CHAPTER IX

SUMMARY & CONCLUSION

Exchange rate which is generally defined as the value of one unit of a national currency in terms of the units of a foreign currency,is in fact the relative price of the different national currencies and is determined like all other prices by the demand and supply schedules. Of course the determination of exchange rate which was a simpler affair in gold standard days, is greatly affected by the purchasing power parity theory, But this theory has been, because of its limitations and various shrotcomings, subject to vehement criticisms. Verily speaking it only helps in determination of a new rate of exchange provided an old rate was in existence, after changes in price level have taken place.

In the history of international trade diverse opinions have been expressed by the exponents of foreign exchange theory for and against the fixed and fluctuating exchange rates, multiple and floating exchange rates. But it can conclusively be said that since changes in the exchange rates have a bearing on prices, employment, and national income, and the changes in prices, employment and national income are bound to bring about variations in the exchange rate, a policy of adherence to fixed exchange rate is rather not possible and is quite unsuitable for developing countries. That is why developing countries prefer flexibility in the exchange rate depending upon the exigencies of their economic situation. Since the world consists of developed,developing and economically backward countries the exchange rate regarding its stability or degree of flexibility on its multiplicity can not be the same. Moreover, the goal of stability may have to be sacrificed a little in the wider interest of other vital objectives of fuller employment and economic developments. Keeping these objectives in view no country allows exchange rate variations left entirely to themselves. It may safely be conceded that exchange rate variations have lost their gold-standard days significance and importance for these are used as taking to bring about to correct various types of imbalances prevalent in the economy. Exchange rate ceased to be a gold, it is used to achieve rather another objective or objectives.

Effects of exchange rate variations directly or indirectly are far-reaching as these go a long way to affect the quantum and volume of productions, income, the magnitude of employment, balance of payments, terms of trade and so on. Thus variations in exchange rate primarily affect the external as well as the internal economy of a country. Exchange rate variations (depression or appreciation) may lead to a rise or fall in production at the cost of ~~a~~ rise or fall in production in other countries. It may or may not lead to a rise or fall in production of all the countries taken together, depending upon whether changes in production have taken conducive to a rise in world trade or otherwise. Exchange rate variations affect namely the nature and quantum of production but it generally go a long way to affect directly and indirectly the magnitude of employment as well. As employment depends upon production, and production on the quantity and quality of various factors of production, technique of production as also technology, infrastructure (vital input of production) , and numerous incentives of which exchange depreciation may be one, it may not be possible to quantify the rise in employment due to exchange rate depreciation, for it is not possible to indicate precisely the extent of rise in production.

However it may be possible to indicate the trends of employment in a country where exchange depreciation has taken place after examining and analysing the nature of rise in exports and the same in decline in imports as well as propensity to consume, employment multiplier, foreign trade multiplier, leakages etc. If the statistics regarding the elasticities of home demand for imports and foreign demand for exports, of elasticities of home supply of our exports and foreign supply of our imports are available, foreign trade multiplier may be estimated and propensity to consume may be worked out. It is possible to measure if not accurately at least approximately the extent of rise in exports and fall in imports and net result in the balance of trade as a result of a certain degree of the depreciation of the exchange rate. Similarly the trends in exports and imports as well as in the balance of trade as a result of appreciation of the exchange rate to an appreciable degree may also be ascertained. Balance of payments is also like balance of trade affected by exchange rate variations. Although it may be possible to bring about an adjustment in balance of payment disequilibrium merely by a change in the exchange rate it may not be desirable to bring about such adjustment in the balance of payments merely by a change in the exchange rate. It may be that the balance of payments problemeof a country may be due to economic and financial policies followed by other countries. In such circumstance it will have to be examined either such problem can be effectively tackled by exchange rate changes or by a change in the economic, financial and fiscal policies. Exchange rate changes to a smaller extent or greater extent may be effective to solve the balance of payments difficulties. But there may be circumstances in which it may not be so desirable.

The effects of exchange rate changes on the terms of trade may be determined to some degree of accuracy only in the short period of tune whereas in the long period so many other variables enter the field that consequences of exchange rate variations may not be estimated. In case of terms of trade of a country being adversely affected by dumping measures adopted by other countries anti-dumping measures may be adopted by suffering countries also with the help of sectoral exchange rate variations. But this is worth while only when elasticity of supplies of imports is less than the elasticity of supplies of exports. As reported by Graham exchange depreciation is likely to have no effect on the terms of trade. But this conclusion largely depends on the assumption that the depreciating country has not effect on world prices. The controversy regarding the effects of devaluation on terms of trade has not be resolved even by the efforts at empirical testing. However, the effect of depreciation on terms of trade will vary from case to case depending upon the conditions facing each country.

When exchange rates are manipulated necessarily there must be some objectives for which these manipulations are to be adopted. For the national economic goals of securing full employment and balance of payments equilibrium different types of exchange rate manipulations are adopted. It has been the constant endeavour of the I.M.F. to exercise firm surveillance over the members' policies and actions in the field of exchange rate with a view to prohibit attempts by members to gain an unfair competitive advantage over other members by manipulating exchange rate. But it has not been successful in its objectives. It is not clear, however, what precisely is ment by manipulation and unfair competitive advantage.

However, simultaneous measures of exchange control are considered necessary to be adopted for the successful policy of exchange manipulations. Precisely defined and explained exchange control is essentially an instrument of economic planning, and is likely to be retained or adopted as long as capital plight and periodic depression plague nations. It is not without significance, therefore, that the Bretton Woods Agreements provide for permanent exchange control over autonomous short term capital movements as well as for temporary exchange control under exceptional circumstances. But it should be remembered that exchange control furnishes no solution to the problem of balance of payments disequilibrium. It deals only with the deficit, not its causes and it aggravates those causes tending to create a more basic disequilibrium. Unless restrictions can be kept moderate or are to be used as a temporary stop gap while other more fundamental adjustments are made, resort to exchange control is likely to be costly and disappointing choice.

The external value of the Rupee in India has been subject to variations since the Mughal period when the silver and gold standard coins were in vogue in North and South India. The modern Indian Rupee owes its origin to Rupia which was prevalent during the regime of Sher Shah Suri and later on for a country as a whole Indian Rupee was introduced by East India Company. Till 1873 the exchange rate between Rupee and Pound continued to Rs 1 = 2sh. On the recommendation of the Fowler Committee the exchange rate was fixed as Rs 1 = 1s.4d which continued till 1917. Later on gold bullion standard was adopted on the recomendation of Hilton Young Commission and the exchange rate was fixed at Rs 1 = 1sh.6d. However, inspite of the great ratio controversy raised around whether Rs 1= 1sh.4d. or Rs1=1sh.6d the Government of India insisted on maintaining the exchange rate at 1sh.6d. which was higher than the pre war rate i.e. Rs 1 = 1sh.4d.

The value of Rupee during 1927-31 passed through two important phases i.e. the period of adjustment and the period of strain. The period of adjustment witnessed a sizeable increase in the total trade as a result of greate improvement in world trade, and the period of strain synchronised with world trade depression. The various actions taken by the government to maintain 1sh.6d ratio indicate that the Indian Rupee was overvalued during the period. However, prior to September 1931 when England went off gold standard the Indian Rupee was virtually equal to 1sh.6d. gold as sterling was convertible into gold and this ratio continued even after 1931. The external value of the Rupee which was fixed at 1sh.6d. with effects from 1927 had not been able to adjust the prices in India even upto 1929. But the trends of price movement in India and the U.K. and brought about the adjustment of 1930. It is curious to notathat the external value of the Rupee did not depend on its internal purchasing power and as such the fate of the Indian Rupee totally depended on the sterling-dollar rate.

During the period of the second world war the value of the Rupee was not uniform and did not mean the same to every body; while it had no adverse impact on those who earned huge profits, limited money either of the black money market or in war contracts, the masses suffered enormously. After war the Value of the Rupee continued to exhibit its tendency to fall and the inflationary rise in prices led the Government of India to adopt a number of measures to check it but in vain. Consequently the problem became a serious one in September 1949 when India devalued the Rupee and Pakistan refused to do so. India's unilateral devaluation in 1949 had a weakening effect on the external value of the Rupee. Since the balance of payments positions was becoming precarious India took resort to devaluation. But its result was very short lived and just after two years the balance of payments difficulties again cropped up. In nut shell devaluation brought about adverse consequences to the economy as a whole and the inflationary tide swept the country at large. However devaluation succeeded to some extent in correcting the disequilibrium in our external accounts. There was no change in the actual external value of the Rupee from 1939 to 1950-51 although the real external value of the Rupee did not remain the same.

The prices during the first five year plan indicated a downward trend consequent upon a rise in national income, substantial increase in food production etc. During the period the internal value of the Rupee became more or less stabilized. In India in case of exchange control and stability of exchange rate in terms of sterling and dollar it is not possible to judge easily the Strength of the external value of the Rupee. The internal value of the Rupee which had appreciated during the first plan was subject to fast erosion during the second five year plan period with the biggest fall between the years 1957-58 to 1958-59 when it fell from Rs 0.90 to Rs0.85. The external value of the Rupee as indicated by the adverse balance of payments position and acute foreign exchange crisis came under heavy strain and stress. However the value of the Rupee which was 0.80 paise at the commencement of third five year plan came down to 59 paise at the end of the plan period a recorded fall of about 26.25 %. As regards the external value of the Rupee it was brought down by devaluation of June,1966 and the balance of payments also continued to deteriorate persistently .

As a matter of fact the fate of the Indian Rupee during the era of planning particularly during the second and third plan periods may be said to synchronize with the constant fall of its external value . Thus the stability of the external value of the Rupee attained during the first five year plan was gradually lost during the second and third five year plans. On account of a number of factors combined together Indian Rupee was devalued in June 1966 which demonstrated the fact that the external value of the currency unit can not be kept intact if its internal value is allowed to fall beyond limit. In short, the main objective of devaluation was to bring about a correction in the mal-adjustment that had prevailed in the external economy for a quite long time. Consequences of devaluation may be seen in price rise, insignificant increase in exports and sufficient percentage decrease in imports. The effect of devaluation on import substitution is natural but devaluation without other measures can not be very effective for a successful policy of import substitution. Import measured as percentage of total supplies (G.N.P.) show that import substitution is substantially taking place in the country. So far as the impact of devaluation on foreign aid is concerned it may be concluded that in the absence of adequate data it is not possible to indicate whether devaluation of 1966 had any impact on foreign aid or assistance. Moreover, it is not necessary that devaluation may ultimately be able to bring about total adjustments in the balance of payments for which a set of other measures leaning mor or more on price mechanism and market forces were adopted by the government of India after June,1966.

The effects of devaluation on tourism are but natural. But actually the arival of tourists and the earnings from them was not equal to our expectations. It is surprising,however, that after 1966 devaluation the number of tourists from the U.S.A. and the earnings from them instead of increasing went on declining. Devaluation of 1966 was expected to provide disincentives to the Indian tourists going abroad. In the absence of reliable data it is, however, not possible to say what happened actually to the number of tourists going from India abroad. Besides it appears that devaluation was able to attain success in reducing the leakages of foreign exchange attributed to the activities of anti-social elements. Moreover, the external value of the Rupee is supposed to depend upon its internal worth. Briefly it may be stated that there has been almost an upward trend in the prices and consequently a continuous fall in the internal value of the Rupee right from 1939.which is actually, not an isolated phenomenon. It may be marked that in determing the external value of currencies the consideration of internal value has lost its previous importance in so far as it can not be ascertained now that the external value of a currency depends entirly on its purchasing power.

Under the Bretton Woods period of 1946-70 it was easy to find the international value of a currency unit and for that matter the international value of the Rupee. The value of the Rupee was expressed as a certain quantity of gold and so was the case with all the currencies which were the members of the I.M.F. and by comparison.the international value was found out. But with the start of the floating era the international value has become altogether meaningless in its earlier sense of the term.

While dealing with the determinants of the value of the Rupee we find that as a matter of fact the internal as well as external value was determined by its metallic contents till 1893 after which there was divorce between the internal and external values and the metallic contents. The external value of the Rupee thereafter was fixed by the government from time to time. However, the main determinant and a guide in the determination was the purchasing power of the Rupee. There has been a continuous decline in the purchasing power of the Rupee in all the three decades. The most surprising and noticeable phenomenon is that in all the successive decades the percentage decline in the purchasing power of the Rupee has been on the increase. Moreover, the greatest decline was registered during the decade 1961-62 to 1970-71 as compared to previous decades. Consequently, intrinsic worth of the Rupee has almost disappeared and its internal purchasing power has been continuously shrinking and it has acquired a shape which is not easily discernable from its original one.

As regards the third aspect of its value i.e. the external value of the Rupee it was kept constant at 18 d right from April 1925 upto 5th June 1966. But with effects from the 6th, June, 1966 the old ideas regarding stability in the exchange rate appeared to have been advanced and the Rupee was allowed to search its new levels and in this search of a new effective level for the external value of the Rupee there was not a considered line of thinking till September 24, 1975. It is, of course, obvious from the published data that the decline in the external value of the Rupee does not reflect the decline in its internal purchasing power and this establishes the thesis that the determination of the external value of the Rupee has been divorced from its internal purchasing power, if not completely, to a very great extent. Besides the internal purchasing power of the Rupee the other factors such as the balance of trade, balance of payments, inflation in foreign countries inflow and outflow of the capital etc. act and react on its external value. It may be stated that upto 1943-44 the balance of trade was not a factor in reducing the external value of the Rupee after that it become an important factor in depressing in its external value. Although if the changes in the external value of the Rupee from time to time have helped more or less in the process of adjustment in balance of payments, the balance of payments has been exerting pressures on the determination of the external value of the Rupee and it has been one of the most important factors in determining a particular external value of the Rupee.

Unlike England and Japan the economic transactions due to foreign trade in India account for only a small percentage as compared to the total economic transactions in the country. In view of this, international relation cannot have as much impact on our economy as it will have on country like England and Japan. The exchange rate variations, methodology to deal with the problems arising out of inflation has lost its ground. Inflow and outflow of capital also have their impact on external value of the currency. If a country some how or other manages for foreign loans or assistances the lowering down of the external value of the currency or in other words devaluation becomes imperative this leads to a rise in prices. If the rise in prices becomes substantial either due to devaluation or due to other factors a further dose of devaluation has to be applied. This is the lesson that we learned from the history and experience of changes in the external value of the Rupee in India for the much greater part during the pre-second world war period when our Rupee was linked with pound-sterling and also during the post-second world war period upto 1971 when the Rupee had its major operational connections with the U.S.A. dollars This lesson together with the circumstance spelt out by someother international factors compelled us to delink the Rupee from the pound-sterling on September 25,1975 and link it with a basket of currencies.The existing floating exchange rate system has,no doubt, been serving the purpose in the special circumstances in which India's foreign trade finds itself set up in the peculiar international monetary situation. But with the change in the monetary climate expected in future this arrangement shall have to be alterred. India herself can not adopt an exclusive system. At the sametime her exchange rate pattern is most likely to be affected by such factors as massive liquid funds with the multinationals and the Euro-currencies dollar deposits and Petro-dollars causing speculative impacts and thus giving jerks to the currently prevailing exchange rate system. This system suffers,in addition, from the difficulties relating to its complex administration and is also not proving so beneficial to the developing countries in particular. Our analysis has made it clear that the future exchange rate system has to be sooner, or later fashioned on what may be called '' stable and adjustable par values ' . This,however, require practical wisdom and sagacity on the part of the entire international community to arrive at a sensible agreement.