in the evolution of a new set of policies to promote balance and help the economy to resume its growth. Besides the complementary policies to be adopted by the Government, factors beyond its controls—such as good or bad

agricultural reasons, the quantum, timing and nature of external aid, and peace or its absence on the borders—may all affect the success or failure of the new exchange rate.

The prices of most imported articles will rise and it is right that they should, to compel their users to find indigenous substitutes or minimize their demands. In the case of those items which have hitherto been selling at the prices they can command in the market on the basis of their scarcity, irrespective of their landed cost, no new factor has arisen to increase the price further. For purely political reasons, the Government may talk for issuing ordinances or running department stores, but these enthusiasms are not to be taken at face value as they are likely to be shortlived as in the past if price increase is kept within reasonable bounds. The Government has been able to do very little about the rise in prices of about 16% since last year over and above that of about 12% in the previous year. It is very difficult to separate this normal price increase from that due to devaluation.

It is not disputed by anyone that the nation has all along been living beyond its means. Unless demands for consumption and investment are limited to the real resources available for both from out of the national production plus aid, the old story will be repeated all over again. The financial size of the Plan must remain flexible, but this need not prevent the formulation of a basic core of projects which can be completed, and the rest which may depend on the emergence of favourable trends in the economy in future years and possible reductions in our defence commitments. Though foreign aid will now be larger in rupee terms, and to that extent swell the total outlay, its real content in terms of the capital goods and materials it can buy will remain unchanged. There is little justification now for any large increase in the size of the Fourth Plan; and by insisting on making this the major issue at this time, Yojana Bhavan has created impediments to clear thinking on the subject.

If the Government's earlier reluctance to devalue the rupee had been based on doubts about the effects on the budgetary position, that fear has now been proved to have been exaggerated. But it is certainly under a greater obligation to avoid excessive reliance on bank credit and increases in money supply; that the Government should have indulged in the largest dose of deficit financing during the last year is shocking, particularly after the frequently repeated exhortation that there should be overall balance in the budget on both capital and revenue accounts, and heavy taxation had been imposed for the purpose.

The expansion of exports will take some time to become visible. The main gain is that the powerful pull of the domestic market has been neutralised by the advantages of selling abroad at the new exchange rate. Production will in many cases have to be reorganized in terms of quantity and quality suited to foreign markets. In some cases, some special export incentives may have to be re-introduced in a modified form but in most cases the new rate should be adequate to stimulate interest in investments for exports.

The Government has not passed on to exporters of traditional items like tea and jute—the full benefit of devaluation. The object is to maintain the country's total export earnings from these goods, the supply of which cannot be increased in the short term and the demand also cannot be expected to expand even if the price is reduced. A second advantage in keeping up their prices in terms of foreign currencies is that our competitors in these items (Ceylon in tea and Pakistan in jute) are spared the effects of our devaluation on their exports and are under no compulsion to devalue in step to maintain their earlier competitive position. A third result of the export duties will be to put a check on the tendency in the industries concerned to compete for raw materials or labour because of the gains in export which can push up their cost and weaken

their competitive power. Criticism of the export duties is therefore unwise. At the same time, the Government has an obligation to keep a watch and vary these rates either way, depending on price trends in export markets; there may also be additional item on which moderate export duties may be justified to earn revenue and keep down prices of some consumer goods in the country.

The new rate may however intensify their interest in long-term investment in this country, because the uncertainty about the rupee has been ended for the immediate future and more capital in rupee terms can be obtained for a given unit of foreign currency. But there are other considerations against a large flow of foreign investments at this time except those in continuation of, or needed to fulfil earlier commitments. Britain's payments position is such that restraints on capital investments abroad may have to be maintained for some more time. In West Germany, the price of money since the increase in the Bank rate is high even for domestic purposes and except among business houses which have a close association with Indian schemes, there may be little interest except as suppliers of goods if Bonn provides the credits for them on a Government basis.

Devaluation

A Wrong Remedy of Bad Diagnosis

Dr. S. R. Mohnot

On the 5th of June, the Finance Minister of India announced the most momentous of all economic decisions since Independence. It was more significant than the decision to devalue the Indian rupee in 1949 and the departure from the mixed economy-cum-welfare State concept to a straight socialistic pattern of society.

Within a few months of his delving into the intricate operations of financial systems, this decision speaks of the Finance Minister's commendable courage. He has performed a drastic surgery with the intent to purge the Indian economic system of all its toxins and malignant growth.

But are spectacularity and courage the two criteria of rational economic decisions? If not, the rationale must lie elsewhere.

It is denied that the decision was the result of external pressures. We hope that it is true. Indeed, it would not be a government worth the name if the suggestion was not denied. But who can deny that the problem is inextricably associated with the question of aid? The decision to devalue the rupee is a demonstration of our desperate dependence on foreign aid.

The decision might not have been the result of pressures of the aid-givers but one thing seems patent. The Government would have not devalued the rupee but for the attitude of the aid-givers. The decision is undoubtedly ours but we would not have taken it left to ourselves.

The problem is not of too much aid. The aid India has received is quite large but not enough. It could be more. But what is wrong with aid is our desperate dependence on it. The problem is of its *criticality*. There is no built-in flexibility in our Plans for exigencies when aid might have to be stopped. Somebody in the political circles has described devaluation as a result of our irresponsible planning and mismanagement of our national economic operations in the past. While such an extreme conclusion is unwarranted, there is no gainsaying the fact that Plans have been so framed and the economic decisions so executed that, in the present circumstances, in which India found herself, the Government was forced to devalue the Indian rupee. Not by pressure, but by the force of circumstances. If our planning methods and techniques had succeeded, there was no occasion for devaluation.

The Finance Minister justified the decision by a reference to 80% increase in the price level in the country during the last decade. The increase in prices should better be related to the 1949 level when the pre-1966 devaluation exchange rate was established. Between 1950 and 1965, the average annual rate of rise in prices in India was of the order of less than 3.5%. The rise in prices in a country has, however, no relevance to the problem of exchange rates unless it is related to other major trading nations. The annual rise in wholesale prices during the same period was a little over 1% in the U.S., over 2.5% in Germany, about 3% in Japan, over 3.5% in the U.K. Comparable rates in Germany, Japan and the U.K. have great significance due to the proportionate value of our trade with them. In 1964-65, Western Europe bought 28.4% and ECAFE countries 21.1% of our exports. Again, 17.7% of our exports were sold to the East European countries. The U.S.A. bought only 18% of our exports. The balance of the exports were traded with countries some of which witnessed even steeper rise in prices.

The rise in the internal wholesale prices, even if related to other countries, has no relation with the question of foreign exchange rates. It is the price of commodities actually traded that matters. It is amazing that our financial experts have generally talked in terms of general wholesale price levels prevailing in India.

With 1953 as the base, our export price index was 115 and import price index 106 in 1965. The indices for the U. S. A. for the same year were 128 and 114 and for the U. K. 138 and 121, for Japan 103 and 91, and for West Germany 133 and 96, respectively. Again, the relative price indices were already tempered by export incentives, import duties and other such countervailing measures.

A great point has been made in world financial circles about the free foreign exchange rates. In a scheme of official exchange rates being determined by the International Monetary Fund and the convertibility supported and facilitated by its operations, free foreign exchange rates cannot determine the variations in the exchange rates. Free rates are determined by the supply and demand of the Indian rupee in the free markets and caters for a very limited size of the market. This market stands on its own. The Government expects that with the devaluation, the unofficial market rate will now approximate the official rate, the margin having been reduced substantially. The hopes seem to be belied if one considers the nature of the unofficial exchange market.

Similarly, one seems to talk again and again about the substantial and continuing adverse balance of trade. Adverse balance of trade is not the result of the price factors, it is a direct result of our desire to accelerate the rate of growth beyond the available resources. We may, to take an extreme example, double the rate of growth and find that our adverse trade balance has assumed unimaginable proportions. It is

artificial demand and not inexorable economic laws which is responsible for our continuing adverse trade balance. Our huge requirements of food imports, necessitated again not by the inexorable economic forces but by the inclement weather, have aggravated the continuing adverse trade balances.

Devaluation was unavoidable, it is further argued, if economic isolation of India was to be prevented. The Chinese example has been given. The example has some political glamour, it has no basis. There is no question of isolating the Indian economy on the pattern of the communist countries where the entire foreign trade is completely controlled, devaluation or no devaluation.

A better example to consider, however, is of the U. K. Our financial experts in New Delhi need to be told that while devaluation in the case of the U. K. can be an effective measure to correct the external imbalances, the same does not apply to conditions prevailing in countries like India.

It is also argued that devaluation is in conformity with the realities of our balance of payments position. There has been after all a real dent on the exchange rate of the Indian currency.

How long can an artificial exchange rate be permitted? It has to be corrected appropriately and the direct and more effective method is to revalue the currency. Which of the currencies of the world are realistically valued? Even dollar rate pegged to gold is an artificial rate. The divergence is greater in other currencies including the pound sterling. Why single out the Indian rupee. And what about the rate at which India is transacting with the controlled economies? And does not the distortion in rates exist due to high tariff walls imposed by leading countries including America?

The example of devaluation effected in 1949 is a good case in point. Much of the rigours of the devaluation of the Indian rupee can be taken away if the pound sterling and other currencies which have undergone distortion in value were simultaneously devalued appropriately and not necessarily correspondingly. The hope is expressed that the devaluation of the pound along with several other currencies is in the offing. If and when this takes place, much of the arguments against the devaluation of the Indian rupee will disappear.

Devaluation serves basically two objectives : it boosts up the exports and helps in the contraction of imports. Our imports are practically inflexible. In fact, the Finance Ministry has already announced its desire and given an assurance to liberalize imports. Half the purpose then in devaluing our currency has been lost. Our exports are also to a large extent inflexible. The inflexibility arises out of the shortages of raw materials and limitations on production due to the peculiar nature of some of our industries. Our three principal exports—cotton and jute manufactures and tea—are covered by these inflexibilities. Reports have been current that apart from block closure of the jute mills last month, a 5% reduction in the consumption of raw jute by jute mills has been ordered by the IJMA. This will be in addition to 10% reduction brought about in last March.

A major part of the advantage has been taken away, *albeit unavoidably*, by the imposition of import duties.

Our imports last year were of the order of Rs. 1400 crores. That amount has been increased by the new measure to Rs. 2200 crores. The exports have declined in value from Rs. 800 crores to about Rs. 525 crores. The yawning gap that the balance of trade will now present, even in terms of rupees, will only aggravate our desperate dependence on foreign assistance. Obviously, the Government of India must have

received assurances from appropriate quarters for stand-by support. At any rate, the gap will not substantially increase in terms of the foreign currency. But how shall we repay all these? Are our exports flexible enough to bridge this gigantic gap? Shall we be able to double—in fact, we must treble—the present exports in physical terms to wipe out the gap? The task before the Commerce and Finance Ministers in the coming years will be, to say the least, a stupendous one. The task before the Government as a whole will, indeed, be extremely embarrassing owing to the precarious dependence on larger foreign aid.

By definition, devaluation reduces the external value of a national currency. The dictates of our Indian economic situation are such that it will make a major dent in the internal value of the rupee. The Finance Minister seems to be very optimistic about the balance he will be able to maintain in the national exchequer. It appears, however, unavoidable that he will have to resort to larger doses of taxation and/or deficit financing. If this can be avoided, it will, indeed, be an outstanding feat in financial management. The justification of this, too, will be the same as one advanced for devaluation now. First you say that it is absolutely necessary and in the interest of the economic health of the country. Did our official spokesmen not say in and outside the Parliament that devaluation was against the interests of the Indian economy?

Apart from the reductions in import and excise duties which may otherwise be counterbalanced by increases in export duties and the increase in the quantum of imports, the rupee expenditure of Government of India will increase tremendously. There will be an increase of all foreign expenditures on defence procurement abroad, on the foreign content of industrial projects in the public sector, of debt repayments, of external debt servicing and for purposes of giving subsidies

for downward adjustments of excise and import duties and for larger financial assistance to industry. These do not take into account the increase in general level of prices which will be generated by the various forces unleashed by devaluation.

In that sense, is not devaluation a self-defeating measure? The Finance Minister quoted the 80% increase in wholesale prices in India during the last 10 years. His measure to devalue the rupee will soon increase this number to 100 and in years to come may be still higher. Confronted with the food shortages, prices will sky-rocket, deflationary conditions created by devaluation notwithstanding. Import liberalization will have to be confined to some raw materials and essential requirements of industry, such as stores, chemicals, spare parts. The assurances to hold the price line is one of those promises which were made in the past never to be fulfilled, the best and most sincere desire of the Government notwithstanding. One of the sheet-anchors of our First, Second and Third Five-Year Plans was the stabilization of prices. This objective was considered necessary also from the point of view of the desirable objective of bringing about greater equality in distribution of incomes. Prices could never be stabilised. A large measure of short-falls in the targets of the Third Plan and the present devaluation measure are attributable to the failure to maintain a stable price level.

All the imported raw materials, stores including chemicals, oils and spare parts, will increase in value by 57.5% minus the reduction in the import duties on existing value. Is it implied that this increase will be absorbed by the industry?

Capital equipment will, likewise, cost more. With it will increase the capital charges, the interest, and depreciation. The foreign loans taken by companies have gone up in amounts by 57.5%. The corresponding repayments in instalments will increase creating additional loan requirements. Even on the

existing loan basis, the interest charges will go up by 57.5%. Thus, a 7% interest charge will automatically become an almost 11% charge on the original amounts. Is it expected that these will all be absorbed by the industry?

Where internal production is supplemented by imports, there will be a sympathetic increase in prices of indigenous production.

Let us take the example of a very essential commodity, fertilisers, about which so much confusion has been created during the last few months. Without recourse to facts, political quarters seem to complain about the higher internal fertiliser prices against the imported ones. The Finance Minister has, by his latest decision, removed the complaint by one stroke of pen. The imported fertilisers will cost more now than internal production. The present price of imported urea was between Rs. 450 and Rs. 500 per tonne depending on the sources of supply. This has been increased to between Rs. 700 and Rs. 800 per tonne. The industry will be thankful to the Finance Minister for taking away at least one of the very oft-repeated complaints against the industry and the Fertiliser Corporation of India should be the happiest. Devaluation will draw a curtain on its unprofitable operations.

So many are the intricate relationships within the economic structure that a steep rise in prices in some commodities will have inevitable and unavoidable chain reaction in others. Many industries do not depend on imported raw materials. But the production of the raw materials might depend on foreign content. Again, its supplies might be products of export-oriented industries. In case of some products, prices will rise in sympathy with rise in prices of other qualities of products of the same industry depending on imported raw materials. In deference perhaps to public or official wishes, a leading manufacturer recently announced that "in spite of

rise in costs" it had "not yet" raised the prices of its products. Let us watch how long will this "yet" last.

And then it will be expecting too much that with a rise in prices of most of the commodities, there will not be a tendency for rise in prices in others.

It must be clearly recognised that the Indian price problem is primarily a cost-push problem rather than an inflationary situation in the strict sense. Any number of cooperatives will not solve the problem if the industry will raise the prices following a rise in their costs of operations including debt servicing and obligations.

But the biggest casualty is our industrial programmes. Most, if not all, of the sizable industrial projects will be delayed by a year or so. This is assuming that the intractable problems in the wake of devaluation will find easy solutions and the governmental red-tape will yield to the exigencies of the situation.

Some of the projects in respect of which all financial arrangements were made last year but because of the protracted deliveries of the equipment could not arrive, will be facing an extraordinary situation. In February, 1965, the regulatory import duty was imposed on all imports. This required a substantial revision in the capital cost of most of the industrial projects. Hardly had the industry recovered from the shock than the overall import duties were increased, even on machinery and equipment. While the enterprises have been still fumbling with making appropriate arrangements for additional finance, the present devaluation will increase the rupee cost of the projects phenomenally both by direct increases of the equivalent of the foreign exchange values as well as by appropriate changes that will occur in the prices of indigenous equipment. Where foreigners are interested in projects which have gone through repeated upward

revisions since last year, including industries which have been given top priority by the Government, devaluation has provided a great deterrent to foreign capital. The Government can very well argue what they can do about it if the requirements of the situation are such that these radical and outstanding measures were to be taken. Fiscal measures are after all the prerogative of the nation States. They are, perhaps, right but this is certainly not the way in which we can promote the inflow of foreign capital and accelerate our industrial development.

Due to a rise in the costs of production and capital outlays, an increase in the debt repayment and interest obligations of industry, a steep rise in import values and a precipitate fall in export values, the problem of internal finance at least during the next one or two years will present insurmountable problems. Neither ingenuity nor the desire available in New Delhi gives hopes of the workable solutions of the problem. The banking system and the financial institutions can only save the situation if a real recession in the industry is to be prevented. The possibilities of the revival of real investment market have been decisively undermined.

Our techniques of planning and machinery of its execution have given India the jolt of devaluation. Unless these can be altered radically, bigger events are awaiting us in the wake of the devaluation. Or may be, another devaluation---at any rate, a justification for it.

Devaluation is now a *fait accompli*. The measures the Government have so far taken to meet the situation are encouraging. We hope the Finance Minister will continue in his bold efforts in the same way as he took the bold decision to devalue the Indian rupee.

Some Thoughts on Devaluation

Ramnath A. Poddar

THE BACKGROUND TO DEVALUATION

The decision to devalue the rupee created as much a surprise as anxiety ; surprise in that Government had taken that decision, when all along its spokesmen helped to create an impression in the country that devaluation was not being considered as a corrective for the economic ills confronting the country. In fact, the previous Finance Minister had taken a number of measures calculated to serve the same objective which devaluation was expected to create. Anxiety because of its possible adverse effect on the economy and the rude reminder it gives of the abject state of the economy. What were the factors in the economy which forced the Government, as it were, to devalue the rupee ?

The obvious explanation is that in all these years the Governmental policies in the economic sphere have not succeeded in tackling the basic issues of the economy. Considerable time, resources and organisational energy have been spent with the objective of strengthening the economy, but it has not favourably reacted; and, if that is so, it would be useful to examine the factors of a basic nature which should have brought about the current difficult position.

For this purpose, one must go through the whole gamut of planning effort over the last 15 years and more particularly in the last decade, and try to answer such questions, as to whether the strategy and the priorities accepted in planning were of a rational nature, examine if there was an adequate

organisational machinery to match the magnitude of the tasks involved in efficiently implementing plans of vast dimensions etc. The reply, unfortunately, is by and large of a negative character. Instead of concentrating on achieving well defined and limited number of objectives through an effective utilisation of the scarce financial resources available, we have allowed our resources as also organisational energies to be diffused over a very wide front with the result that even when some progress is recorded in one direction, it fails to have an appreciable impact on the economy as also on the minds of the people. This is more so because of the fact that the effort made for progress in some other directions gets lost in administrative proliferation and economic waste.

When diversion of scarce resources to non-productive uses create real shortage of resources for development purposes, Government resort to the facile expedient of stepping up the rate of taxation, both direct and indirect, with the result that the springs of savings are dried up and there are hardly resources left for being invested in productive enterprises. The capital market for a long time continued to be shy and although recent efforts have helped it to look up a little, there is no material change in its conditions and new industries continue to find it difficult to sell their stocks in the market. This together with stringent credit policy in force have made it very difficult for entrepreneurs to obtain finance for running their enterprises or to obtain rupee resources necessary for financing the purchase of capital goods, machinery and spares for setting up of new industries. The limitation of real resources have not come in the way of Government trying to fix ambitious financial targets of investment and adhering to the same. If resources raised through taxation are not adequate, the shortfall has to be made up through deficit financing. The disastrous effect that this has had on the economy is quite well-known. Its effect on prices was so adverse that even at the beginning of the Third

Plan, Government decided to scrupulously avoid resorting to deficit financing except to the limited extent provided for under the Third Five-Year Plan. That limit has been far exceeded as would be seen from the fact that against the estimate of Rs. 500 crores of deficit financing in the Plan period as a whole, the deficit financing for the year 1965-66 alone has been placed at Rs. 400 crores. All these factors individually and collectively led to a continuous deterioration of the economy and instead of dynamism and growth, we are landed with stagnation and confronted with the possibility of a further slide-down. This is the background in which the decision to devalue the Rupee has been taken by Government.

IS DEVALUATION JUSTIFIED ?

The next question that poses itself is whether Government was justified in taking the decision which it did ; was there no other alternative open for correcting the imbalances in the economy and more particularly for improving the foreign exchange resources of the country ? This is a question on which opinions are bound to differ. One could say as many things in favour of devaluation as against it. Whatever one's personal view, it has to be remembered that devaluation has been effected and that, that position cannot be changed. A controversy in regard to the justification or otherwise of this momentous step can, therefore, hardly yield practical results, excepting for the possible pleasure and satisfaction, that one may have, in the years to come, of saying "I told you so".

EXAMINE THE IMPLICATIONS OF DEVALUATION

It is clear that it is futile to engage in a controversy of this character and instead it would be advantageous to employ one's energy in understanding all the implications of devaluation, finding out whether the impact of devaluation on the various sectors of the economy is going to be beneficial; whether

the expected benefits would automatically follow from the fact of devaluation. If not, what steps should be taken to see that they are fully realised. If one comes to the decision that devaluation is bound to have adverse impact on the various sectors of the economy, then thought has to be given to the ways and means which would help the economy to get over the impediments resulting from devaluation and creating conditions in which the efforts for further progress will have a reasonable chance to succeed through an increase in production, maintenance of price line, stepping up of exports and widening the industrial base through the process of import substitution.

EXPORT PROMOTION

Let us firstly examine the impact of devaluation on exports. One of the principal benefits expected to follow from devaluation is the encouragement that it will provide to exports by the lowering of the prices in the process of refixing the exchange ratio between the Rupee and the foreign currencies. There is no gain saying that on devaluation, exportable products become to that extent, more competitive and as such it is obvious that in certain circumstances, devaluation can help promote exports. There must be adequate availability of supplies for purposes of exports which were otherwise also competitive but which were rendered more so by devaluation. Is this circumstance present in today's conditions of our economy? Agriculture has continued to be stagnant over a period of years and there are hardly additional surpluses which could be diverted for export, taking advantage of the added prospects for increased exports through the price edge afforded by devaluation. In other words, quite considerable portion of the export trade in agricultural products is inelastic and there is little scope for a significant increase in such exports even after allowing for marginal step-up as in the case of exports of tea. In the long run, of course, it may be possible to increase production to an extent which, while catering to the demands

of the internal market would permit diversion of sizable supplies to export markets.

What is mentioned about agricultural products applies with equal forces to manufactured products also, only with this difference that while there is an assured market so far agricultural produce is concerned, the same is not true in the case of manufactured products. Intensive efforts have to be made both at official and non-official level to create new and continuous demand for our manufactured products. Even if the efforts in this direction had succeed and there is a good measure of demand for our products in the foreign countries, will it be possible for the country to take advantage of the same except perhaps in the case of engineering goods and that too on a marginal basis? Is the production of manufactured goods on a scale and at prices which would make it possible to effectively increase exports of such products in the foreign countries?

In this connection, it has to be remembered that our manufactured products are priced out of the international markets due to high prices which, in turn, are reflective of the high costs of production. It is well-known that devaluation will increase the cost of the imported raw materials and components required by existing industries. And to the extent that such imported raw materials enter into indigenous production of products which are exported, they are bound to affect their cost and, therefore, the sale price adversely. Export trade in manufactured products has largely been built up on the basis of export incentives. With the devaluation of the Rupee, all the schemes of export incentives have been withdrawn. The price difference consequent on devaluation will not be adequate, however, to make up for the entire benefit that was made available through import entitlements. The result will be that exports of manufactured goods will become slightly more uncompetitive than they were hitherto. If, therefore, exports of

such goods have to be increased, that is possible through a significant reduction in the cost of production. This is not the occasion when one could go into the various factors which make for increased costs, but the fact remains that so long as the cost of production continues to be high, the prospects for increasing exports even after devaluation are, to say the least, not very bright. Apart from anything else, therefore, Government must consider early restoration of export assistance schemes, duly modified, to suit the present requirements. The levy of export duties will also have to be carefully and continuously watched, so as not to allow slightest chance for the level of duties to have adverse impact on the course of exports in a particular product at a given time.

DEVALUATION AND PRICE-LINE

What would be the impact of devaluation on prices? This is an important question, for devaluation which was necessitated by the fall in the external purchasing power of the rupee is in itself occasioned by reduction in the internal purchasing power of the rupee due to a steep rise in prices. The effect that devaluation would have on the prevailing high prices is, therefore, of great significance. There cannot be any difference of opinion that devaluation does cause an increase in costs at least in respect of such of the items as are imported from abroad and which either directly go into consumption or are used as raw materials or components in industrial production. The impact of higher costs of imported material on industrial costs generally would be adverse and that would inevitably lead to a further pressure on the general price level. The business community has been exhorted to ensure that there is no price increase consequent on devaluation. As an enlightened section of the community, it is its responsibility—nay its duty—to see that no advantage is taken of the confusion resulting from devaluation for increasing the prices, except to the extent and in cases where devaluation makes adjustment of prices unavoid-

able. I have every hope that, barring some stray anti-social elements which would, under any circumstances, endeavour to exploit the situation to their own individual benefit, the business community as a whole will rise to the occasion and resist the temptation of making immediate gains through unwarranted price increases and justifying such action on the plea of devaluation. This, however, is not to suggest that price increase can be avoided altogether following devaluation. In fact, there is a wide recognition of this fact even in Government quarters and it is to be sincerely hoped that it will be kept constantly in mind with a view to holding back the inclination in certain quarters to pass on the blame to the business community for all untoward developments in the economic spheres.

THE PROCESS OF IMPORT SUBSTITUTION

A process which is likely to be helped by devaluation is that of import substitution. Import substitution is made possible through making in the country itself products which were till then imported from abroad or by making use of similar articles produced in the country. There is no doubt that since imports become costly consequent on devaluation, there would be a break on the desire to import even essential requirements from abroad and that there would be a concerted drive to find out substitutes from indigenous sources. There can hardly be any difficulty in appreciating this position. To the extent, therefore, that devaluation helps in stimulating indigenous effort and harnessing ingenuity and assists in inculcating in the minds of the entrepreneurs the Mantra of 'Swadeshi', it is really to be welcomed, but it should be quite clear that welcome as this position is, it should hardly lull us into a wrong belief that devaluation is likely to be an instrument of lessening strain on our foreign exchange resources by reducing imports. It has to be recognised that the very process of import substitution gives rise to demand for new products which are not available from indigenous sources. The process

of import substitution would only help in bringing about a further change in the character of import trade and not necessarily a reduction in the volume of goods imported from abroad. While, therefore, devaluation would have a definite beneficial impact in hastening the process of import substitution, it is not likely to help save substantially foreign exchange resources required for financing essential imports. The required foreign exchange resources have, therefore, to be more and more found through increased exports of goods and services.

NEED FOR INCREASED PRODUCTION

If, as has been mentioned in the above paragraphs, the impact of devaluation is not likely to be favourable on some of the major issues confronting the economy, a question naturally arises as to whether there is a 'multi-vitamin' which could be injected in the economy. To attempt to find such an all pervasive remedy involves going into the root cause which has created the various imbalances in the economy and such an endeavour unmistakably would point out that it is the lack of adequate increase in production, both in agricultural and industrial that is responsible for creating all the economic difficulties. If agricultural production had increased as envisaged an industrial production had not been discouraged by industries being obliged to function within the four corners of rigidities, controls, regulations and procedural formalities, it is possible that the shape of the economy would have been somewhat different than it is at present. Once this fact is recognised, there should be no difficulty in appreciating that production and more production should be the slogan of the day and all energies should be diverted towards creating a production-oriented economy. Devaluation in itself is not going to help solve our economic problems. At best, it can provide an opportunity to so direct our resources and energies as would effectively strengthen the economy and reduce the impact of,

if not remove altogether, the adverse pressures on the various sectors of the economy.

CREATE CLIMATE CONGENIAL TO INCREASE PRODUCTION

If production has to be increased, whether in the field of agriculture or industry, it hardly requires to be emphasised that necessary conditions will have to be created wherein the programmes of production are effectively implemented and every rupee that is spent for the purpose is made to go the farthest in that direction. In other words, all sections of the societies, and more so Government will have to learn to make more efficient use of the limited resources available in the country and concentrate on measures necessary for taking the economy forward on the road to recovery and further progress, essentially steadily and slowly, if necessary.

NEED FOR REALISM

Overall there is need for a realistic approach to our problems of planning, living well within our resources, and exercising strict fiscal discipline by the Central and State Governments. It goes without saying that any further dose of deficit financing can have a ruinous effect on the economy which is already in a bad shape.

MEASURES NECESSARY FOR AIDING PRODUCTION

It is not necessary to burden this article with the various steps that are necessary in order to reap all the expected benefits of devaluation and bringing about a significant increase in production, but the essentials have to be stated and the most important among them would be to undertake a review of the fiscal and economic policies and modify them in a manner which would give stimulus to savings and investment so that

they in turn could encourage production and help curb the inflationary tendencies in the economy. The process of de-control has to be carried forward and industrial production freed from the limitations and restrictions prescribed under innumerable rules and formalities. The available industrial capacity has necessarily to be intensively utilised and it is good to note that the import policy recently announced is designed to fulfil this objective. At the same time, the creation of new industrial capacities has also to be encouraged. Towards this end, Government should take adequate measures to ensure that industry is able to have adequate resources and its requirements of term-capital which will substantially increase consequent on devaluation. It is well-known that the Reserve Bank's credit policy is more than stringent with the result that industries are finding it difficult to meet the requirements of investing finance on an adequate basis. With the rise in the cost of imported materials consequent on devaluation, the requirements of finance is going to measurably increase. If the monsoon turns out to be good and let us fervently hope that it will be so, it is certain that a larger volume of agricultural produce will have to be marketed for which finance would have to be found. All in all, commercial banks would have to have larger resources if they are going to adequately serve the needs of agriculture and industry during the coming months. The need to undertake an urgent review of the credit policy can hardly be over-emphasised.

There is no doubt that given the necessary tools in the form of adequate supplies of raw materials, components and capital goods, enough finance at reasonable cost and allowed sufficient elbow-room to operate within a well-conceived scheme of overall regulation, the private sector can deliver the goods and successfully meet the challenge of devaluation.

These are some of the thoughts which occur in the wake of devaluation. The more I think about it, the more posi-

tively I feel that if devaluation has to serve any useful purpose, it can only be by way of imbibing in all of us—Government and the business community—the virtue of increased production as a sovereign remedy for all the economic ills confronting the country.

Devaluation and the Indian Economy

G. D. Somani

Devaluation is a very controversial matter on which economists and experts differ widely. Its adverse implications are the automatic scaling up of the rupee value of the massive foreign debt and interest charges thereon contracted by the Government as also a number of Companies in the private sector ; and the higher cost of imports of raw materials and components for maintaining production as well as capital goods required for developmental purposes ; and a fresh impetus to price inflation. There are, on the other hand, many advantages accruing through devaluation, such as incentives to exports, which become relatively cheaper abroad and fetch more in terms of rupee value to Indian exporters ; discouragement of imports and a corresponding impetus to import substitution ; decrease in the burden of remittances in respect of profits earned by foreign capital invested in India ; and greater attraction for foreigners to invest in India in view of lower risks of capital depreciation.

I think devaluation marks the culmination of the chain reaction set off by the Chinese aggression in November 1962, the last link of which was the conflict with Pakistan in 1965, necessitating the diversion of domestic resource and foreign exchange from development to defence. The failure of the 1965-66 food crops due to the drought complicated the situation. The country's deficit in its foreign trade has also been widened, especially due to the necessity of importing defence equipment as well as food grains. The acceleration in price inflation as

also the stoppage of foreign aid on the outbreak of conflict with Pakistan were factors that precipitated this drastic measure.

Now that this drastic decision has been taken we have all to engage in constructive thinking to implement the follow-up measures necessary to make the best of the new situation rather than keep harping on the error of devaluation.

Government have already announced the liberalisation of imports of raw materials, components, machineries, etc. against foreign loans and aids, which will help Indian Industries to utilise more fully their installed capacity lying idle so far due to the shortage of these materials. The increase in production due to free availability of raw materials and spare parts should be substantial although sometime will elapse before the impact of this improvement will be visible.

The Government have also initiated measures to check price inflation. In a situation charged with inflationary propensities, the Government may be tempted to try out negative measures such as blanket price controls. Such symptomatic treatment will not erradicate the main cause of the trouble, which is inadequate production. As a matter of fact, excessive resort to controls would depress production and thus perpetuate scarcity conditions. Whilst every effort should be made to keep in check the prices of basic necessaties of life ; this should be done by providing stimulus to production rather than by direct controls of price and distribution. There is sufficient unutilised capacity in the country's industries and agriculture itself to reach higher levels of production and this should be fully exploited. Industries are now in need of raw materials, components and certain capital equipment, particularly imported, and the supply of these is already being ensured liberally. As regards agriculture, the emphasis should be on intensive cultivation through more facilities for irrigation,

fertilizers, better seeds, better implements and better methods of production. It may be argued that the shift of emphasis towards better utilisation of existing capacity would limit the scope of further growth, but it should be realised that mere multiplication of capital equipment is meaningless, and, even wasteful, unless the full utilisation of existing capacity is ensured. The Government seem to have realised this and think the steps now being taken in this direction are appropriate.

The country's industry has been now adequately diversified, and an adequate import structure established. Many new industries have sprung up during the planning period and not only has capital equipment been set up, and machine-building industries established, but also the requisite technical know-how gained to set up expansions and new industries with ever decreasing reliance on imported capital equipment, know-how, components and raw materials. This is a remarkable achievement in itself, and it brings us to a stage only a few steps short of the most desired stage of self-sustaining growth. All we now need is the full utilisation of our existing capacity, the creation of sufficient internal resources and know-how, and then a final spurt to achieve that stage which would lend maturity to the country's economic structure.

The progress to a self-sustaining stage would require appropriate conditions, which can be created by suitable adjustments in the existing fiscal-monetary policy. The burden of taxation should be lowered in order to afford adequate scope to industry for creation of internal resources for ploughing back. Industry would also need more external resources, through better credit facilities for working capital requirements as also completing expansion plans in hand, and also through equity capital, which can be obtained by reviving the capital market. These institutional changes are the minimum

necessary to give the required stimulus to economic development. The reorientation of fiscal policy is called for with a view to restoring appropriate incentives to production, savings and investment.

Devaluation also brings price inflation in its wake. Imported commodities became costlier, but in a country like India, where prices of many imported commodities form the basis of domestic prices, the entire sector governed by import prices is affected by inflation. Although the value of imported commodities is relatively small as a proportion of the gross national product, the effect of the rise in import prices on the price structure tends to be disproportionately large in view of the sympathetic rise in the prices of other commodities. It should be appreciated that prices are closely inter-related and changes in an important sector like import prices can have a substantial effect on the general price level. Such inflationary propensity of the economy shall have to be checked by direct exhortation to exercise self-discipline ; by fiscal re-adjustments, especially reduction in excise duties and import duties and even by direct subsidies, especially in the case of foodgrains. However, there is no greater insurance against inflation than higher production and productivity, and all our future efforts should be aimed at achieving these.

The above discussion leaves out the important problem of increasing exports to balance our imports. In this regard, it would be relevant to point out that the levy of export duties and elimination of export incentive schemes at the time of devaluation will substantially neutralise the stimulus which devaluation affords to export. In case our exports do not immediately pick up to the required extent, the reduction of such export duties and the re-introduction of export incentive measures should be considered. It should be realised that export promotion as also import saving can result only by producing well in excess of domestic requirements. Moreover,

it should be also realised that the creation of an exportable surplus could embarrass the entire economy if the cost of production is too high by international standards, as in the case of sugar industry, the production of the cost of which is high due to high price fixed for sugarcane, which renders the export of sugar a losing proposition. This should not happen in the case of other industries. From this angle, it should be desirable to encourage and help all industries to rationalise and become cost-conscious so that the exportable surplus which they create could compete in the world markets from the point of view of both quality as well as price.

The key to the problems created by devaluation and as a matter of fact all basic problems such as poverty and inflation, lies in higher production and productivity, the achievement of which should receive the highest emphasis in all matters of public policy.

Implications of Devaluation*

Dr. D. K. Rangnekar

Why should the rupee have been devalued at this stage of our development ? What is India likely to gain ? These are the questions people have been asking since June 5, and these are the questions which no member of the Government has answered convincingly. What the Government has been saying is much too vague for the general public to believe.

The Government's line of propaganda is that devaluation will usher in some kind of millennium—all our problems will be solved just like that, and none left for the Government to tackle.

But is this true ? Devaluation can work no miracles. It is a plain and simple monetary reform. According to the text books, devaluation is a change in the par value of the rupee which makes your currency cheaper and foreign currency dearer. It follows, therefore, that imports become expensive because you have to pay for them in foreign currencies and your exports become cheaper and, therefore, more attractive, since foreigners have to pay less for them in terms of their currencies. The text books, therefore, suggest this so-called surgical operation to tackle the balance of payments problem of a country which has surpluses to export, but finds its exports priced out.

But text-book theories cannot be regarded always as the best guide in actual policy-making, particularly when the pres-

*Some of the points contained in this article were made in the course of a speech at the Indian Council of World Affairs, Sapru House, New Delhi on June 24, 1966. The views expressed here are the personal views of the author who is the Resident Chief at the Delhi office of The Economic Times and are not to be attributed to his paper.

criptions ignore the true state of affairs of a newly industrialising country. Devaluation may have worked in some other countries like France, Britain, and even in the Communist countries like Yugoslavia and the Soviet Union. But the circumstances in India bear no parallel to the conditions in any of these countries.

In the first place, none of these countries, which gambled on a monetary reform, did so without assessing its productive capacity and export potential. Nor did any of these countries actually take the plunge in a hurry and without any preparatory work. Consequently, the follow-up was swift and effective and so were the gains.

In contrast, the Indian Government took the decision in a sense of desperation because aid was not forthcoming without devaluation, and the decision was announced without any sufficient preparatory work. Consequently, a situation, which was difficult already without devaluation, has become more so because of it.

Secondly, the European countries could experiment with par values and various other gimmicks because they had sufficient reserves of capacity to play with the value of their currencies. Indeed, the risks were calculated and based on the sure knowledge of available surpluses as also of the potential. There was knowledge, not just a vague notion, of reserves of capacity in the economy to sustain a fairly large increase in exports without undue internal disruptions.

In contrast, again, India has neither the type of surpluses nor the reserves of capacity to make the most of a devaluation. Countries like India, Pakistan and Ceylon export almost every available product in order to earn what they can by way of foreign exchange. The case is not that these countries do not ex-

port enough. The case is that they do not get a fair price for what they do export. Apparently, therefore, devaluation cannot be regarded as a measure for improving our terms of trade. On the contrary, the unit value will now be affected.

The third formidable point against the gamble is the delicate balance of population and resources in the Indian economy. None of the European countries, which devalued their currencies was so miserably poor at the time of devaluation as India, and none had the type of population pressure on supplies and resources as we do today. For, too many people in our country still remain, and multiply, precariously near the bread—line. The abject poverty of the majority of the people, the pressure on resources, and the rapid growth of population bear no comparison with the conditions of Britain, France, Yugoslavia and the Soviet Union. For this reason, the government should have thought several times over before seeking the wrong type of foreign inspiration (or is it consolation after the event ?) for a decision which, in any case, was taken under external "advice" or pressures.

Purely on a factual basis, therefore, the Government cannot hope to carry conviction to the public by citing the devaluations in other countries to justify the devaluation of the rupee which, as we all know, was clearly brought about by a combination of external pressures and the Government's obsession with PL 480 and foreign aid.

If ever devaluation could have offered an incentive for large exports, it is not today. We are already experiencing all the strains and hardships of an economy of acute shortages. This is also another way of saying that we do not have large enough surpluses or enormous reserves of capacity to exploit the so-called price advantage offered by devaluation.

Almost one-half of our export earnings • depend upon the

sales of three commodities—tea, cotton and jute manufactures. The rest of the earnings usually come from a limited range of products, wholly or mainly, based on agriculture. The truth is that the bulk of this type of trade, which accounts for roughly 80 per cent of the total export earnings, does not need any major subsidies. The proportion of trade, which needs substantial assistance, is about 15 to 20 per cent, which is the list of some odd products including manufactured items.

The Government claims that devaluation is superior to all other incentive schemes because it has no arbitrary element. But what a developing country like India normally needs is not uniform treatment at all points, but selectivity all through, for various reasons, including the fact that the pace of development of the different sectors and producers is not uniform. Since a major part of the trade was not in any case priced out, devaluation has only reduced the unit value of such exports. In the case of the newer lines of manufacture and exports, devaluation does offer an incentive, but this cannot be regarded as a satisfactory inducement to such exports. These goods rely, in varying degrees, on import of materials, equipment and technology, the cost of which will now go up. Here what is important to bear in mind is not merely the specific costs of materials or parts utilised in the manufacture or production of any particular product. What is also relevant is the import cost of capital goods, machinery, balancing equipment, and a host of other items which add up to what is called the capital cost, the capital structure of the exporting industries. All these items will go up and further swell the ultimate costs of production.

The demand for many of India's major exports is inelastic. So is the supply. Apparently, devaluation will reduce the unit value of some of these exports, which will mean that we will have to raise the physical volume of exports even

to maintain our past level of export earnings. But actually the Government has levied an export duty on 12 major commodities, with the ostensible purpose of preventing a sharp decline in prices and, consequently, a sharp decline in export earnings. Even so, there is a margin which could lead to a slight fall, however slight in some cases, in export prices (in a sense, the export duties would seem to defeat the obvious purpose of devaluation, which is to make export prices attractive in order to bring about a surge of exports).

Even allowing for all these considerations, the fact is that, with or without the price advantage of a devaluation, we simply do not have sufficient surpluses or reserves of capacity to step up our export earnings significantly in the immediate future. And in this game time is an important factor. You cannot devalue today and expect to reap the fortunes in the (unspecified) long run, when we will all be dead. You must have the ready surpluses (or the reserves of capacity to produce goods) to exploit the price advantage offered by a devaluation today. If you do not have either of these, then you will only have a devaluation now and a situation leading to another one later. The so-called benefits of devaluation will get eroded by the time the economy moves to a point where it can look forward to an export boom or a sharp and sustained growth in new exports. And by that time we might also invite a new problem of absolescence.

A rough and ready commodity analysis exposes the falsehood of the claims of appreciable export gains as the result of devaluation. Take the case of tea or textiles which are the largest export earners. None of these could derive any benefit from devaluation. In the case of tea, for example, the danger is that the export earnings may fall, even if slightly. Our tea exports actually have been falling from 529 million lb. in 1956 to 467 million lb. in 1962, 464 million lb. in 1964,

and 440 million lb. in 1965. Simultaneously, domestic consumption has been increasing by something like 14 to 16 million kg. every year. We, who were at the top of the world export ladder for ages, have lost that position to Ceylon. The scramble now will be to regain that position, and that can be done only by a slight reduction in prices. The margin left by the export duty is small in the case of high quality teas, but significant enough in the case of common teas which bulk heavily in our exports.

In the case of jute, our export prices were high, but they essentially reflected higher costs. An immediate increase in jute exports is ruled out by the acute shortage of raw jute and by the high cost of imports. Already, the jute industry has had to resort to block closure of mills. The jute mills will now have to pay an extra cost of Rs. 23 crores for the import of $1\frac{1}{2}$ million bales of raw jute and the export duty will add to the bill another Rs. 68 crores.

In the case of oilseeds, production has increased, but there is an acute shortage of edible oils within the country itself. The proportion of oilseeds exported has also been falling. Sugar exports were heavily subsidised and were falling, and recently, as in the case of iron ore, export prices of sugar were declining. So, there can be no special gain here too.

In the case of cotton textiles, the rise in import costs will probably offset the benefits of devaluation. The major hurdle in the case of cotton textiles is not price, but quotas and other curbs placed on the import of Indian textiles by the United States, West Germany and other countries. In fact, in most of the Western markets, we are not priced out so much as shut out by artificial restrictions like tariffs, quotas and internal levies. And this applies not merely to cotton textiles, but also to some of our newer items of manufactured exports.

The list of doubtful beneficiaries is quite long and includes a range of primary and processed products like tobacco, leather, iron ore, cashew kernels, spices, etc. As against this, there is only a small group of products which may derive some incentive from devaluation. This would probably include plastic goods, certain chemicals, certain drugs, some light engineering goods and some consumer goods. But the actual gains will be limited by two factors—higher costs, following devaluation, of materials and equipment used in the production, and generally inflationary conditions in the country.

One should also realise that any possible increase in the export of these products will not be of such a large order as to make a substantial difference to the small export picture. Engineering goods account for only two per cent of our exports today. We cannot push these exports in a short period of time to a point where the setback in other fields will be of minor consequence, and the gains here so significant as to eliminate or reduce sharply the trade deficits we have been nursing. My fear is that, by the time we begin to step up the exports of manufactured goods significantly, the devaluation of the rupee would have been eroded fully.

Now let us look at the import picture. The import prices will shoot up automatically. Since the import content in our manufactured exports varies, it is not possible to determine precisely the likely impact of the higher import prices on these products. But the overall effects may be quite serious. In addition to the cost of the goods, one must realise that there is a whole range of services, such as freight, insurance and other handling charges, to pay for, and all these will be marked up. My rough guess is that import costs will go up by anything between 20 to 25 per cent, even after making allowance for the reduction in the basic import levy announced by the Government. And this sharp and sudden

increase in import costs will be a setback to those nascent industries which were reckoning on an immediate breakthrough.

As for the balance of payments, I see no hope of relief. We may be in for more trouble. There is a built-in contradiction in our approach to devaluation. Devaluation is supposed to discourage imports, but we are actually looking forward to larger imports. The larger and more expensive imports will increase our trade deficit, not reduce it. The magnitude will be reduced only to the extent we are able to increase our export earnings sharply and significantly, the foreseeable prospects of which are dim.

Whether devaluation will induce a larger inflow of private foreign capital is perhaps a matter of opinion. On the face of it, the average investor now has an initial advantage in transferring his capital to India. But when it comes to remittance of dividends, profits and capital back home, the investor will be a loser. One wonders whether this will not be a formidable disincentive since the foreign investor is unlikely to prize an initial advantage and discount the subsequent returns.

Similarly, in the case of invisibles, the initial inducement can be illusory. The firm in London which used to remit to India, say £ 100 a month in order to maintain some Indian branch services at a level of Rs. 1,333, will not increase the remittance simply because there is an inducement offered by devaluation. It is more likely that the London firm will want to bring down its remittance in Sterling from £ 100 to say, £ 63, because it is mainly interested in maintaining the rupee expenditure, not increasing it.

There really is no basis for us to imagine that devaluation will provide an answer to India's problems today, problems

which in the ultimate analysis, boil down to poverty, economic mismanagement leading to inflation and, more recently, a tendency for unrestrained dependence on foreign aid and doles. Problems such as these can be tackled only by economic policy, not by a devaluation. There is a misleading belief that an official fiat, changing the par value of the rupee, will work wonders. But it is doubtful even if the so-called corrected official rate of exchange will ultimately determine the real value of the rupee.

In the first place, the notion that the Indian rupee is overvalued is largely based on the unofficial values quoted in the black market for foreign currencies. These values can certainly not be taken as an appropriate measure of the appreciation or depreciation of a currency when there is a tight import control and foreign exchange allocation, a vigorous policy of tariff protection and a flourishing business in smuggled imported goods. To a certain extent, the unofficial rates reflect the profitability of dealing in smuggled goods in a newly industrialising economy. They partly reflect also the inadequacy of economic management and the trail of inflation. Weaknesses and distortions such as these cannot be corrected by a flat devaluation.

If it is doubtful whether devaluation will discourage gold smuggling which has been draining our foreign exchange resources surreptitiously. My own feeling is that devaluation may increase gold smuggling because of the prospects of larger profits in rupee terms on the one hand, and the uncertainties about economic stability created by devaluation on the other.

Thus, while there are no significant or perceptible gains from devaluation, the unfortunate thing is that the economy will be saddled with newer burdens. The Reserve Bank Governor's suggestions at his Calcutta press conference (*The Statesman*, June 8) that the budget would be in balance, be-

cause the revenue losses on account of cut in import levies and the increase in food subsidies etc. would be offset by the gains from new export levies, are, I must say, of superficial propagandist value. Such naive claims ignore the detailed impact of devaluation on the budgetary position. Devaluation would have put up the costs of a whole range of items in the budget. The defence budget, for example, will shoot up. The Government's import expenditure will increase. Many project costs will go up. The rupee burden of foreign debt serving will rise and so on and so forth.

As against the increase in the burden of expenditure, there is every likelihood of a fall in certain direct tax revenues. One must at least consider the possibility that, because of the abrupt increase in costs and the resultant disruption of certain line of production or business programmes, profits and other similar incomes may in such cases be reduced and, consequently, the tax revenues related to such activities may fall. It is unfortunate that the Government did not work out in detail the budgetary implications of devaluation. If it did, it might well have been cautious before taking the plunge. There is now every risk of increased deficit financing to ease the budgetary difficulties. The net result we will see as time passes being reflected in further distortions in the economy, of which the pressure on costs and prices will be one outward manifestation.

We have already seen that our industries will now pay more for imports of machinery, capital goods, equipment and almost everything else. The tax payer will now pay more for imported food in one way or another. There will be more to pay by way of freight and other service charges on food imports. PL 480 supplies already cost the country roughly Rs. 110 crores every year by way of freight and other charges. The freight bill on the proposed 14 million tonnes of PL 480 imports will go up roughly by Rs. 50 crores to Rs. 84 crores. If, as the Government says, the imported food grains will be

subsidised to the public, the subsidy will cost the exchequer anything between Rs. 150—160 crores. Who is going to pay for all this? The tax payer, of course.

As a result of devaluation, the cost of all subsidies, including food, kerosene, petroleum products, fertilizer etc. will probably add up to a formidable bill of the order of Rs. 250 to Rs. 300 crores. These figures are rough but they illustrate the magnitude of the new burdens which the Government has imposed on the budget and on the people. Any suggestion that this burden will be offset by increased revenue from export duties or anywhere else can be lightly dismissed. I think the net burdens will increase further, not decrease, because in addition to the subsidies on food, fertiliser etc., there is also a lowering of import levies in certain cases and there will now be a tendency to revive the much—maligned export incentive schemes by the backdoor in order to counteract the adverse effects on certain export products.

Any real reduction in export prices can be ruled out so long as domestic costs of production do not fall. In a situation where inflation will gain, costs can only go up. An artificial fall in export prices will reduce the profit margin of exports and discourage the creation of additional capacity, if not the fuller use of existing capacity.

Theoretically, devaluation should not by itself cause an internal price rise. But, in practice, this again does not work out so in an economy of shortages. Prices do not rise and fall according to a set formula. In most cases, the change in prices is a strange and a seemingly illogical reaction to a set of decisions, measures, attitudes and expectations. In our country, where the distribution system is not well organised and there is really no such thing as a distribution policy in important sectors of the economy, I have a great fear that costs and prices will rise pretty sharply in many cases, even where import duties

may have been lowered or eliminated and then will follow the usual cumulative process. Since we have already an acute shortage of food and most other consumer goods, only the area of distress will now be widened. Prices of industrial products would be pushed, I think, by anything between 10 to 20 per cent very soon. All this means that we will get deeper into the vicious cycle of inflationary pressures leading to greater inflationary pressures.

The revival of special incentives for exports is inevitable because the Government will want to bring about an increase in exports to throw dust into the eyes of the public by attributing the gains to devaluation. And the tax payers will pay for this too without even knowing about it.

Since the Government has devalued the rupee as the price for aid under Washington's pressures without carefully analysing the economic facts of life, it reinforces the impression that it has exposed itself to further external pressures from the World Bank or the U.S. which could be reflected in other similar miscalculated decisions. With one thing leading to another, today it is devaluation, tomorrow it may be some other undesirable change in policy (what is desirable is understandable). There are already moves in the U.S. to force India to grow less cotton and divert the present cotton acreage to food. The Government has not reacted, ostensibly because it has no official intimation. The logic of the situation will perhaps lead to a position where India's dependence on other countries will increase and with that will increase pressures on the payments position and on the economy. Here I am not discussing the political implications of such a situation which are, I may say, no less serious than the purely economic.

What do we do now, after having taken a miscalculated plunge like that of the Hat Yogi? We can only cut our losses and forget the gains. We have to recapture our sense of

direction and revive our faith in our people and in our own spirit of nationalism, and in the resilience of the economy. This may encourage us to take some decisions which may not be attractive to superficial politicians, who may tend to place their own, or their party's, interests before the interests of the country.

Economic policy must consciously aim at higher production, lower costs and discourage rising prices. I do not seriously believe that we can lower prices very much. But we can certainly prevent a sharp increase in prices of important commodities. Temporarily, we will get some aid (because that was linked with devaluation) and that will permit the Government to liberalise imports. But this liberalisation of imports will be restricted only to materials and components which we cannot eat. This means that the import surplus that we run will not help us in augmenting domestic supplies of goods and services to counteract inflationary effects of the present policies. The indirect effects of increased imports, inducing larger industrial output, cannot conceivably be significant enough to offset the inflationary pressures stemming from higher likely costs and larger rupee expenditures in general.

If we are to deal with inflationary pressures seriously, there must be a drastic curb on private and public expenditures. I would suggest a ban on all major new private and public sector investments involving free currency outlays for a year or two. I think it is necessary because our defence expenditure has to continue and its burden is going to increase as a result of devaluation.

Perhaps we should also make it a penal offence to indulge in ostentatious expenditures on housing, public buildings, public functions, including marriage ceremonies. Public buildings are a scandal in our country today. Their size,

structure, fittings and furnishings, and everything about them are out of all proportion to the poverty of this country and to the agonising inflationary pressures on the economy. In the last five years, public buildings must have involved an expenditure of over Rs. 3,000 crores. If this is not scandalous, I should like to know what is? There also ought to be a very high tax on transactions in real estate.

The Government has set a bad example to landed proprietor and contractors who try to outdo ministers and other VIPs (the concept of a VIP in a miserably poor country seems to me rather undemocratic) in their housing, entertainment and general way of living. So, ministers must set the example by adopting a way of life which is more in line with the general conditions in this country. This will at once cut out the budgetary burden of official pomp and show and induce a reduction in the ostentatious expenditures pressing on the economy generally.

It is also imperative now for the Government to pursue a conscious policy to reduce our aid commitments and to check wasteful investments. My suggestion would be to recast the Fourth Plan completely and base it essentially on our own resources. It is a great pity that, in the last few years, planning has become foreign-oriented, just as food policy is becoming foreign-oriented. A plan is meaningful only if it is related to planned allocation of our own resources, not of other people's. A plan involving an absurd increase in foreign debt of this country will make the condition of the economy worse than that of the Hat Yogi.

A Fourth Plan, involving Rs. 4,800 crores of foreign aid and rupee investment about five times as large, will not merely unleash further inflation, but also increase our dependence on other countries and barter away the welfare of the future

generation and condemn it to the kind of misery which the present generation has been called upon to suffer.

I might make one more point. I think we now ought to abandon the recent concepts of planning for import surpluses. These concepts have led to an obsession with foreign aid and have, consequently, encouraged economic mismanagement, laxity in spending, and neglect of the difficult, but critical, task of controlling costs, increasing productivity and making the most of every rupee. Planning must now aim at progressively curtailing import surpluses and generally achieving a balance between external receipts and payments. This is another way of saying the obvious—we must strengthen our balance of payments. But the logic of what is obvious is not easily accepted by the Government—setting of limits on foreign debt instead of negotiating for an increase, reducing food imports, and concentrating essentially on the use of India's own resources.

For the next two years, the Government should plan for a more effective exploitation of our own available resources in men and materials. Isn't it about time we became really serious about food production and distribution? Isn't it about time we asked the Chief Minister to take on the portfolio of agriculture and pay political penalties for failure to deliver the goods? Is it not about time we accepted the concept of political penalty for inefficiency and economic failures?

Industry-wise a programme can be prepared for increasing production, with targets for each major factory and with an element of compulsion for diverting certain production to export. Institutions may have to be created to procure supplies at the source for export. This is particularly important, if we have to step up exports immediately, as indeed we have got to. Here, too, compulsion may become necessary to divert large supplies to export of commodities which have a ready market abroad and a growing demand in the country, as in the case

of cashew nuts, tea, coffee etc. Nobody in this country will die of starvation for want of cashew nuts or extra tea.

The poor people in our country can be protected from the evil effects of the present policies only if the Government is able to formulate and, more important, implement a distribution policy. By this I mean not merely distribution of essential commodities, but also distribution of income. The setting up of control rooms and observation towers will not reduce prices. Nor will a two-year programme or a five-year plan for consumer stores provide the consumers with consumer goods at fair prices. Without a proper distribution policy, we are doomed to higher prices, unless the Government procures at the source of supply and rations out in major towns normal consumption goods, such as food, clothing, essential drugs, salt, edible oils, kerosene, pulses and sugar. There can be little hope of preventing further increase in prices of essential consumer goods, if the Government continue to substitute PL 480 for a foodgrain production and distribution policy, and also continues to indulge in wishful thinking about the impact of so-called co-operatives on the national price structures. The co-operatives have failed to have any sustained influence on the price spiral. In many cases, they aggravated the price distortions, particularly by encouraging the illusion in New Delhi that organisation of some co-ops. can hold prices.

If the Government is able to formulate an effective distribution policy, weaving in a system of rationing for essential goods, it should be possible to enforce a wage-salary freeze for a period of time also. At least, there will be an effective argument for such a freeze, when real benefits are conferred and an erosion of income averted. This approach should have a wholesome effect on the economy and mitigate, to some extent, the inflationary pressures. A dozen of Pant markets can not be a substitute to an economic policy. An imaginative system

of distribution will also have to be supplemented by fiscal measures to mobilise savings, particularly in those areas where there are likely to be windfall gains from devaluation. Taxation may have to be reduced to lower the burdens on the people, but in the context of inflationary pressures, this will be justified only if there are substantial economies achieved elsewhere and the Plan and investment policy are also recast suitably.

Another important thing the Government ought to do is to seek re-negotiation of the agreements concerning the disbursement of PL 480 funds. Under the new terms of agreement, 25 per cent of the PL 480 counterpart funds will be made over to the US Government for disbursements here and partly abroad. There is a convertibility element involved in this and also threat of inflationary pressures, apart from political complication. The unexpended amount of US Government's PL 480 funds stood at Rs. 398 crores at the end of March this year. There will be a 57 per cent mark-up in the counterpart funds on all new supplies of PL 480 foodgrains, and these are swelling everyday. As against this, the country will be deprived of the slender accrual of dollars to our foreign exchange reserves because of the US insistence on the scale of rupees by its Embassy to American tourists coming to this country. I think we ought to take some remedial action before it is too late.

Since export we must, the Government will have to adopt measures to mobilise surpluses with an element of compulsion. Perhaps even the new incentives to export industries may have to be linked, directly and effectively, to actual exports. We are in a crisis not of our choosing but we have all got to pull the country out of it because the country belongs to us.

Impact of Devaluation on Prices

Virendra Agarwala

Devaluation must now be accepted as a settled fact. The Finance Minister has categorically denied that the Government has been pressurised by the International Monetary Fund though the Western press has been jubilant. The IMF may not have served any ultimatum that the foreign aid would be resumed only when the rupee is devalued but still their advice has proved most effective. At this stage, it is not at all worthwhile to impute motive on the part of its authors though the national interests have been sacrificed.

The Finance Minister has claimed that devaluation would provide a better corrective to the price rise and distortion of the past than the remedial measures pursued so far by the Government. He could have done a better job if he would have dwelt on the alternatives for boosting the economy. None can deny that the mere fact---that the devaluation had to be resorted reveals that Government's economic policies have a miserable failure. It is true that when the Government was not able to enforce strict discipline in its own functioning and was not in a mood to bring about a radical change in its economic policies then there was no other alternative but to devalue the rupee. The Government's prolonged silence had indicated that such a step, however disadvantageous it may ultimately prove, could not be postponed for long.

The decision obviously means that the Government deems the external position so bad that the rupee had declined from the official rate of 20 U. S. cents to 10 cents last month. It is

often argued that 56 countries in the world are still following multiple rate system which means different rates for exports, imports and tourists. It appears that the Government was required to act in haste and it hardly found time to take all these alternatives into full consideration. It was also repeatedly suggested that Registered Mark could have been introduced at approximately 50 per cent more to tourists. It could have served exactly the same purpose what the devaluation is sought to achieve. It had worked well in the German Republic during the inter-war period. The Finance Minister has liberally quoted the instances of France and Yugoslavia but it is not necessary that the conditions prevailing in those countries were similar to those now existing in India. The arguments which are now advanced in favour of devaluation were used against devaluation till yesterday. A State Minister has remarked that the disadvantages of devaluation will far out-weigh its advantages.

A person no less than Shri P. C. Bhattacharpya, Governor of the Reserve Bank has declared that the devaluation of the rupee is no panacea for the economic ills of the country. It is widely felt that devaluation must be accompanied by other fortifying steps to get the real benefit on the economic front. Otherwise it will only be a recognition of the crumbling state of the rupee. The Government should be bold enough to accept the failure of the past policies. It is not too late to take all such necessary steps to bring about a radical change in the basic policies so that the corporate sector could assume greater responsibility for accelerating the rate of economic growth. The steps required to push forward the wheels of production are widely known. They hardly need to be enumerated but what we need today is to translate them into specific action. It is widely known that production remains to be the key for most of the economic problems. All controls and such regulations which have hampered the growth of industrialisation

must be removed. It is obvious that many industries would be required to be setup : therefore, the industries Development and Regulation Act needs to be accordingly modified. It is not merely liberalisation of imported raw material and other components but the licensing system must be simplified and procedural delays need to be avoided. It should actually result in maximum use of the installed capacity. Secondly, the Government must show its capacity to effect economies in non-plan expenditure. There must be ruthless pruning of every item which does not have a direct bearing on development. Whatever the former Finance Minister had promised to reduce the civil expenditure by 10 per cent needs to be given a practical shape. All unproductive and wasteful expenditure must be altogether eliminated. Thirdly, the Fourth Plan needs to be so formulated that the targets are related to the physical resources available. The basic industries in the public sector need to be so phased that their gestation period does not necessarily become an unbearable burden on growth. Agriculture and consumer goods industries should receive the highest priority so that the market is flooded with farm products and such other essential items that the price index becomes stable and last but not least the simplification and rationalisation of the tax structure. It is widely appreciated that the individual corporations must be provided with such incentives so that the production capacity is further expanded to meet the growing demand for consumer goods. To keep the prices low and encourage production, there must be a substantial reduction in both direct and indirect taxes. The Reserve Bank has rightly pointed out that devaluation has to be supplemented by the strictest fiscal and monetary discipline to prevent aggravation of the inflationary pressure and by increased agriculture and industrial production. It is believed that if all these steps are simultaneously worked out then the ill-effects of devaluation on the price index may be nullified to some extent. It is for the national leadership to be effective enough to take such bold

steps to contain the new dangers and make good use of the new opportunities.

The Government has claimed that both devaluation and liberalisation of imports taken together would result in higher exports, curtailment in imports and self sufficiency. The Government is likely to lose about Rs. 120 crores on account of downward revision of import duties on machinery, primary raw materials, other raw materials, and intermediaries and another Rs. 45 crores on major petroleum products. This would be covered by the import duty on 12 items (estimated to yield Rs. 140 crores) and another Rs. 25 crores from abolition of export tax credit and other measures. It is claimed that the overall budgetary position would not be worse but it might even show improvement. Such window dressing may help in improving the budgetary imbalance. But it is widely known that the devaluation should reasonably effect the budgetary position in many ways for instance through adjustment in customs and excise duties and export taxes. The rupee value of the debt services charges would naturally go up. It has been argued that Finance Minister should better present a revised budget to Parliament when it meets for the monsoon session.

Whatever the Government may say in respect of the twin objectives of devaluation, it is almost certain that it cannot help either in promoting exports or to reduce imports. The Ministry of Commerce had pointed out that almost 80 per cent of the exports are so inelastic that they cannot be expected to earn more foreign exchange. A Government's report says that out of India's total exports to the value of Rs. 807 crores in 1965, nearly 83 per cent moved out more or less at world parity of prices and only about 17 per cent requiring Government subsidy because of the difference between internal prices and world prices. Our imports are rigidly controlled and are of

such nature as essential to us for furthering and consolidating our economic development. There is no possibility of reducing our imports and they are likely to go up if we have to accelerate the rate of economic growth. In fact devaluation could not be postponed for another period of six months or so for the simple reason that an absence of imports in this country affecting the industries could have resulted in mass unemployment. The immediate short term goal, of course, is larger imports of vital raw materials, spares and components for want of which a large portion of the industrial capacity is lying idle today.

The common man is so much perturbed because of its adverse repercussion on the price index that he is not in a mood to appreciate that devaluation can ever help in arresting the price spiral. The Finance Minister himself has admitted that some rise in the prices of products of industries which depend on imported components and raw materials is inevitable. But this rise is likely to be much more than he believes. Almost all imported items of consumption are either not available or their prices have already shot up by 20 to 80 per cent. A number of Ordinances are also likely to be issued so that such traders who are indulging in hoarding or profiteering are awarded exemplary punishments. A permanent watch dog committee has also been constituted to study the state of economy closely and initiate remedial measures when necessary. The Finance Minister has asserted that in the sphere of indigenous commodities the purchasing power of the rupee should not in any way be affected by devaluation. Quick decisions have also been taken for making available larger supplies of certain commodities, including vegetable oils, kerosene, diesel oil and raw cotton so that the consumers are not put to any hardship. The Government has also decided to subsidise a larger number of essential items of common consumption. It is clear from all these steps that the Government has a fair appreciation of the likely consequences of devaluation. It is absolutely essential that devalua-

tion does not result in prices getting out of hand. The next few months are a period of trial and if the Government succeeds in preventing inflationary pressures gathering momentum then devaluation may have positive role in economic growth.

It is true that we are passing through the most difficult and crucial period since the very first year of independence. Therefore the Government is not at all required to feel shy to admit that the money lender has got the inherent right to judge whether the debtor has acquired the capacity to repay the loans. Devaluation may prove disastrous if it is not accompanied by the delicensing of industry, removal of controls and scaling down of unproductive administrative expenditure. The Government has a good deal of responsibility to see that prices atleast of indigenous items do not rise because of its own actions. Devaluation will nevertheless prove a supreme sacrifice, the people of this country have been called upon to make for the mistakes committed by the planners. But the people are now required to convince themselves that it is their determined effort and patriotic fervour needed to defend their rupee can only help the critical situation. Devaluation may be an act of compulsion but the ultimate justification will have to be found in terms of the action that follows it and the success that attend the efforts to impart dynamism to the economy.

Round-up of Reactions

A. PRESS

(a) Foreign

The New York Times (June 6, 1966), in an article by J. Anthony Lukas, said :

The United States and International Bank for Reconstruction and Development had been pressing for Devaluation as one of the measures to get the Indian economy moving. Increased Western aid for India's fourth five-year plan had been held up until India acted on these recommendations.

The Daily Telegraph, in a Delhi despatch by Rawle Knox, said :

The decision in fact is believed not to have been his (Finance Minister's) but that of Mr. Subramaniam, Food Minister, and Mr. Asoka Mehta, Planning Minister, both of whom have recently visited the United States and been firmly given their working orders by the International Monetary Fund.

The Guardian (June 7, 1966) Madras Correspondent wrote :

Judging by reaction here, devaluation of Indian rupee announced is unlikely to be popular. It could create political crisis in spite of the fact that inevitability of devaluation is conceded by many Indians.

There is a general belief in the country by no means wholly unjustified • that rupee is being crucified as a result of

pressure from International Monetary Fund, World Bank and the United States. It is no secret here that the Congress President Mr. Kamraj strongly advised Prime Minister against devaluing rupee and that four senior Cabinet Ministers were as strongly opposed to devaluation.

The Daily Telegraph (June 6, 1966) commenting editorially under the heading 'Realistic Rupee' said :

Yesterday's devaluation is certainly sensational, but hardly too sensational. The step is long overdue. Failure to take it before has meant for Indian people much unnecessary suffering. Why was it so long postponed? For any reason one must search the psychology of India's rulers, with their melancholy conviction doubtless inherited in part from us that economic reality could in some way be kept Canute-like at bay by strict controls and restrictions, by the proliferation of grandiose paper plans, and in this case by rigid adherence to an arbitrarily fixed and totally unrealistic exchange rate.

There have been several signs lately that the Indian Government might be coming to its senses. Various factors have played their part in the grim educative process : severe droughts, with consequent famine or what looks like it ; reduced aid prospects since the war with Pakistan ; outflow of capital ; increased gold hoarding ; an ever-deteriorating balance of payments. Pressure from the World Bank and from Washington must not be discounted either.

Some credit must nonetheless go to Mrs. Gandhi and her advisers. What they now do runs counter to all their preconceptions. The pressures to which they have been exposed, moreover (the last-mentioned in particular), might well have confirmed them in obstinate folly. They have had the courage to recognise their friends and to accept their advice on how disaster may yet be averted. Certain good consequences

will flow from devaluation itself—notably a great increase in India's power to export. Others should follow as potential donors become convinced that aid need not necessarily disappear down the drain.

The Financial Times (June 7), Foreign Editor wrote :

Devaluation of the Indian rupee by fairly drastic rate of 36.5 per cent must have taken even the World Bank and the Americans by surprise although they were the strongest advocates of such a step. Every member of the Indian Cabinet was against devaluation and successive Finance Ministers put out their denials as though they really meant them—and yet India has finally taken the plunge.

Mrs. Gandhi has shown great political courage in going the whole hog. Will her Finance Minister now have skill to turn opportunity such as it is into achievement ?

City Editor writing on the Business Page of *The Times* (June 7, 1966) commented :

How stable the new rates for the Indian rupee will prove depends greatly on the aid that is now forthcoming from the United States. For the devaluation, long resisted by the Indian authorities, together with the accompanying measures, seem plainly to have been effected to placate in particular, the World Bank and the U. S. Administration. The hope must now be that considerable financial assistance will shortly be rendered and that the Aid-India consortium will at last be revived. If the Indian economy can thus be launched forward again, the devalued worth, in sterling terms, of British business interests in India should be more than offset. Britain's investments at books value are put at £580m., between 600 and 700 manufacturers having subsidiaries there.

Clyde H. Farnsworth, in an article in *The New York Times* (June 7), noted :

Devaluation of the rupee will have little direct effect on British payments. Though in the short term it devalues the sterling worth of Britain's substantial investment stake in India, and all permitted profits, Britain's biggest purchase from India is tea, which will still continue to be sold at world prices.

The U.S.A.'s *Baltimore Sun* (June 7, 1966) said :

The Indian devaluation is an act of boldness none less admirable because there was no real alternative. The effect will be harsh on millions of Indians already living at poverty levels inconceivable even to American poor though Government aid is pledged. It will make imports that much more expensive. But it will down price Indian exports things like textiles in which India is the third largest producer in the world. This should boost sales in world markets and over long haul more exports will mean more imports.

Canada's *Globe And Mail* (June 7, 1966) published a despatch from David Van Praagh quoting a Western trade official in Delhi commenting that the Government could generally hold the price line if as intended devaluation brings fuller use of the industrial capacity.

The despatch reported the Western economic expert saying that devaluation was the only way to correct the structural imbalance in the Indian economy and that trade would now find its own level.

Dawn (June 7) from Pakistan Commented :

It is gratifying to note that this country is under no compulsion to follow in India's footsteps:

By and large our exportable primary commodities will remain unaffected by the Indian measure. But the lowering of the price of the Indian exports of manufactures may in some way affect the competitive strength of the manufactures in which we already possess or are keen to develop an export market. If it does, appropriate measures will be urgently required to prevent any weakening of the export drive.

(b) *Indian*

Hailing the devaluation decision *The Statesman* (June 6) said :

With devaluation of the rupee India takes a very big step towards putting its economic house in order. An artificial parity was not only aggravating the balance of payments problem by pricing India out of export markets and diverting in-coming remittances to non-banking channels, it was also distorting the basic decisions on economic priorities.

There is no denying that the devaluation decision is linked one way or another to aid. But to look upon it as an instance of arm twisting by the aid-givers is to lose sight of the realities of the Indian situation. The steady decline in reserves since the end of 1964 had left India very vulnerable indeed ; a change in parity might have had to be made a good deal earlier but for the emergency assistance provided by the International Monetary Fund in February 1965 and again this year. Having completed this piece of cleaning up, India can now count upon further help from the IMF to tide her over the difficult transition period that lies ahead. The decision provides striking evidence of India's willingness to face up to the challenges of the present situation which should finally convince her friends that any assistance they offer for the Fourth Plan will be put to good use in the cause of self-reliance. The courage of the Government is grasping the nettle is sure to win admiration ; devaluation is

a difficult decision to take at any time but especially so nine months ahead of a general election.

The Hindustan Times (June 7) called the drastic alteration in the external value of the rupee as "much more than a technical correction of a chronic imbalance in our external payments position" and proceeded to say :

If devaluation is understood as the first step in a process of rectification of the basic untenability of an economy with a currency undoubtedly overvalued in terms of its price among its peers, and which, for that reason, cannot be assisted to achieve dynamism, however massive the assistance, then it may be said to constitute an act of faith. If this necessary fundamental correction is followed by a series of related policies, the economy may engender a measure of dynamism which may well pull the country out of its present stagnation.

The essential ingredients of the related policy package are three : first, imports will be liberalized both in quantum and ease of availability, though not in their rupee price; secondly, such liberal imports will be financed by special assistance from the IMF and the World Bank ; thirdly, the economy will be freed of the constrictions of the control mechanism so that the consequential productive elan can turn into full account the liberalized imports.

All this is not to say that the decision to devalue the rupee had not created a number of problems or that it is free from hazards. The rupee costs of imports are sure to offer difficulties, especially in the context of finding the funds for capital imports. Secondly, the pressure on prices within the economy will certainly be great. The kind of argument that seeks to minimize it by saying that in strict logic wholly indigenously produced articles should not cost more is extraordinarily naive since it ignores, among other things, the impact of the

new policy on internal money generation. But the best hopes of combating these pressures lie in the spurt in production consequent on liberal imports and the untrammelled functioning of the economy.

Describing the measure as a "Grievous decision" the Financial Editor, *Indian Express* (June 6) commented :

It is the inescapable price the country has to pay for its gay indulgence in grandiose planning, consequent unbridled Government spending and generally living far beyond its means over a number of years. It is obviously the price for foreign aid on a grand scale being sought by our country from the world finance institutions and from Western countries, to whose pressures the Indian Government has had to yield.

It is an open secret that recent missions from the World Bank and the International Monetary Fund have been seriously canvassing devaluation of the rupee all over the world. If the suggestions were turned down earlier on the grounds that the country's production and exports were inelastic, and that it would reduce its export earnings and increase import bill, nothing whatever has happened in recent weeks for the Government to change its stand.

It is true that the price of foreign exchange should be fixed on the basis of strictly economic considerations and it should reflect economic realities. But this argument holds no promise that the Government and the Congress leadership which dictates to it the national economic policy, have learnt their lesson.

If the Government still does not mend its ways and does not foster the spirit of economy, further devaluation may conceivably become warranted precisely on the same ground that the Finance Minister has advanced.

Under the caption "After Devaluation What", *The Hindu* (June 7) wrote :

While it would be absurd to argue, however unpleasant devaluation may be, that it is not a measure that has been taken on account of the inherent factors affecting the rupee's external value, it cannot be denied that the extremely knotty problem of securing foreign aid of the dimensions required has compelled the Government to pay more attention to the advice of the World Bank and the I.M.F. than it would have otherwise done.

It is clear from Mr. Chaudhuri's broadcast that the Government has a fair measure of the consequences of devaluation. The changes in the import tariffs that have been announced are intended to reduce the impact of devaluation on the rupee prices of essential imports. The Government must be prepared to abolish completely the duties on machinery and spare parts which are vitally necessary and retain low duties on those which are not manufactured in adequate volume in the country. If the Government is to answer satisfactorily those opposed to devaluation, it would have to institute new policies so as to ensure that there will be no sharp rise in the capital costs of new industries. The promise of greater liberalisation of imports and relaxation of the many vexations associated with import and exchange licensing procedures could, if it is honoured promptly and fully, go far towards making devaluation the prelude to a realistic development of the economy.

It is, however, as a means of providing a much-needed stimulus to exports that devaluation has been welcomed in the past. In the Indian context, the argument against devaluation has been that over 80 per cent of our export earnings are from commodities the external demand for which is not likely to increase substantially by competitive reduction in prices. While this is true, the Government's major hopes of increasing exports

are based on building up trade in new lines like textiles, light engineering goods, etc., in which the price factor is no small element. Here again a great deal would depend on how these hopes are translated into fruitful action through intelligent planning and harder work.

Devaluation as such is no solution to the basic problems we confront. They stem largely from a grievous failure in the past to relate economic performance to investmental outlays, to promote the all-round disciplines required in a developing economy, to exercise restraints on inflationary finance, and to release the economy from the burdens of regulations and taxes which have had a stifling effect on growth. Unless in all these respects there is a real break with the past we may have more trouble to face in the future.

The Eastern Economist (June 10): The Finance Minister had inevitably been led to dramatising the possible gains from devaluation while glossing over the probable losses. His most melodramatic declaration in this regard was, of course, his scare-mongering assertion at his press conference that the Government had waited long enough and that, had they deferred devaluation any further, there would have been an absence of imports leading to a genuine fear of mass unemployment. This, of course, is plain nonsense.

Even the increased export earnings that may be expected will not be realised quickly enough for Shri Chaudhuri to stave off the mass unemployment which he fears.

So far as the immediate liberalisation of imports is concerned, the export-promoting potentialities of devaluation are irrelevant. The only way we could liberalise the import of essential components and raw materials in the short period is to fortify ourselves with foreign exchange resources provided by sources such as the International Monetary Fund and the Aid-

India Consortium for balance-of-payment support and maintenance imports.

It is surely pathetic that the Finance Minister and his official advisers should attempt to wish away the price problem as they have been trying to do. Unfortunately for these optimists, the economy does not work in water-tight compartments. The Government will have to be very circumspect indeed in assessing the direct and indirect impact of devaluation and its consequences on the price level in a basically inflationary situation.

Indian Finance (June 11) : We are not convinced yet that we are out of the economic woods, for all the brave explanations advanced by the Finance Minister and the Governor of the Reserve Bank. However, it is conceded that at some time the erosion in the value of the rupee consequent on the inflationary spending under the Plans had to be corrected by 'formal' devaluation. But such corrective devaluation would help only if at the time there were in the country an exportable surplus that could not be sold abroad only because of price and cost considerations.

Whether it is the imported raw material itself, or the manufactured article, it will be necessary for both Government and industry to strengthen the distributive apparatus.

The Economic Times (June 7) which characterised the step as an "Ill-Advised Plunge" in a lengthy editorial, commented :

A drastic devaluation of the rupee in a pre-election year can be justified only in terms of an alternative prospect that could be far more embarrassing for the party in power—perhaps a stoppage of aid and a much smaller Plan. But once this political reasoning behind New Delhi's abrupt plunge is explained away, there is little in the devaluation measure to

commend itself as an integral part of a well-considered and constructive economic policy.

In a broadcast to the nation, the former Finance Minister asserted that devaluation is no answer to our basic and immediate problem "which is that of living within our means." He rightly pointed out that our problem here is that of enlarging the base of domestic production and that this task may receive a set-back by a "sharp, sudden and across-the-board increase in the price of all imports." More recently, the annual report of the Ministry of Commerce for 1965-66 ruled out devaluation on the ground that about 80 to 82 per cent, of our export commodities moved at almost the international price and that only about 18 per cent. required substantial assistance in the form of import entitlement or cash subsidy. The report also highlighted the aspect that our foreign trade of about Rs. 2,250 crores works out at only 15 per cent. of the national gross product of about Rs. 15,000 crores. Of this imports amounts to Rs. 1,425 crores and any change in the value of currency will put up the internal costs of all the products made out of these imports in such a manner that both the living standards and the wage structure of the working classes will be "highly distorted and upset." Apart from this, it was pointed out, the exports of items manufactured from these imports will require further heavy subsidies. Has the political and economic equation changed so much in the intervening months that what a Finance Minister has had no hesitation to denounce as an "opiate" and "an enticing but nonetheless illusory short cut" has suddenly become acceptable as a "permanent remedy" to our problems?

The crux of the Indian economic problem is low productivity, unutilised capacity, high costs, all of which boil down to production. The obsession with foreign exchange shortage and exports has unfortunately tended to devalue this primary role of

production. Surely, an incentive to exports of this nature would have been justified if the country was plagued with export surpluses that could not find their way to foreign markets because of price competition. But the Commerce Ministry's finding has exploded this myth and shown how pathetically the country is dependent on higher imports and production for boosting exports, with or without devaluation.

To what extent will devaluation act as an incentive to the inflow of foreign private capital is also a matter of opinion, for the average investor abroad thinks not only in terms of the initial advantage in transferring funds to India, but also the terms of recurring repatriation of rupee profits and dividends back home.

Both from the short-term and long-term angles, two major aspects that induce caution are the unhealthy repercussions that devaluation is bound to have on the domestic industrial cost structure and the money market. To the extent that the money market will now have to accommodate not only the increased costs on current imports but also the higher imports that are assured to be under way, the scramble for rupee finance may become more pronounced.

Commodity-wise, the decision to levy export duties on leading export items, ostensibly to avert the danger of a precipitous decline in export prices, may prove to be a drag.

The evil effects of devaluation can be countered only by an increase in exports (which remains as hard as before) or by a cut in costs. Any real reduction in export prices can be ruled out so long as domestic costs of production are not reduced. A fall in export prices as a result of devaluation will mean a depletion of the profit-margin on exports, and this in turn will affect the creation in additional capacity, if not the

maintenance of existing capacity. This creates a vicious circle because without an increase in our production and in our exportable surplus, devaluation has no meaning.

The hope that prohibitive import prices will inspire substitution in industries is rather slim, because any creation of such specialised capacity will call for, at least initially, considerable investment in imported plant and equipment.

Viewed from any angle, New Delhi seems to have been singularly ill-advised in discarding flexibility and selectivity of import duties and export incentive schemes in favour of a blanket, indiscriminate measure that has so little to offer in the direction of both export promotion and import substitution especially in the Indian context of economic development and technology. It may be that devaluation may herald a temporary spell of economic euphoria flowing from closer accord and amity with our foreign lenders and some isolated patches of improved export performance, but when the final reckoning in terms of national costs and higher amortisation and interest charges on foreign loans arrives, devaluation might prove too expensive a luxury that a developing country like India had better refrained from. The best one can hope for in the circumstances is that the jolts and pressures inherent in devaluation will succeed, where others have so woefully failed in the past in laying the foundation for a more enlightened and sounder domestic policy.

B. Political Leaders and Public Men

Shri T. T. Krishnamachari, former Union Finance Minister, commenting on the devaluation [of the rupee, said, "There is no other way than what they have done."

He, however, declined to be drawn into further discussion as he said he was not in power now,

Shri C. Rajagopalachari, founder of the Swatantra Party, said : The devaluation of the rupee is the consequence of mismanagement of affairs during the last 15 years and cannot be helped. It is no good camouflaging the fall in the real value of our rupee. Our insolvency is a fact. This mismanagement must be terminated in 1967. Those who allowed the long misrule have no right to be shocked now. We have to suffer the distress caused by the devaluation.

Shri V. K. Krishna Menon said that apart from adverse effects both internally and externally, the devaluation would undermine the confidence of the people because the Government had been swearing that it would not devalue the rupee. The effect will be both internal and external as our liabilities abroad will increase.

It will be wrong to view it merely as a problem of economic technocracy. This will have a social impact, particularly on the morale of the people.

I cannot help thinking that we are up against the consequences of indiscriminate dependence on foreign aid and lavish imports under P.L. 480. The nation has to now pull itself out of this state of affairs.

Shri Bhupesh Gupta, leader of the Indian Communist Party, who bitterly criticized the measure, said that "India will be fleeced to the bone" by the devaluation of the rupee.

Shri Gupta further characterised the devaluation as the "greatest betrayal of national interests since independence."

The Government has yielded to the pressure of Washington and London. By this action, the Government has hit all sections of the people, including businessmen and industrialists. Once we used to boast of the stability of the

rupee. But now, not only the rupee has been devalued but India's creditworthiness abroad has been seriously damaged.

Prof. Hiren Mukherjee, leader of the right Communist group in Parliament, in describing the decision as the Government's latest surrender to Western capitalist interests, said this was reprehensible. The Government's dismal record ensured that the economy would totter and prices soar.

It was most extraordinary, he said, that after repudiating repeatedly that the Government had any intention to devalue the rupee and "bundling" off Parliament, the Government should announce its decision.

Shri A. K. Gopalan, left Communist M.P. said the devaluation—coming after categorical statements in Parliament that there would be no devaluation—showed that the ruling party had no respect for parliamentary democracy.

National honour, dignity, self-reliance and economic independence had all been reduced to mere "vote-catching phrases."

Shri Dahyabhai V. Patel, M. P., Swatantra leader, said : Devaluation was the "heavy price" that the people of this country were forced to pay for the "fiscal indiscipline" of the Congress Government.

"Taking the easy and irresponsible road of deficit financing for finding resources for its grandiose plans has become a habit with the Government during the past decade."

"Where will the growing and new industries find the capital to finance the extra cost arising from deferred payment dues, higher costs of raw material imports and essential parts," he asked,

The myth of the benefit of the rupee payment agreement would now stand exposed since all rupee payment agreements and invoices of imports of spares under them had a clause linking the price not to the rupee or the currency of that country but to gold, he said.

Shri A. B. Vajpayee, leader of the Jan Sangh group in the Rajya Sabha, said : The Jan Sangh will join any opposition move to censure the 'Indira Ministry' for its 'wholly unexpected and dangerous' decision on devaluation.

Dr. Ram Manohar Lohia : The future generation will have cause to curse the present generation for burdening it with loans and debts stemming not from expansion of the economy, but from current expense.

Shri S. N. Dwivedi, M. P., leader of the P.S.P. group in Lok Sabha termed the Union Cabinet's decision to devalue the rupee when Parliament was not in session as a "highly objectionable procedure."

About the Government's decision on a matter of "such great importance" after the budget was dopted, Shri Dwivedi said : "This step is against the best interest of India and inflationary tendencies are bound to increase and hardship of the people will affect every sector of economic development.

"This decision to devalue the Indian rupee is a definite shift in the Indian economic policy. It only shows how dependent our economy has been on the foreign interest," he said.

Shri Gaure Murahari, S. S. P. member of Parliament, said he did not think devaluation was going to be advantageous to India. "Prices would increase and there would be a general demand for more dearness allowance," .

He said the rupee had "already" been devalued in the international market and "what has been done is to bring the official rate of the rupee on par with what exists in the black market." Exports of non-traditional commodities, which the devaluation was expected to promote, had already reached the "saturation point".

Shri S. M. Bannerjee, M. P. said devaluation had created serious financial problems and the price of all essential commodities, whether imported or indigenously made, had gone up.

The price index had also risen so high as to make it difficult for the common man to manage his domestic budget.

Shri Masani, M. P., and General Secretary of the Swatantra Party said if devaluation constituted a first step in a policy of economic realism in place of the doctrinaire policies pursued by the Congress Government, it would have some desirable results in boosting the export and promoting the inflow of foreign capital.

Dr. L. M. Singhvi, an Independent Member of Parliament from Rajasthan, said : The devaluation of our rupee represents a tragic development of prolonged economic malfunctioning. It bespeaks a flabby and a flagging economy. Debased and debauched, the Indian currency was brought to a precipice by an inexorable momentum of persistent folly.

Not only does devaluation run counter to the categorical assurances of the Government to Parliament ; it does not hold out the hope that even this drastic remedy would enable the Government to salvage our rupee from foreign exchange wreckage. The remedy obviously is worse than the disease itself. One wonders whom it is intended to benefit, for the advantages claimed remain unconvincing. The suspicion is

inescapable that we have finally yielded to the pressure of the World Bank and the IMF by accepting devaluation. My fear is that devaluation might unleash fresh inflationary pressure by enhancing the cost of imports and may not actually secure a realistic parity of exchange, with the result that black market will continue to flourish.

Devaluation brings home to us the compelling necessity of intensely vigilant foreign exchange budgeting, unsparing import substitution and a purposeful and pragmatic industrial policy, for after all our foreign exchange crisis was not an act of God : it is a man-made disaster. The object lesson of devaluation is that fiscal management is not a mere matter of manipulation, it is a function of resilient far sightedness and efficient implementation of policies, and on both these scores our economic administration has been found wanting.

Shri N. C. Chatterjee, M. P. in a telegram to the Prime Minister, said : it is absolutely essential that a proper clarification should be made that devaluation is not really the price we have got to pay for our dependence on foreign aid and foreign food.

There is a general feeling of suspicion that in spite of previous declarations to the contrary by responsible Ministers, devaluation has been forced (upon us) by a mandate of Washington.

The prevailing feeling in Bengal is that in spite of the Finance Minister's statement, the price line will not be held firmly to the detriment and acute suffering of millions of people belonging to the low-income groups.

Shri Joachim Alva, member of the Parliamentary Consultative Committee of Finance, in his comment warned the nation that American loans "are going to strangle us like snakes and fatally twine themselves around our body."

Shri Kamalnayan Bajaj, M. P. The devaluation of rupee has made the country more dependent on foreign aid, which is not desirable.

Shri Peter Alvares said devaluation, if it is necessary at all, is not an unmixed blessing. While imports will become dearer, it is questionable whether this measure will itself force up import substitution.

As regards the claim to a larger quantity of exports, the wisdom of this assumption is doubtful because developed nations are taking less exports from under-developed countries. Incidentally, devaluation may as well force up the export of essential raw materials to the detriment of the national economy.

The proper thing for the Government would have been to rehabilitate the rupee. In the present situation, there was partial, though unofficial, devaluation in the measures, of higher import duties and import entitlement schemes. These should have been given a fair trial.

(c) Trade and Industry

Shri S. S. Kanoria, President of the Indian Chamber of Commerce and Industry, describing it as "a bold step" said the objective behind the measure—stabilisation of economy and raising of exports—needed further bold steps to speedily remove obstacles in the way of increasing production. Industry had to be freed from various controls on production like industrial licensing, price controls and distribution controls which had been inhibiting industrial expansion. In this context, he welcomed the liberalisation of imports. Government must give highest priority to the need for more rupee funds for effective utilisation of larger foreign aid which would flow as a result of devaluation.

Shri P. A. Narielwala, former President of the Indian Merchants' Chamber said : "The measure would not help India in any way, but would only result in raising the prices internally and making our raw material cheaper for the developed countries".

He said in his view the country would also suffer in the repayment of foreign loans which would go up by nearly 57 per cent.

Shri B. D. Somani, President of the All-India Manufacturers' Organisation, stated that the drastic rupee devaluation is too strong a dose to be smoothly absorbed or assimilated in the present state of the country's economy.

Most of the imbalances in the present economic situation are of a structural nature and, therefore, devaluation will not be a proper remedy for correcting these imbalances as such.

These are several projects which are in the course of implementation and for which import licences have been issued and commitments already made. These will be adversely affected by the devaluation. It will further aggravate the spiralling price structure. One thing seems to be inevitable and that is the vast majority of fixed income groups, already affected by the increasing cost of living, will be further hit. It is difficult to imagine how such people will be compensated for such a rise in the general price level.

He has suggested that in order to encourage export of non-traditional items, export incentives must be maintained, particularly to cover import requirement of such industries, and the import duty must be substantially reduced.

Shri K. K. Sheth, President, All-India Exporters' Chamber : It is doubtful if the devaluation of the rupee will help in

stepping up exports to the extent expected, because our exports mainly comprise primary products and there is not much exportable surplus in the country available for increasing foreign exchange earnings substantially.

In the absence of a large exportable surplus, the selective devaluation followed under the Export Promotion Schemes was better than the general devaluation of the rupee now announced. This measure is likely to reduce our export earnings in 80 per cent, of the commodities which were standing on their own legs without incentives.

Shri R. C. Shah, President of the All-India Importers' Association: The rupee devaluation is a major catastrophe to the trade and industry in the country which is passing through difficult times. It will do irreparable harm to our economy.

In view of the repeated denials of devaluation rumours, the drastic devaluation of the rupee, abolition of import entitlement, and adjustment in export and import duties come as a bolt from the blue. The present economic malaise is largely the cumulative effect of the Government's wrong economic policies all along.

Our imports, which are more than one-and-a-half times the exports, and which are bound to increase because of our development and defence requirements, would become more costly. The benefits claimed by the Finance Minister on the export front are problematical and doubtful.

Shri J. H. Doshi, President, All-India Association of Industries: As the Finance Minister has himself pointed out, there has been a price increase of as much as 80 per cent in the course of the last ten years and it is difficult to understand how this trend can be countered by resorting to devaluation, inasmuch as import costs of all essential items such as machi-

ner, components and raw materials will increase, thereby pushing the cost structure of finished goods. Again, there does not seem to be any big scope for increasing our exports because of the inelastic nature of some of our main export items and the difficulties of having sufficient exportable surpluses in respect of some others. We must also reckon with the fact that the country has to meet some important obligations such as debt-servicing, amortisation payments and repatriation of profits by foreign investors, which cumulatively will add to the burden on the balance of payments position.

In an economy which is afflicted by all-round shortages and which is dependent on outside sources not only for developmental but also maintenance imports, devaluation can hardly be a corrective measure for correcting the imbalances in the economy and restoring it to normal health.

Mr. Kantilal Ishwarlal, President, Bombay Stock Exchange: It is bold decision. It will stabilise the country's economy.

Mr. Padampat Singhania, a prominent industrialist, said that he did not accept "the theory that devaluation of the rupee would give a fillip to exports".

The present critical situation, had been brought about by extremely heavy borrowings. The country's assets were "practically mortgaged".

The real remedy was to increase production and productivity both in the industrial and agricultural fields. Unless the country got rid of foreign debt and the country's manufacturing and agricultural tempo was accelerated, "we will have a very dark future."

He suggested slowing down the race of borrowing, reducing the inflation in prices and lowering the cost of living.

Shri Chunilal B. Mehta, industrialist and economist, said : By this measure industrialisation will be delayed. The cost of imported capital goods will go up considerably. Reducing the value of the rupee should generally increase exports but in our case it will not be so, because India has so little to export. The internal price level may also increase and this would be bad because as it is our prices are above world prices and devaluation would further raise the prices.

Shri G. D. Somani, President, Cement Manufacturers' Association, said : The imposition of heavy export duties on certain items and the withdrawal of export incentives may neutralise substantially the benefits that would have otherwise accrued to the export trade.

Shri Kasturbhai Lalbhai, a well-known industrialist, while congratulating the Government on its bold decision, called for pruning of the Plan to prevent a repetition of the situation.

“Even now unless the grandiose Plans are cut down to our capacity, we shall face a similar situation in the not too distant future.”

Dr. R. C. Cooper, Vice President of the Indian Merchants' Chamber, said : It was open to serious consideration whether devaluation would be an enduring encouragement to exports as visualised by the Finance Minister.

In the past, if incentives failed to boost exports in an expected measure, it was because of their half-hearted nature rather than any basic defect of such schemes.

Although export incentives could not be expected to become a permanent measure, even now they could be judiciously combined with the devaluation on a selective basis to boost the country's exports of non-conventional items to a consider-

able extent. Such a combination would have the desired effect of increasing the competitive capacity of India's exports in the world market.

Referring to the Finance Minister's contention that devaluation would quicken the pace of import substitution, Dr. Cooper pointed out that there was a limit beyond which import substitution could not be carried as a short-term measure firstly, on account of international division of labour, and secondly, because it would take a considerable time for the indigenous know-how to substitute imported components or raw materials.

Shri B. C. Ghosh, a leading tea planter, said that devaluation would help boost Indian tea exports not only to the U.K., the largest importer of Indian tea, but also to the U.S. and Australia.

He said that this would neutralise the special advantage of better shipping facilities enjoyed by Ceylon which had gradually been displacing the Indian tea. The export duty of Rs. 2 per kg. imposed on tea is not likely to affect tea export. The U.S.S.R. which imported annually about 75 per cent of Darjeeling's tea output amounting to 15 million lb., was still a sure market because the export duty 'will have no effect'.

Shri M. S. Talualicar, president of the Goa Mineral Ore Exporters' Association, said: The rupee devaluation will undoubtedly boost the mining industry in Goa in general, resulting in an overall benefit to the exporter as well as non-exporter.

From the date of the devaluation each ton of ore will bring an extra amount in rupees. At least three-fourths of this money will go into the hands of the producer. The iron-ore mines in Goa, numbering about 400, which are at present idle,

because it is uneconomical to work them, will be able to start production and in consequence our yearly export will go up considerably. The same will happen in regard to manganese-ore.

Shri A. K. Rungta, vice-president of the Federation of Indian Mineral Industries, said: At present export of important foreign exchange earners like iron-ore, manganese-ore, bauxite, ferro-manganese etc. is done through the STC. If the benefit of the devaluation is thus usurped by the STC, it will rather have a demoralising effect on the industry. On the other hand, free exports will enthuse production and exports to a great extent.

D. Economists

Dr. P. S. Lokanathan, Director of the Indian Council of Applied Economic Research, said that the Indian economy would not derive the benefits of devaluation promised by the Finance Minister.

The Finance Minister is right that our problems are deep-seated, but his view that through devaluation they can be solved is too naive.

The fact of the matter is that the World Bank and foreign investors have been greatly exercised and annoyed at the complexity of our controls and regulations.

The Government by agreeing to devaluation has confessed its incompetence to administer controls in an efficient manner.

As a result of devaluation, the prices of all imports would definitely go up as also the cost of production of all products depending on imported equipment. The cost of living, which had gone up very badly during the last twelve months, would further rise partly on account of the new inflationary pressures

generated by devaluation and partly on account of the higher prices of all imports.

The prices have already reached an intolerable level and the patience and forbearance of the public will be put to the severest test.

It would be excessive optimism to think by devaluation foreign investments would be further increased. Whatever India had done and could do to facilitate foreign investment, the sphere of private investment would be of only small value.

The most significant fact is that the burden of our external debt repayments have gone up by devaluation. We have to find more rupees for repayment of our external debts. The budgetary position will become more difficult than it has been so far.

Devaluation will not and cannot solve India's economic problems, which are really due to insufficient production and inadequate distribution.

Dr. B. R. Shenoy, Director of Gujarat University's School of Social Sciences, who has been one of the most consistent advocates of devaluation of the rupee for years, said that devaluation was, doubtless, a most welcome measure, though by far the best course to adopt would have been to float the rupee, as this would have completely eliminated the balance of payments headache of the past two decades. The extent of devaluation might seem heavy at first sight. But the new rate chosen still left behind an ominous [measure of over-valuation. It was unfortunate, too, that in the case of about 56 per cent. of our exports, the scaling down of the hurdle of currency over-valuation should be accompanied by the erection of fresh barriers of export duties which cancelled, one-fourth to one-third of the benefits of devaluation in the case of the major earners of foreign exchange.

The purpose of devaluation was three-fold : first, to eliminate the black (free) market in foreign exchange ; secondly, to restore to exporters the full rupee worth of their foreign exchange earnings ; and thirdly, to shift production back to the overseas markets from production for the home market and so to step up our exports.

The adequacy and achievements of devaluation had to be assessed in terms of these three purposes. If the black (free) market in foreign exchange was not eliminated, our balance of payments difficulties might remain endemic, rendering chronic our dependence on foreign aid for the external viability of the economy, he added.

Referring to the second and third objectives of devaluation, he said, during the past two decades, with every rise in costs and prices—the result of inflation—the rupee had been more and more over-valued. In consequence, exporters got for the same output less and less rupees on exports and more and more rupees on sales in the domestic market. This, coupled with aggressive policies of indiscriminate import substitution, had led to enormous shifts of resources and production from export industries into industries catering for the need of the home market.

This production shift was at the tap root of our balance of payments difficulties.

Dr. Shenoy said that it was incorrect to suppose that, because we did not today have surplus export goods, there was no room for devaluation. Increased exports emerge when, first producers diverted their output from the home market to the external market under the inducement of higher rupee receipts; and, secondly, when this inducement led to increased production for export.

With regard to criticism that the World Bank forced us to devalue, he said critics missed the realism of human affairs. India was the largest single debtor of the Bank, our total loans from it being \$735 million, Japan coming next with \$664 million. The Bank had also played the role of a friendly and sympathetic broker in getting U.S. loans from the Aid-India Consortium, which it organised. It had now found that there was little hope of our ability to meet our external debts without increased exports and that exports could not increase without devaluation. Quite naturally the Bank felt compelled to use the lever of aid to see that we devalued.

An over-sensitive people should not indulge in over-borrowing.

Dr. A. N. Agarwala, a noted economist and head of the department of commerce and business administration of Allahabad University, said that the devaluation of the rupee had followed the continued failure of the Government administration in working smoothly a poor but large-sized economy committed to an ideology of socialism.

Therefore devaluation may be expected to break new ground and it might be the beginning of a shift in the basic character of the Indian economy and of India's economic policies.

Devaluation could not be an isolated act. In fact, the devaluation of the rupee would lose much of its logic unless it was followed by measures which impinged on the controlled character of the economy and the rates and character of the Customs duties.

Dr. B.N. Ganguli, pro-Vice Chancellor of Delhi University, and a noted economist said : Devaluation should be followed by concerted efforts to effect monetary stability at home if the desired results were to be attained.

As for the benefits of devaluation, Dr. Ganguli said, they depended on how soon Indian industries picked up and whether India had a good agricultural harvest this year. "If the monsoon fails again we are sunk," he said.

Dr. D. R. Gadgil, noted economist and Vice-Chancellor of the Poona University, said : Devaluation underlines the grave defects of past policies of import licensing and export incentives which were costly to the economy and had a highly corrupting effect. A complete rethinking in this respect is called for. A rational plan of restriction of consumption and socialised trading can alone take effective advantage of the favourable situation for exports created by devaluation.

Professor C. N. Vakil said : Devaluation can be successful only if the Government cuts its wasteful expenditure and all sections of the society co-operate with it.

The external value of the rupee had been falling for a long time and this unnatural state of affairs could not continue. The 'bubble had to burst' and devaluation was the only way of restoring reality to the situation, since incentives for increasing exports and steps to curb imports had failed.

Prof. Vakil said that the fruits of the move could be expected after about three months. It would take some time before the forces of demand and supply started to operate. The process would no doubt cause some friction.

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FINANCE MINISTER'S BROADCAST

June 5 1966

The Government of India have just taken a number of economic decisions of great consequence to the health and progress of our economy. The central decision was a change in the par value of the rupee from a 18.66 grams of gold per hundred rupees to 11.85 grams of gold. This involve a reduction in the external value of the rupee by 36.5%. In practical terms, this means that the value of a United States dollar will be Rs. 7.5 as against Rs. 4.76 so far and of the pound sterling Rs. 21 as against Rs. 13 and one third. Other economic decisions, to which I shall refer later, essentially flow from this act. My object now is to tell you why the change has become necessary and how it will help the progress of our economy.

First of all I would like to explain what the par value of the rupee means. Simply put, the par value or the exchange rate determines the rate at which the Reserve Bank will provide rupees against foreign exchange surrendered to it and the rupees that it will charge for the foreign exchange supplied by it. In other words, the exchange rate is nothing more or nothing less than the price of foreign exchange. In this sense, it is like the price of anything else and is not a matter which should affect pride or raise emotion. On the contrary, as in the case of any other commodity, the price of foreign exchange should be fixed on the basis of strictly economic considerations. It should reflect economic realities as they are today. Only so can it serve the main purpose of a price which is to enable and facilitate the

right allocation of resources. An unrealistic price will not serve this purpose. On the contrary, it will increasingly lead to distortions which can only harm the economy.

There is little doubt that the value of the rupee today is not what it was 10 years ago. You all know that internal prices have been rising for some years. Today the general level of prices is 80% more than what it was 10 years ago. On the other hand, the official par value of the rupee has remained unchanged since 1949. Prices have not risen to anything like this extent in the main countries of the world with whom we trade and in consequence our exports have been meeting increasing resistance in foreign markets. At the same time, our need to increase our exports and foreign exchange earnings have become greater and greater. In order to overcome price resistance to many of our exports in foreign markets, we have, during the last few years, tried many measures. We have, for example, been subsidising exports in several ways by important entitlements to exporters, by direct subsidies and more recently by tax credit certificates. These measures succeeded only to a limited extent. Had our difficulties been temporary in character, they might even have been enough to restore our competitive position. But experience has clearly demonstrated that our difficulties are more basic. For instance, it is quite out of question to bring down the general price level in our country to the level of even five years ago. Indeed it will require great effort and self-discipline on the part of each of us to arrest further increase in prices.

The real question is whether, in this situation, the kind of remedial measures, which might have been suitable for temporary difficulties, could be relied upon on a continuing basis. To my mind, the answer is definitely "NO". Consider, for example, the Import Entitlement Scheme. Under this scheme exporters could incur losses only because on the sale of the articles they could import under their entitlement they could

make profits more than enough to compensate them. They were able to do so only because of our increasing import restrictions and the consequent high prices for imports. But we cannot afford to keep up this condition of scarcity merely to encourage exports by this particular device. Even for enabling our existing industries to work to anything like full capacity, not to mention the requirements of new industries that we desire to set up, we must arrange for a much greater flow of imports of raw materials and components. Every effort is being made to secure this. To the extent we succeed, the effectiveness of import entitlement schemes will correspondingly go down. This method, therefore, cannot be relied on. We shall then have to resort more and more to the device of tax credit certificates and other types of direct subsidies. This will involve an increasingly intolerable strain on our budgetary resources which are so badly needed both for the development and the defence of the country. Further direct and open subsidies, if continued for long, will carry the grave danger of retaliation by the countries to whom we export.

We had, therefore, to devise a more enduring and reliable way of restoring and indeed increasing the competitive power of our exports. The change that we have made in the par value of the rupee, or devaluation, as it is commonly called, will do precisely this. An exporter who earns 100 dollars will from now on be able to earn 750 rupees as against 476 rupees so far. You will easily appreciate how strong a stimulus this will be for our export effort. Quite apart from restoring the competitiveness of our exports this will provide a strong inducement for the flow of investment into export industries and thereby progressively strengthen our export position. It is true that in the case of some of our traditional exports this degree of stimulus is not called for. In those cases we have levied export duties to moderate the stimulus and yet leave sufficient incentive for growth.

Devaluation will also quicken the pace of import substitution. The cost of imports in terms of rupees will now automatically go up. This will make it really worthwhile and attractive to invest in those of our industries which produce goods which are still being imported. This is equally true of agriculture as it is of industry. Enduring encouragement to both exports and import saving activities will enable us to move faster towards self-reliance all-round.

The new rate will apply not only to exports and imports but also to inward and outward remittances which are called 'invisibles'. Therefore, remittances into India will be encouraged and remittances out of India will be discouraged. The foreign exchange burden arising from repatriation of profits capital and royalty payments by private foreign investors will automatically go down. On the other hand, new private investors who bring foreign exchange into the country will be able to realise more rupees and this would serve to encourage new foreign investment in the fields in which we desire it. Similarly, India will become more attractive to foreign tourists whereas foreign travel by Indians will become more costly and, therefore, less attractive.

Many of you would know that because of the decline in the purchasing power of the rupee, a number of unhealthy practices had developed and were indeed becoming more widespread. At the older rate for the Indian rupee, anti-social practices such as under-invoicing of exports, over invoicing of imports, sale of 'travellers' in the unofficial-markets, remittances through unauthorised channels, smuggling of gold and other articles, such as watches, cameras and transistors, were becoming increasingly attractive and, therefore, difficult to check. Even legal imports enable the marketing of substantial profits, some of which go to swell the flow of unaccounted money in the country. At the new rate, all these anti-social activities will be-

come substantially less attractive and therefore, less widespread. With the reduction in the leakage of foreign exchange through these means, our official foreign exchange reserves should get strengthened.

Let me now turn to some aspects of devaluation on which there is sometimes a genuine misunderstanding. We have been borrowing from abroad for our development on a substantial scale and the burden of debt repayment is continually increasing. You may well ask whether this burden will not increase as a result of devaluation. In terms of foreign exchange, neither the total value of the debt nor the annual payments we have to make in respect of it will change as a result of devaluation. In terms of rupees, undoubtedly, the burden of repayment will go up. Indeed, the rupee cost of Government imports and other foreign expenditure will also go up. But against this the budget will also benefit from devaluation in a number of ways. For example, export duties to which I referred earlier, will yield substantial revenue. Similarly, the rupee value of the foreign aid we get will also go up. On balance, it is expected that devaluation will have no adverse effect on the budgetary position. Indeed, if we can liberalise imports, the budget may actually benefit.

This expectation, of course, takes account of the fact that the revision in import duties that we have just announced will not reduce significantly the revenue from these duties.

Taken together with the incidence of import duties, devaluation will certainly increase the cost of imports substantially. But as I have said earlier, it is only by doing so that we can provide an enduring stimulus for import substitution. I should also remind you that in the present conditions of scarcity actual prices paid by consumer bear little relation to landed costs and are, in fact, fixed by what the market can bear. In practice, therefore, the price that final consumers will now pay may

often not be significantly higher because a part of the increase in landed cost will be absorbed by present excessive profit margins.

An increase in the cost of imports generally is an essential feature of devaluation. But I am well aware that in the present situation we cannot allow the prices of certain essential commodities to increase as a result of devaluation. In the package of measures decided upon we have provided that the prices of foodgrains, fertilisers, kerosene and diesel oil will not increase as a consequence of devaluation. We have also provided by way of loans on easy terms for assistance to meet the increase in the rupee cost of students who are already abroad.

In the ultimate analysis, we can achieve price stability only by higher production and greater productivity. You are aware of the major efforts now being made to increase agricultural production. In the field of industries, most of our factories which have increased largely in number as a result of our three Plans---are unable to produce to full capacity because of lack of enough imported raw materials and components. This state of affairs also comes in the way of greater productivity in a situation of scarcity and the edge of competition and the drive towards cost reduction necessarily gets blunted. We are, therefore, taking active steps to provide substantially larger quantities of imported components and raw materials. We shall also attempt to do so in a manner which reduces procedural delays and other obstacles in the way of a quicker flow of imports. Both simpler procedures and larger flow of imports will particularly benefit small scale industries. We also propose to import on a more adequate scale articles like kerosene, copra and raw cotton to increase the availability of essential consumer goods. I hope to make specific announcements in this regard in the course of the next two weeks.

Finally, I would like to refer to the effect of devaluation on the terms of trade, that is, on our export and import prices in terms of foreign exchange. On the foreign exchange price of imports, there is no reason why devaluation should have any effect whatever. In the case of exports also, the foreign exchange price should remain unchanged for those of our exports which form only a small part of total world trade. Most of our exports are in this category. There are, however, a few commodities such as tea and jute where our exports constitute a substantial part of world trade and where total world demand is also relatively inelastic. In their case in order to obviate the danger of a decline in prices, we have levied export duties.

To sum up, devaluation would provide a better corrective to the price rise and distortion of the past than the remedial measures we have pursued so far. Even more important, it will facilitate a better allocation of our resources and strengthen our foreign exchange position on an enduring basis. With renewed determination and discipline on the part of all of us to hold inflationary pressures firmly in check, it would be a major ally in our march towards self-reliance.

New Delhi, 5th June, 1966

Appendix II

SHRI T. T. KRISHNAMACHARI'S REMARKS ON DEVALUATION

Excerpts from Minister's Broadcast of July 17, 1965*

In the course of his special broadcast on July 17, 1965 reviewing the economic situation of the country, the then Finance Minister, Shri T. T. Krishnamachari, said :

Some of you have perhaps also come across the suggestion that our balance of payments difficulties will be cured by devaluation of the rupee. Government have considered this question most carefully and are firmly of the view that devaluation is no answer to our problems. I shall briefly tell you what our reasons are.

First and foremost, devaluation is no answer to our basic and immediate problems which is that of living within our means. Indeed, it might well serve as an opiate by creating the impression that by taking what is generally considered a drastic action, we have really done all that needs to be done to correct the imbalance in our external payments.

Over the long-run also devaluation is not the best means of giving the necessary impetus to export promotion and import substitution. Essentially, our problem here is that of enlarging the base of domestic production and this task may well receive a set-back by a sharp, sudden and indiscriminate increase in the price of even those imports which cannot

* as reported in *The Hindu*, dated July 18, 1965.

conceivably be produced at home in the immediate future. This is not to say that selective increases in imports costs cannot give a stimulus to import substitution. We ourselves have recognised this in the selective increases that we have made in our imports and excise duties over the recent past. But what devaluation implies is a sharp sudden across-the-board increase in the price of all imports.

SELECTIVE APPROACH ON EXPORTS

On the side of exports also, our structure of production and exports is such that a selective approach is preferable to a general one. There would be little point in lowering the prices of exports such as jute or tea where demand abroad or supply at home is inelastic. I should think that the same is true even of invisible earnings like those from tourism. On the other hand, our newer products like engineering goods might need subsidies on a discriminating basis. It is this kind of selective approach that we have been pursuing, and we can extend and refine it from time to time to the extent necessary in the light of changing circumstances. But to think that we can do away with the necessity of a discriminating approach to the problem of export-promotion and import-substitution is tantamount to assuming that the Indian economy has already arrived at that stage of development and technology where structural rigidities are a relevant, which is not true.

CALL FOR SENSE OF DISCIPLINE

Let me then say this in conclusion. Government are determined to restore strength to our balance of payments both in the short and the long run by selective deployment of the instruments we have already forged. Situated as we are, a greater sense of discipline and determination will be required over a period of years to avoid recurrence of similar crisis. It must be reflected continuously in our budgetary and credit policies and indeed in the shape and size of our plans for

development. We do not propose to be deflected from this basic endeavour by enticing but nonetheless short-cuts. It is never a day too soon for a nation of 470 million people to begin to rely essentially on its own strength and genius. And it is my earnest hope that our present difficulties would instil in all of us a new sense of purpose and determination in our struggle for economic independence.

ANSWERS TO SOME QUESTIONS IN LOK SABHA RE: DEVALUATION

February 17, 1966

U.S.Q. 326 Shri Balmiki & Others :

Will the Minister of **Finance** be pleased to state :

- (a) Whether it is a fact that there is a proposal to devalue the rupee ;
- (b) if so, the reasons therefor ; and
- (c) how far the devaluation will help strengthen the Indian currency ?

The Minister of Finance (Shri Sachindra Chauduri) :

(a) No, Sir. (b) and (c) Do not arise.

On the same day, in the course of supplementaries to Starred Q. No. 63 **Shri Nath Pai** enquired :

In view of the Minister's blunt and rather surprisingly unembarrassed admission that the real value of the rupee in the international market is not on a par with the official value of the rupee, what steps Government were taking to stabilise the rupee and prevent a further fall in its value ? Or are Government contemplating accepting the inevitable, namely, devaluation of the rupee ?

The Minister of State in the Ministry of Finance (Shri B.R. Bhagat) replied : • A number of measures to stabilise the

economy which reflects the foreign exchange situation and the strength of the economy are taken. From time to time, a number of measures have been taken in the past. In his Budget speech, the Finance Minister will deal with this question along with others.

Shri Nath Pai : What about devaluation of the rupee ? Why is he hesitating to answer my question which has been agitating the public mind and is coming up again and again ? What is Government's attitude a devaluation ? Is it in the offing ? Is it also coming with the budget ?

Shri B. R. Bhagat : In a matter like this, Government do not come forward with any opinion. We cannot say anything earlier than when action is actually taken. These are not announced beforehand.

When another member **Shri Daji** asked : Is the Minister aware that in the London economic papers, persistently and even yesterday, a report has been broadcast very loudly that the Indian rupee is about to be devalued, and will the Minister be able to inform the House whether there is any such scheme afoot or not ? Otherwise, if you do not contradict this, it will create a great monetary crisis in the country. We cannot wait till the Budget, we want to know it.

The Minister's reply was : Government cannot be asked to confirm or deny it. The Government, if it has to do anything on a matter like this, will come forward with an announcement. Before that we cannot say anything.

When upon this **Shri Nath Pai** remarked whether that meant that the Minister was confirming the fears, the Minister of Planning (**Shri Asoka Mehta**) intervened to say : There is no question, as far as the Government is concerned, of considering the question of devaluation.

BELL MISSION'S RECOMMENDATIONS*

The Bell Mission came to India towards the end of 1964 to assess the economic development in India. The mission split itself into several groups to study the Indian economy from different angles. There were at least 10 reports, one dealing with agricultural policy in India, another with problems of public financial policy in India, the third on export and import policy, the fourth on physical controls on resources allocation and investment, another on the Indian family planning programme, one on the problem of development of manufacturing industries with special reference to public sector enterprises and so on. On the basis of these various reports, Mr. Bernard R. Bell made an overall report and presented it to Mr. George D. Woods, Chairman of the International Bank for Reconstruction and Development sometime in September 1965.

OBJECTIVE OF MISSION

Mr. Bell made it clear that "there is no attempt in this report to present a carefully balanced evaluation of the efforts of the Government of India or the aid givers to further India's economic progress. No space has been devoted to noting and describing the successes and the achievements. There is no lack of these and some are especially notable, but we did not conceive our function to be that of the historian. Our mandate

* Excerpts, reproduced with minor adaptations, from K Rangaswami : "Bell Mission's Report—1 : A Critique of Indian Planning", The Hindu, dated 20th June, 1966.

was not to record successes, but to seek opportunities for greater success. Less euphemistically, our task was to find and to understand the failures, the deficiencies and the obstacles to more rapid progress in order that they might be overcome, that the achievements might be greater and that progress might be accelerated. The statement concentrates on these and, therefore, will probably seem to be an unremittingly critical catalogue of failures. Its purpose, however, must be understood."

The Bell Mission suggested a series of measures to be taken by the Government of India. Some of these were :

- (a) Devaluation of the rupee, preferably by formal devaluation to a single fixed rate with export taxes on jute and tea and some differential import duties. Alternatively, the same effective devaluation via an across-the-board increase in the recently imposed 10 per cent import surcharge and an export premium uniform for all products except jute and tea.
- (b) Removal of direct administrative controls on the import of production materials (raw materials, intermediates, spare parts, certain components). Retention of bans on most finished consumer goods and use of special import duties and excise taxes to restrict import of certain goods.
- (c) Mounting of a massive, energetic and reorganised population control programme.

AGRICULTURAL GROWTH

- (d) Allocation of more resources to an intensive effort to double the rate of growth of agricultural production by (1) providing all necessary supplies of fertilizer; (2) accelerating and improving Government develop-

ment and distribution of water supplies; (3) providing materials necessary for private tube-well development; (4) providing stable incentive prices through operation of Government purchasing for buffer stocks at support prices; (5) providing adequate production credit to tenant as well as owner farmers; (6) improving security of tenure; (7) augmenting supplies of power equipment, plant protection materials and service; (8) improving research directed toward development of improved seed, more suitable plant protection materials, etc.; and (9) improving extension work and administration.

- (e) Restraint and, if possible, reduction of Defence expenditure;
- (f) Removal or simplification of existing administrative controls over material flows and prices.
- (g) Improvement and change in the planning process to ensure competent economic and technical formulation and evaluation of sectoral development and specific project plans and also to ensure more systematic analyses of current developments in the economy.
- (h) Reform of present practices in management of public sector enterprises to give greater authority, autonomy and responsibility to their managements.
- (i) Improvement of research, investigation, information flow.

Mr. Bell also suggested the actions to be taken by the aid-giving countries. These were :

- (a) Establishment of a specific (I.M.R.) contingency fund to ensure safe and successful devaluation of exchange

rate and reduction of quantitative import controls; (b) increase in the level of aid for the Fourth Plan and increase in the proportion of non-project aid to permit a substantial increase in imports, especially of production materials required for fuller use of industrial capacity and as inputs for agriculture. Consideration of re-scheduling of existing debt as a means to these ends; (c) provision of new aid on terms which do not impose excessive burdens; (d) insistence as a condition of (a) and (b) above on (1) the necessary changes in Government of India policy and (2) more adequate and fuller supply of information of progress in all activities.

In his report, Mr. Bell finally said : "We are confident that, with the necessary and appropriate changes in the Government of India's policies and practices and with a higher level of aid for at least the next five to ten years, India can within the next few years significantly accelerate the growth of its economy, can begin measurably to raise the level of living of its people and can, at the same time, move on to a path which will eventually permit sustained growth on a self-supporting basis.

"We are equally confident that, without the combination of important changes in the Government of India's policy and practice with additional aid for at least the next five to ten years, there will be no acceleration of growth and no progress towards either improved living levels of eventual sustained and self-supporting growth. We would expect, in fact, retrogression in all these respects."

CASE FOR DEVALUATION OF THE RUPEE

Mr. Bernard R. Bell, in the course of his report to the World Bank Chairman, Mr. George D. Woods, also analysed

other impediments to India's economic progress apart from the slow rate of industrial and agricultural growth. One was, according to him, the Government of India's policy on maintaining the over-valuation of the rupee and the associated system of direct administrative controls over imports.

He has observed : "The overvaluation of the rupee works directly to defeat the massive import substitution and the export expansion which are essential to achievement of the objectives of the development programme. It has resulted in increasing losses of foreign exchange through all the familiar devices which come into play in such circumstances. It has also operated against economy in the use of imports and in the use of capital equipment. The associated system of import controls has been an inefficient allocation of scarce supplies of imports, has failed to maximise the aggregate output obtained from a given supply of imports, has reduced enterprise efficiency has and had other negative effects.

"On the import side, the Government of India attempted to counter the over-valuation of the rupee by intermittent increases in import duties. At times, these have been highly selective, at others, as in the case of the 10 per cent regulatory duty of February 1965, general and virtually uniform. These moves, however, have not yet, in our judgment, gone far enough to establish an appropriate relationship between the general levels of import and internal prices.

PREFERENCE FOR IMPORTS

The over-valuation of the rupee creates powerful financial incentives to import rather than to procure in the domestic market. The absence of an appropriate import exchange rate has also removed an important guide to investment.

On the export side, the Government of India, has employed a variety of devices to counter the financial disadvantages of

export sales, Mr. Bell says and deals with the import entitlement system. He points out that "this has been a highly selective device which has in effect provided premiums to exporters which vary among commodities and from time to time. The premium is essentially merely the subsidy which all importers receive, but in increased amount."

Adversely commenting on the system, he points out that the system provides no stable or permanent basis upon which producers would plan investment or production for export markets. "There are few instances in which today producers are deliberately designing their operations for or are attempting to promote export markets. We do not minimise the difficulties of expanding the export markets for India's traditional exports or of developing markets for new products. We believe, however, that the present highly selective, non-uniform and sometimes inadequate export exchange rates reduce the possibility of overcoming the difficulties. A standard, stable rate at an appropriate level would open opportunities to which India's entrepreneurs would, we believe, respond.

"There is in any event little or no disagreement, we believe, with the conclusion, that except in the case of tea and jute and a few products of lesser importance, no Indian products can to-day be sold in export markets without loss to the exporter unless some premium above the official exchange rate is paid. In part, this reflects the difference in foreign and internal prices. In part, it reflects the level of internal costs. The prospect that these disparities can be sharply reduced in the near future are not bright."

CORRECTIVE MEASURES

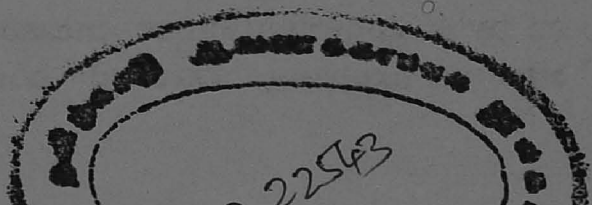
"We believe, therefore, that equilibrium should be achieved by a combination of measures. One is that a rise in the effective exchange rate will correct the present relationship of

import to internal prices and costs, which should thereby somewhat reduce the excessive demand for imports and desirably alter the composition of that demand. Another is the freeing of maintenance imports from the existing direct controls and the provision for maintenance imports of a supply of foreign exchange adequate to meet the demand at the newly established effective exchange rates. The demand, we believe, should be limited by the continued banning of imports of non-essential finished consumer goods as well as of components and semi-manufactures used only in the production of such goods and by the imposition of high excise duties on less essential or lower priority domestically produced goods which have an import component. The third measure is the continued direct control of imports of capital goods through the related industrial licensing and capital goods import licensing operations."

Mr. Bell who advocates larger maintenance imports than project imports comments : "We are suggesting that the alteration of the present balance between maintenance and project imports and higher import exchange rates and elimination of direct control of imports would bring important advantages. We believe that a larger total supply of foreign exchange is essential for these purposes and that in the immediate future, only additional aid, above the level received during the Third Plan period can provide a sufficiency augmented supply.

"In the longer run, we would expect exports, stimulated by an appropriate exchange rate and other measures, to provide an increasing part of the growing requirements of maintenance imports."

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