

When prudence is made subservient to populism - The Rupee Problem

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"**THE**

depreciation of the rupee, measured in terms of exchange or price of gold or sovereign, ranged somewhere between 25 to 30 per cent. So great was the depreciation that it redoubled the difficulties confronting the Government when the rupee was not fixed to gold", wrote B.R. Ambedkar, in his 1923 book- ***The Problem Of The Rupee: Its Origin And Its Solution*** .

The solution to the plummeting value of rupee is more elusive today than what it was under the British Raj. It had constituted few committees to fix the problem of currency and finance.

The issue of both external and internal value of Rupee was vigorously debated in Council of States and Legislative Assembly during the Raj era. After Independence, the debates spilled over to the Constituent Assembly of India (Legislative) and the Provisional Parliament. Nothing could, however, stop the Rupee from tumbling.

Fifteen years after Dr. Ambedkar's seminal work, F.E. James, European Member from Madras, spoke against devaluation in Legislative Assembly on 18th December 1938.

Participating in debate on RBI Bill, Mr. James stated: "

I would like to say that we do not think that rupee devaluation will solve any of the ills from which the country is at present suffering"
.

He added: "

My whole purpose is to claim that devaluation of the rupee today will take us nowhere. It must be considered along with the other great forces which are going to make for disorganisation in the economic and financial spheres".

What Mr. James stated about devaluation applies equally well to depreciation in the external and internal values of Rupee(twin values) that has occurred over the decades. The depreciation of Rupee against hard currencies has been more frequent since the launch of market-determined exchange rates in 1993.

Like Mr. James, a committee constituted by British India in 1919 voiced concern over devaluation of currency. The panel's mandate included examining the effect of the World War I on the Indian exchange and currency system.

The '***Committee on Indian Exchange and Currency***' concluded "

large changes in the exchange value of a currency are an evil, which should be avoided so far as possible; but if a large change has taken place it may be preferable to establish stability at the new level rather than to submit to the further change ...â€

The twin values problem has persisted due to the short-sightedness of successive regimes. No one cared to resolve the issue holistically. Post-Independence history shows the Government of the day never wants to tackle a web of factors extending from population explosion to populism-driven expenditure financed by debt.

Factor in innumerable hurdles that blunt the competitiveness of Indian products and services. Reckon the opportunity cost of missed and delayed opportunities for policies and projects.

The common bond between external and internal values of currency is inflation. Domestic inflation and depreciation of Rupee against hard currencies have a symbiotic relationship. The inflation-led decline in internal value of rupee (IVR) necessitates depreciation of external value.

The Rupee's depreciation, in turn, results in import of inflation. Inflation through depreciation is imported in form of increase in rupee expenditure on Dollar-denominated import of crude oil, liquified natural gas, coal, fertilizers, edible oils, pulses, gold and diamonds, etc. The higher rupee expenditure for the same volume or quantity of goods gets transmitted as increase in retail prices. If the prices of commodities rise in the global markets, then the severity of imported inflation is much more, as is the case now.

Imported inflation, coupled with domestic one, necessitates periodic correction of external value of rupee. It is a vicious circle. No wonder then that after three devaluations in 1949, 1966 & 1991 and the umpteen depreciations, Rupee shows no signs of stabilizing within a certain range, say plus or minus 5-10 percent, over the long term.

There have been months in which rupee has appreciated due to favourable external factors – the chief being robust inflow of foreign investment. RBI's interventions in exchange market and policy changes also facilitate appreciation, which is, however, unsustainable.

The impact of even slight depreciation can be substantial as evident from an official reply to question in Rajya Sabha given during January 2019. As stated in the answer, "

For every change in the exchange rate by Rs 1/\$, the crude oil import bill would change by about Rs 12,100 crore per annum (workings based on average price of crude oil at \$72.26/bbl for the period 1st April, 2018 to 26th December, 2018)".

This issue was crisply explained by industrialist Padampat Singhania in Constituent Assembly of India (Legislative) on 6th October 1949. Participating in debate of rupee against US dollar, Mr Singhania said: "

For the sake of example, let me say that one machine which I have to import I used to day, in terms of raw materials, 10 maunds of jute. If tomorrow as a result of the devaluation, I have to pay for the same machine by sending 15 maunds of jute then there is poverty in the country".

Similar is the story of the foreign debt. India has to generate more rupee wealth to pay for the same size of foreign loan. As disclosed by the Government in Parliament during July 1991, "

In rupee terms, the external liability would increase by about 21 to 23 per cent as a result of the exchange rate adjustments on first and 3rd July 1991, depending upon the currency in which the borrowing is denominated".

The Government has, at times, defended depreciation as a "**correction**"

in the exchange rates for inflation rate differentials between India and the major countries. At other times, the Government has justified depreciation as logical outcome of the increase in absolute amount of current account deficit. It has also blamed abnormal external factors such as Iraq crisis in 2014.

According to Finance Ministry's reply to a Lok Sabha question put during March 2020, "

As reflected in the Economic Survey 2019-20, the value of Indian currency in the medium to long term decreases with the growing size of current account deficit (CAD). The current account deficit of India has increased from USD 26.9 billion in 2014-15 to USD 57.3 billion in 2018-19".

CAD is primarily driven by trade deficit, which is an eternal woe of the Indian economy. CAD gets moderated or turns positive in exceptional years due to robust inflow of foreign direct investment, enhanced remittances by non-resident Indians and rise in the foreign loans. The last factor includes both the external commercial borrowings (ECBs) by companies and multilateral and bilateral loans taken by the Union Government.

In the present situation, the Government has put the blame for depreciation on external factors such as Russia Ukraine War (RUW) and certain policy changes by the US Federal Reserve. These have led to outflow of capital by fair-weather friends, foreign portfolio investors (FPIs) and rise in global prices of commodities.

To prevent further and sharp depreciation of rupee, the Government and the Reserve Bank of India have unveiled a few initiatives to moderate capital outflows and enhance inflows. Such efforts are expected to contain volatility in exchange market due to mismatch between demand and supply for US dollars.

Reverting to IVR, it is generally referred to as the purchasing power of the Rupee (PPR). It is measured as reciprocal of consumer price index for industrial workers (CPI-IW). PPR's decline is thus synonymous with the rise in retail prices.

The Opposition and the media's obsession with daily changes in the Rupee-Dollar exchange rate has eclipsed the importance of PPR, which reflects the cost of living.

As the recent data on PPR is hard to come by, one has to recall earlier data to drive home the plight of common man due to eroded PPR. It plummeted from 100 paise in 1971 to 8.38paise in 2001 with 1971 as the base year CPI-IW.

Assuming same CPI-IW series were followed today, the IVR of one Rupee might have been one Paise, if not zero in 2022.

PPR however, gets a new lease of life on paper through periodic launch of new series of CPI and wholesale price index (WPI).

This assumption appears reasonable if we reckon the sole statement on PPR made by Modi Government in Parliament. As Minister of State for Finance, Nirmala Sitharaman departed from standard PPR measure, CPI-IW, while answering a question in Rajya Sabha on 22nd July 2014.

Data given by her in the Reply showed that PPR in terms of WPI (Base 2004-05=100) declined from Rupee 0.76 in 2009-10 to Rupee 0.56 in 2013-14.

Compare this data with one given in an official reply to a Rajya Sabha Question dated 30th September 1964. This showed that PPR, as the reciprocal of the WPI with 1938-39 base as 100, fell to Paise 41 in 1945 and further to Paise 23 by 1951.

How can PPR more than double from Paise 23 in 1951 to Paise 56 in 2013-14 in spite of annual inflation over this period?

The cost-of-living crisis faced by teeming millions cast responsibility on the Opposition to convince the Government to prevent further erosion in the PPR.

Unstoppable decline in external and internal value of Rupee puts a big question mark about Government's claim that India's economic fundamentals are strong. Persisting trade deficit and fiscal deficit don't constitute strong fundamentals. Neither do unemployment, job losses and soaring public debt (Central and States debt combined). Nor do the surge in poverty, especially after the emergence of Covid-19 and the consequent lockdowns and other regulations that constrain economic activities.

It is high time for TV channels to shift national discourse from avoidable discords to inflation, depreciation and plummeting PPR. It is time to lay a roadmap for strong rupee.

Mere increase in GDP growth or absolute size of economy can't hide the weak economic fundamentals including abysmally low consumption or availability of resources on per capita basis.

A basic cause of inflation is the Union Government's obsession with the Pay Commissions, whose recommendations are implemented religiously after every 10 years. This is done in spite of recommendations from successive Finance Commissions as each Pay Commission award starts a new cycle of inflation.

The second major cause of inflation is the annual increase in minimum support prices (MSP) of major foodgrains, oilseeds and pulses, etc. MSP benefits only a section of wheat and paddy farmers.

Farmers can't enhance crop productivity and cost competitiveness without statutory MSP, without genetic-engineered crops and without rational pricing-cum-subsidisation of fertilisers, etc.

Annual hikes in MSP, at present, thus largely benefit the traders. Such hikes strengthen the bulwark for inflation. This hurts those citizens who buy foodgrains or their value-added products from the open market. The Government has insulated the poor from impact of MSP hikes since 2013 by not revising the price at which foodgrains are rationed. This, of course, has increased food subsidy and fiscal deficit, which contributes to inflationary forces.

Regular announcement of increase in MSP also benefits foreign farmers and traders who export oilseeds, edible oils and pulses worth several thousands of crores to India. Increase in MSP, without adequate and pan-India procurement by Government agencies, does not help farmers. Self-sufficiency in the production of oilseeds and pulses has thus remained a grand illusion for decades.

Similarly, bottlenecks in exploration and production of fossil fuels and development of hydro-power has contributed adverse balance of payments position. A similar situation exists in case of mineral resources such as bauxite and beach sand minerals. We have missed opportunities over the decades to tap such resources for exports as well as for creating value-addition chains of metals.

Unsustainable fiscal deficit, ballooning public debt and proliferating vote-catching populist schemes are a few more underlying causes for inflation and depreciation.

The link between fiscal deficit and inflation has been well established by researchers across the world. According to RBI's Occasional Paper (OP), published in 2010, "

Inflation, at times, may become effectively a fiscal phenomenon, since the fiscal stance could influence significantly the overall monetary conditions".

OP adds: "

Empirical estimates of this paper conducted over the sample period 1953-2009 suggest that one percentage point increase in the level of the fiscal deficit could cause about a quarter of a percentage point increase in the Wholesale Price Index (WPI)".

It is here apt to recall what late Arun Jaitley said on 29th August 2013 while initiating a debate on inflation and rupee depreciation. As leader of the Opposition in Rajya Sabha, Mr Jaitley cautioned: "

when prudence is made subservient to populism, you will probably not even have enough money in your pocket to service that populism".

This happened to us in 1991 and it is happening to Sri Lanka and Pakistan at present.

Another factor that aids depreciation of the Rupee is avoidable ECBs by companies for financing overseas investments. The Government ought to tax such ECBs that only help create jobs for foreigners or increase India's dependence on imported commodities.

This list of factors that fuel inflation and dent Rupee's twin values is long. It is here pertinent to recall what P. V. Narasimha Rao said in a broadcast to the Nation on 9th July 1991 when Indian economy was left with depleted foreign exchange coffers.

A few days after assuming charge as Prime Minister, Mr. Rao stated: "

We believe that the Nation, as well as the Government, must learn to live within its means. Normally a family borrows money to buy an asset and not to meet daily expenditure. So it is with Government. There is much fat in Government expenditure. This can and will be cut".

The Government's unproductive and wasteful expenditure has grown by leaps and bounds since then. It is time for Prime Minister Mr Narendra Modi to do a PVNR in the national interest lest India one day goes the Sri Lankan way.

As Gujarat Chief Minister, Mr. Modi spoke so much against depreciation of Rupee. He repeatedly cautioned the nation against its adverse impact. The citizens expect him to lead the nation out of this vicious circle of inflation-depreciation.