

FROM
HYPER-INFLATION
TO ,
DEVALUATION

BY

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APPENDIX I

While the manuscript was in the press, the Minister of Finance gave the Indian Parliament on 5th October 1949 a full account of the course of events and the reasons for devaluation. Important extracts from his speech are given below to enable the reader to judge the case for devaluation and the logic of the proposed programme:

In view of the very short time between the time the decision of the U.K. was communicated to India and its announcement next morning, the Government of India had no opportunity for arranging a "sort of leisurely consultation" which the Ceylon Government had in mind. As soon as the Government of India reached the decision to devalue the rupee on Saturday Dr. Matthai tried to get in touch with the Ceylon High Commissioner, but he was away from Delhi.

Making full allowances to the difficulties of the United Kingdom Government, he nevertheless felt that it was possible, if arrangements had been made in time, for the U.K. Government to take the Commonwealth Ministers more fully into their confidence than they apparently did. He made this statement because he felt that not only had India been placed in an inconvenient position, but it had caused inconvenience to "our neighbours, Ceylon and Pakistan." He would always make every effort to avoid inconveniences to others.

"I feel that in this matter I have had to act not on conviction necessarily born of logic but, so to speak, by the compulsion of events.

"I am not happy that I have had to make a decision in these circumstances. Nevertheless, since the pound sterling was devalued, I felt—and my colleagues entirely agreed with me—that there was no other course open to us."

Dr. Matthai reminded the House that nearly 75 per cent of the export trade of this country was with the countries included in soft currency areas. Indian piecegoods would have had to compete with Lancashire piecegoods in the markets of the sterling area.

The same applied to Indian competition with Ceylon tea, groundnut and manganese from East and South Africa and Dundee jute goods. Because of our dependence on the sterling area for exports, because of our unfavourable balance of trade, because of our high level of prices, everybody who understood finance and business in any country would have presumed that a high rate for the rupee would be unmaintainable.

With regard to the balance of trade with the United States, India's main exports were jute goods and tea. In respect of these two commodities neither the demand for these articles in the United States nor the supply in India admitted of any substantial variation in response to the changes in prices.

One way in which this could be obviated was by a system of customs duty on exported articles consistently with the maintenance of our position in the export market. On the import side India's dollar expenditure would increase. The remedial measures that they would have to take were to stop imports of food grains as far as possible and reduce imports such as motor vehicles and divert our machinery imports to soft currency areas.

As far as the United Kingdom was concerned, he thought the position would be left unaffected except for two factors, namely, the prices of goods exported to India by the U.K. using materials produced in the United States would necessarily increase. Due to increased demands on soft currency areas because of the higher dollar prices of goods, prices of goods in soft currency areas might increase to some extent.

He claimed that the movement of capital from India to other countries would now diminish and similarly investments in India for hard currency areas would be more attractive.

"We are a member of what is called the sterling area. So long as we are a member of the sterling area, it is an obligation which is placed upon us, and which we must be prepared to honour fully, that whatever we do must be in keeping with the general objective of that area."

"The essence of the sterling area is that all the hard currency resources earned by the members of the sterling area are pooled. All the members of the sterling area have the

right to draw upon this central reserve for meeting their deficits in respect of dollar resources.

"It so happens today that next to the United Kingdom, we are the country which makes the biggest demand upon these central reserves. That was not so till a few years ago."

Dr. Matthai explained that the rupee today was not linked to sterling any more than to any other currency. There was a par value between the rupee and sterling in the same way as there was between the rupee and other currencies.

He said that if, as the result of the devaluation of the pound sterling and other measures which the United Kingdom Government had taken, there was no improvement in the dollar position of the United Kingdom and other countries of the sterling area and the dollar reserves of the sterling area continued to diminish, "it is not inconceivable that we should be faced with the position that the sterling area would be dissolved."

"All the agreements that we have made with Pakistan regarding payments for commodities are based on the parity of the Indian rupee with the Pakistan rupee. They are based also on this consideration that all settlements should be made in sterling."

On the ratio now proposed by the Pakistan Government, Indian manufacturers would be compelled in their own interest as a matter of sheer self-preservation to refuse to buy raw jute and raw cotton from Pakistan to the extent they had done in the past. This was not a matter of retaliation at all but simply the play of economic forces.

The Pakistan Government were understood to have a fairly big industrialization programme. The moment that programme came into operation, imports of capital goods would begin to increase. That again would be a factor on the other side. "It seems to me, therefore, that forces are likely to work in a direction which will diminish and eliminate this favourable balance."

Referring to the question of price level in the country, he said, he would leave out speculative increases. From the purely economic point of view, the cost of living index should

not increase as all the items on which the cost of living index was based were of indigenous origin.

As regards food, imports from the United States for the current year had already been completed and there would be no additional expenditure on that account.

As regards cloth, the medium and coarse varieties were produced out of short staple cotton of indigenous origin.

Concluding, the Finance Minister said that this devaluation should be looked upon as a "timely warning." "For many years now, we have been living beyond our means both internally and externally. I say this is a timely warning because we have yet time to put things together and to remedy the situation before it becomes too bad to mend."

The Finance Minister announced some of the steps which the Government of India had taken or proposed to take to meet the situation created by devaluation. The measures are:

(1) Formulation of the future pattern of trade which in the new situation with which we are faced should reduce our expenditure of foreign exchange to the minimum, having regard to the essential requirements of the country.

(2) Employment of such purchasing power as we have for the purpose of bringing down to reasonable minimum prices of industrial material imported from countries whose currencies have appreciated in relation to Indian currency.

(3) Prevention of speculative prices by legislative and administrative measures and by regulation of credit facilities.

(4) The imposition of customs duties consistently with the principle of non-discrimination on articles exported to hard currency areas so as to ensure maximum amount of foreign exchange and at the same time to secure advantages resulting from devaluation, distributed among the foreign importer, Indian manufacturer and Indian exchequer.

(5) To further stimulation for investment which devaluation generally provides and thereby assist production and promote development by an intensified savings drive by propaganda and, failing this, by compulsion and provision of suitable Government assistance for the extension of banking facilities in rural areas.

(6) With the same object in view to extend facilities for voluntary settlement of taxes payable in respect of war profits of assesseees whose cases have not been referred to the Income-Tax Investigation Commission.

(7) Introduction of economy measures for securing a reduction of approximately Rs. 40 crores in revenue and capital expenditure for the current year and not less than twice that sum next year as compared to the Budget estimates of 1949-50. It is, however, expected that if the scheme for stimulating investment makes satisfactory progress, further sums would be made available for development expenditure next year.

(8) To take steps in co-operation with the Provincial and State Governments to bring about a reduction of ten per cent in the retail prices of essential commodities, manufactured goods as well as food grains by a reduction of ex-farm and ex-factory prices or by reduction of distribution costs and incidental charges or by both.

APPENDIX II EXCHANGE RATES

| <i>LONDON on:</i> | <i>Old Rate</i> | <i>New Rate</i> | <i>Percentage change</i> |
|--------------------|-----------------|-----------------|--------------------------|
| New York (\$) | 4.03 | 2.80 | —30.5 |
| Brussels (Fcs.) | 176 | 140 | —20.4 |
| Montreal (Can. \$) | 4.03 | 3.08 | —23.6 |
| Paris (Fcs.) | 1097 | 980 | —10.6 |
| Tokyo (Yen) | 1450 | 1008 | —30.5 |
| Moscow (Roubles) | 10.38 | 14.84 | +30 |
| Zurich (Fcs.) | 17.35 | 12.12 | —30.14 |
| Milan (Lira) | 575 | 617 | + 6.8 |
| Karachi (d) | 18 | 25.9 | —30.5 |

INDIA'S FOREIGN TRADE (In Crores of Rupees)

| <i>Twelve months ended March:</i> | <i>Exports</i> | <i>Imports</i> | <i>Balance of Trade</i> |
|-----------------------------------|-------------------|----------------|-------------------------|
| 1948 | 395.31 (7.88)* | 398.62 | — 4.57 |
| 1949 | 415.53 (7.29)* | 518.00 | —95.18 |

* Re-exports.

PRINCIPAL EXPORTS AND IMPORTS

(In Crores of Rupees)

| EXPORTS (including re-exports) | | | | IMPORTS | | | |
|-----------------------------------|----|--------|--------|-------------------------------|------------|------------|------------|
| Twelve months ending : | | | | Twelve months ending : | | | |
| | | | | March 1948 | | March 1949 | |
| | | | | March 1948 | March 1949 | March 1948 | March 1949 |
| Jute Yarn and Mfgs. | .. | 127.82 | 146.31 | Machinery | .. | 59.14 | 80.87 |
| Raw Jute & Waste | .. | 25.86 | 23.89 | Grain, pulse, flour | .. | 23.00 | 66.51 |
| Cotton Yarn & Mfgs. | .. | 20.53 | 41.13 | Cotton Yarn & Mfgs. | .. | 9.51 | 17.06 |
| Cotton Raw & Waste | .. | 39.87 | 19.15 | Cotton Raw & Waste | .. | 31.20 | 64.23 |
| Tea | .. | 54.90 | 63.69 | Metals | .. | 23.03 | 32.89 |
| Hides & Skins | .. | 14.49 | 12.69 | Vehicles | .. | 26.64 | 32.68 |
| Gums, resins & Lac | .. | 9.87 | 9.49 | Chemicals, drugs & medicines | .. | 20.04 | 28.89 |
| Tobacco | .. | 6.65 | 8.36 | Electrical goods & appliances | .. | 9.72 | 11.40 |
| Spices | .. | 6.42 | 5.53 | Oils | .. | 36.97 | 37.66 |
| | | | | Cutlery & hardware | .. | 21.83 | 16.44 |
| | | | | Paper, pasteboard | .. | 14.21 | 15.08 |

COUNTRY-WISE IMPORTS AND EXPORTS OF MERCHANDISE OF INDIA

(In Crores of Rupees)

Twelve Months ended March 1949

| <i>Devaluing Countries</i> | | | | <i>Non-devaluing Countries</i> | | | |
|----------------------------|---------|---------|---------------------|--------------------------------|---------|---------|---------------------|
| | Exports | Imports | Balance of Trade | | Exports | Imports | Balance of Trade |
| U. K. | 97.26 | 152.04 | -54.78 | U. S. A. | 70.64 | 104.24 | -33.60 |
| Australia | 20.52 | 20.93 | - 0.41 | Pakistan | 46.12 | 22.37 | +23.75 |
| Egypt | 6.72 | 31.89 | -25.17 | Canada | 8.39 | 7.91 | + 0.48 |
| Sweden | 2.12 | 6.05 | - 3.93 | Belgium & Belgian Congo | 6.87 | 7.62 | - 0.75 |
| Burma | 10.56 | 18.77 | - 8.21 | Argentina** | 16.76 | 6.60 | +10.16 |
| Portugal & Portuguese | | | | Switzerland | 1.22 | 8.66 | - 7.44 |
| Africa | 2.32 | 2.65 | - 0.33 | Japan* | 4.59 | 6.37 | - 1.78 |
| Total | 139.50 | 232.33 | -92.83 | Germany* | 2.60 | 2.25 | + 0.35 |
| Other countries | 126.14 | 119.57 | + 6.57 | Total | 157.19 | 166.02 | - 8.83 |

**Multiple exchange rates.

*Controlled economy and foreign trade and arbitrary rates.

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TO

MY WIFE

Who has more cause to resent inflation being
concerned with things outside the study-room

P R E F A C E

The first part of this book is a mere reprint of *Shadows of Hyper-inflation* which was completed at the end of the year 1948 and published early in 1949. The economic situation analysed in it continues unaltered even today and forms necessarily the background of Part II.

The second part is a restatement of a lecture delivered at the Sydenham College on 19th September, the day of devaluation, and elaborated in another lecture to the Commerce Graduates' Association on 26th September.

Revision of exchange parities is a highly technical subject. There is much to be said for every alternative and the decision must rest on the balancing of several forces and estimates of their workings in the near and distant future. Those responsible for the destinies of a country cannot afford to overlook any aspect of the intricate situation.

Events alone must prove or disprove the wisdom of the technical decision. The people of this country would do well, however, to recognize one simple truth. It is the privilege of every one to ask and work for the maximum payment and income. But it is also the moral obligation of every one to offer in return the maximum honest work of which he is capable. Levels of investment, employment and output, the balancing of exports and imports at the maximum levels, and efficiency of public and private administration cannot be achieved on the basis of the maximum of pay and the minimum of work and character. Under a half-free and half-controlled economy, a competently framed and competently implemented economic policy is of the utmost importance. But so is also the determination of the people to face toil, sweat and tears.

S. K. MURANJAN

*Sydenham College of
Commerce & Economics,
Bombay, 4th October 1949*

PREFACE TO PART I

The present booklet is a restatement of a theme first advanced in an article contributed to the Independence Number of the *Forum* of Bombay and elaborated subsequently in four lectures delivered to the Banking Association of the Podar College of Commerce, the Marathi Literary Association of the Sydenham College, the Bombay Discussion Group and the Social Contact Group.

A few months before the end of the War, I wrote in *Economics of Post-War India*, "...the danger of a further inflation superimposing itself on the inflation of war years arises from more than one quarter—the unleashing of the pent-up forces of investment, the release of hoarded currency and bank balances, the super-normal level of cash reserves and subnormal level of loans and advances of banks..... In an all-round sanguine environment like this a cheap money policy by the Reserve Bank can only aggravate the upward trend and make the ultimate crisis and collapse more certain."

In discussing the "International Background of Post-War Planning", I observed in the same book: "It is more consistent with the logic of facts that the co-operation of the future will be one of pacts, compacts and agreements and that behind this facade will operate not rational economics, but political power, pure and simple. If this analysis is correct, closed economy rather than inter-country mobility of capital and labour will be more compatible with the spirit of the future."

Immediately after the end of the War, I observed in the second edition of the aforesaid work: "It appears therefore reasonable to conclude that the volume of expenditure during war whether financed out of taxation and borrowing or by inflation need not leave behind it a legacy of adverse effects on the volume of output or employment."

Unfortunately, those who were in power and those who offered themselves to be their advisers were all haunted by fears of uncontrollable deflation and they blundered into

measures which kindled the fires of an uncontrollable inflation. Whatever chance there appeared for a short time of reaching stable conditions were more than destroyed by precipitate decontrol unaccompanied by any precautions to hold in check monetary factors.

The outcome has been described by some as an 'economic crisis'. We are certainly not in the midst of an economic crisis in the scientific sense of the term. We are at present treading the road to economic attrition and atrophy. The crisis, if it ever comes, will not be an economic crisis: it will be a crisis of social relations—between man and man, class and class, the power of Capital and the power of Labour. The voice of Economic Wisdom, if there ever was any in this country, will be as ineffective then as it has been in the past. In no country is Truth invoked more *ad nauseum*; in no country is Truth, when unpalatable, more resented or covered with genuine or calculated quackery.

I must acknowledge thanks to the Editor of the *Forum*, through whose kind courtesy the article referred to earlier has been reproduced as an Appendix in this book.

31st December 1948

S. K. M.