

**Statement of the effect on the financial position of the Government of India of an alteration in the exchange value of the rupee from 1s. 6d. to 1s. 4d. gold.**

In this statement an attempt is made to arrive at an estimate of the probable effect on the civil and military expenditure and on the general revenues of the Government of India if the present ratio of the rupee at 1s. 6d. were changed to 1s. 4d. The problem is mainly considered with reference to the financial effect on the Budget of 1927-28, which has been framed on the basis of 1s. 6d. but the same effect will probably continue without material abatement in 1928-29. As regards future years, an attempt is also made to gauge the broad results of the various processes of adjustment to the new conditions so far as these can be estimated with any degree of certainty. It is outside the scope of this note to examine the effect of the lower ratio on the financial condition of the Provincial Governments. The realisation of their hopes for the final remission of Provincial contributions would be deferred but, apart from this, they would have to meet considerably increased expenditure while their difficulties in regard to provision of funds for the development of beneficent services would be greatly accentuated. Nor would further financial embarrassment in the Provinces fail to repercuss on the Central Government.

2. The estimate is based on the assumptions, which are obviously exceedingly questionable assumptions, that—

- (a) the Government would not be required at any early date to adjust the pay and allowances of its establishment, amounting to nearly Rs. 26 crores in the military estimates and 14 crores in the civil estimates, on account of the fall of 11 per cent. in the real wages now in force.
- (b) the rates of interest on which Government borrows at present will not be increased.

Further, no allowance is made for the possibility of an early increase in railway rates or in certain of the postal and telegraph charges. The cost of transport by rail to the civil and military estimates is approximately Rs. 3 crores per annum.

3. The effect on expenditure may first be estimated.

(a) *Sterling expenditure charged to Revenue (net)*—The net sterling expenditure on interest, stores, pay, pension and allowances of establishment and other non-effective and miscellaneous charges on both civil and military account amounts to a total of £18,862,000. The additional expenditure which would be necessary to meet these charges, if the ratio were 1s. 4d., amounts to Rs. 3.14 crores which would clearly constitute a continuing charge for some years to come.

(b) *Rupee expenditure charged to Revenue*.—Excluding outlay on pay and allowances of establishment, military and civil, amounting to about Rs. 40 crores, the principal expenditure which would be affected by the change in the ratio is that involved in the purchase in India of numerous classes of

supplies and stores for the various civil and military departments. The price of these commodities would respond at once to a sudden fall in exchange and the increase in prices would be practically instantaneous in those articles, the price of which is regulated by world factors. The present scale of rupee expenditure on commodities is in the neighbourhood of Rs. 15 crores, of which Rs. 12 crores appertains to the military estimates. This amount represents the maintenance charges of the Army in respect of rations (atta etc.) fodder, clothing, local engineering and medical stores and multifarious other supplies. The cost of similar supplies in the civil estimates is Rs. 3 crores. The alteration from 1s. 6d. to 1s. 4d. would, within two or three years, involve the full additional charge of 12½ per cent. or Rs. 1·87 crores but for 1927-28 it may be assumed that the full adjustment will not be reached throughout all classes of stores and an average increase of 7½ per cent. would be a reasonable and cautious estimate. This increase on Rs. 15 crores means an additional expenditure of Rs. 1·12 crores.

(c) *Expenditure charged to Capital.*—The capital expenditure of the Government of India, on other than railway account, amounts to about £200,000 in England and Rs. 2 crores in India, the latter being a diminishing figure as New Delhi is approaching completion. The increased capital expenditure on the basis of 1s. 4d. on account of exchange and higher price of commodities purchased on capital account may be taken at Rs. 12 lakhs. On account of sterling debt disbursements in England additional remittance of Rs. 36 lakhs would be required. The small additional charge on account of interest on these two items has not been taken into account in this statement.

4. *Revenue.*—The principal heads of revenue are dealt with below :—

(a) *Salt.*—The cost of manufacture, which would increase with a general rise of prices, is recovered from the consumer and there would be no net additional charge to Government on this account. As regards the salt duty, which depends upon consumption, it may be assumed that a general rise in the cost of living in advance of adjustment of wages would affect the consuming power of the public. Experience however indicates that the effect of a general rise in prices is not likely to be appreciable in the case of an article so essential as salt on which the expenditure of the individual is relatively small. No material change is therefore assumed in salt revenue.

(b) *Opium.*—Excise opium is sold to local Governments at cost price. A rise in the cost of manufacture would therefore not affect Central revenues.

Provision opium is sold to consuming Governments on rupee contracts. Where the selling price cannot be altered during the currency of the contract, the net profit of Government would be affected by the increased cost of cultivation and manufacture, but, as the revenue under this head is already decreasing in pursuance of the policy of Government in regard to exports of opium, no further reduction in receipts has here been taken into account.

Medicinal opium is sold in London at sterling prices. The effect of the alteration in the ratio is not appreciable.

(c) *Taxes on Income.*—The effect on Taxes on Income is problematical. As the taxes, collected in 1927-28, will be assessed on the basis of the current year's profits, there will be no immediate effect on the revenue, but the general dislocation of trade, which would assuredly follow from a sudden fall to

1s. 4d., would make it difficult to collect a certain proportion of the taxes. No reliable estimate can be framed of this loss in revenue but it would be appreciable.

As regards the future, it is probable that a period of rising prices would afford a temporary stimulus to certain industrial concerns. Profits would increase at first and with them the yield of these taxes, but any gain from this source would be more than counterbalanced by losses resulting from the serious disturbance of general trade which would follow from the sudden reversion to the 1s. 4d. ratio. When complete adjustment has taken place, it may safely be assumed that no material change, attributable solely to the lower exchange, could be traced in this source of revenue.

(d) *Customs*.—As regards Customs duty, a statement is appended which gives, under the various categories, the expert views of the Central Board of Revenue. They estimate the immediate effect as a net loss of Rs. 1,26 lakhs in 1927-28. With the sudden rise in prices of imported goods and with the general dislocation of trade, a definite set-back would be imparted to the import trade in the first year or two which would be partly counterbalanced by increased duty on articles assessed *ad valorem*. There are many factors to be taken into account, but it is certain that there would be an immediate and considerable loss in Customs revenues which may be, for present purposes, assessed, on the most optimistic considerations, at not less than one crore of rupees. This loss would gradually disappear as adjustment to the new ratio was effected and as trade settled down after the initial disturbance and probably a definite increase of revenue could be expected from *ad valorem* duties after the revival of the import trade.

5. The general conclusions are that the finances of Government would suffer to the following extent on the basis of present scales of expenditure and revenue —

	(In crores.)	
	1927-28	After adjustment.
Sterling transactions . . . . .	3.14	3.14
Rupee purchases . . . . .	1.12	1.87
Loss in revenue . . . . .	1	...
	—	—
	5.26	5.01
	—	—

The estimate for the period after adjustment to the new conditions of exchange makes no allowance for the increased revenue from Customs duties charged *ad valorem*, which may fairly be estimated at Rs. 1½ to Rs. 2 crores in the circumstances described in the last paragraph of the note by the Central Board of Revenue.

On the other hand, the estimate takes no account of any increase in establishment charges or in the cost of railway and other transport. Under the former head an allowance of even half the reduction in real wages, which would follow from the reversion to 1s. 4d., would involve extra expenditure

of over Rs. 2 crores, while increased railway rates would involve at least Rs. 30 lakhs more. Nor again has any account been taken of the effect on the rates at which Government will borrow in the future, of a widespread dislocation of the money market and of the serious damage to the credit of the Government, both in India and abroad, which would undoubtedly ensue from a forced and unnatural depression of the exchange value of the rupee.

6. There is a further result which should not be overlooked. The sterling debt of India (excluding Railway debt) amounts to £339 million. The additional amount of rupees required to redeem this debt on a basis of 1s. 4d. would be no less than 56½ crores.

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The 28th February 1927.

*Statement by the Central Board of Revenue on the probable effect on Customs Revenues of an alteration in the exchange value of the rupee from 1s. 6d. to 1s. 4d. gold.*

(Where not otherwise stated, all figures represent lakhs.)

The final estimates for 1927-28 calculated on the basis of 1s. 6d. to the rupee are as follows:—

Import duties . . . . .	41,89
Export duties . . . . .	5,22
Miscellaneous . . . . .	2,49
	49,60

#### IMPORT DUTIES.

2. Import duties may be divided into the following three groups against each of which the estimated revenue thereunder is shown:—

(a) Specific duties . . . . .	16,89
(b) <i>Ad valorem</i> duties levied on tariff valuations . . . . .	5,23
(c) <i>Ad valorem</i> duties levied on real value . . . . .	19,77
	41,89

3. The effect on the selling price in India of a rise in the landed cost of goods liable to specific duties must depend to some extent on the amount of the duty. The selling price is made up of the landed cost, *plus* the importer's expenses and profit, *plus* the duty. The effect of any increase in the first of these three items on the selling price, and thereby on the demand, will be greater with a low duty than with a high duty. The average incidence of our specific duties is about 38 per cent. on the landed cost, so that, allowing another 20 per cent. for expenses and profit, the increase in the selling price will be approximately 8 per cent. A reduction of demand by 6 per cent. may therefore be expected, involving a loss of approximately one crore.

4. For goods liable to *ad valorem* duties assessable on tariff valuations, somewhat similar considerations will apply. These valuations are fixed

annually by notification, and ordinarily have effect from the first of January to the 31st of the following December. They are fixed, after discussion with the trade, primarily on the basis of the average prices ruling during the preceding year. It is, however, usual to take into consideration any very marked tendency of prices, whether upwards or downwards, at the close of the year if there is reason to believe that such tendency is not of a temporary nature. The Government of India have the power to alter these valuations at any time; and they have used this power occasionally to reduce a valuation during the interval between the annual revisions, when they have had reason to believe that it was based on erroneous calculations or, for other reasons. But it is many years since the power was employed to increase valuations at any other time than that of the annual general revision. The trades concerned have accepted with equanimity the present system under which a valuation in excess of market rates in one year is balanced by a correspondingly low valuation in another, and to enforce a general revision from the first of April on account of a fall of the exchange value of the rupee would cause considerable disturbance and opposition.

5. Assuming, then, that the tariff valuations will not be generally revised before the first of January, 1928, there will be 9 months during which duty will be collected on the valuations already in force. The duties in this class are at rates varying from  $7\frac{1}{2}$  to 30 per cent. the average being about 17 per cent. The rise in selling price is likely to be nearly 9 per cent. and the loss for nine months approximately 5 per cent. of the total for the year, that is 26 lakhs. For the remainder of the year, when higher valuations are in force, selling prices, with the higher incidence of duty, will be increased by 11 per cent. over the present figures. For this period there will be roughly a fall of  $8\frac{1}{2}$  per cent. on the value of the trade and a gain of  $12\frac{1}{2}$  per cent. on the duty, a net gain at the rate of 4 per cent. per annum, or say, 1 per cent. of the total for the year, that is 5 lakhs. Thus, on this class of duties we may expect a loss of 21 lakhs.

6. The third class of duties, those levied at *ad valorem* rates on the real value, apply to certain trades which are particularly sensitive to fluctuations in price. Prominent among these are the piece-goods and motor trades. The yield from cotton piece-goods has been estimated at 700 lakhs. A rise of  $12\frac{1}{2}$  per cent. in landed cost is equivalent in effect to an increase in the duty from 11 to  $24\frac{1}{2}$ ths per cent. It would be unsafe to assume any very large fall in shippers' prices, but assuming that the manufacturer reduced his price by  $2\frac{1}{2}$  per cent., imports are likely to decrease, involving a drop of not less than 10 per cent. in value. The resulting loss would be 70 lakhs.

7. Motor-cars are assessed on their landed cost, and as between different makes of car selling in India at the same price, there is a very wide variation, amounting in some cases to as much as 80 per cent in the landed cost. This results from the very low prices at which cars can be landed in India from countries with depreciated currencies. One effect of a fall in the rupee would be the replacement of cars whose landed cost is relatively high and which yield a high duty compared with their selling price, by cars which contribute relatively little to our revenue. This transfer of demand would operate to reduce the revenue quite apart from the general depressing effect of increased prices on the trade. It may further be observed that the Budget includes proposals to reduce the

duty on cars from 30 to 20 per cent, but if this reduction is combined with an increase of 12½ per cent. in cost, it will be converted into the equivalent of an increase in the duty from 30 to 35 per cent. It would not be safe to assume a smaller loss than 20 per cent. or 21 lakhs.

8. Other *ad valorem* duties contribute 11,69 lakhs. Higher values will mean higher duties, but a smaller volume of imports. Assigning a higher relative importance to the first of these factors, a net gain of 3 per cent. or 35 lakhs may be assumed.

#### EXPORT DUTIES.

9. The duty on skins is an *ad valorem* duty leviable on a tariff valuation. Again, assuming that this will not be changed before the end of the calendar year, the trade should derive a stimulus from the fall in the rupee, and it may be assumed that for 9 months the revenue will increase by 12½ per cent. and for the remaining 3 months by 25 per cent., a total increase of 3 lakhs.

10. The duties on jute are specific and the volume of trade is very little affected by fluctuations in price. It is unlikely that exports would increase to the extent of more than 5 per cent. as a result of the fall in the rupee. On this basis, the gain would be 19 lakhs.

11. The duty on rice is also specific, and as export rice is to some extent in competition with rice from French Indo-China and elsewhere, an increase of 20 per cent. may be taken, giving a further gain of 24 lakhs.

#### MISCELLANEOUS.

12. The principal items under this head are the excise duties on motor spirit, 1,00, and kerosene, 1,10. The depression of the motor trade may be expected to cause a loss of 5 lakhs on motor spirit, but the kerosene duty should increase by 10 lakhs as a result in the fall in the imports of foreign kerosene, a net gain of 5 lakhs.

Other items under this head are not likely to be affected seriously.

13. *Refunds* of import duty should decrease, but export refunds are likely to increase and, on the balance, this item of the expenditure Budget should not be affected.

#### SUMMARY.

14. The effect on the gross revenue may be summarised as follows:—

Paragraph	Gains.	Losses.
Paragraph 3 . . . . .	...	1,00
" 5 . . . . .	5	26
" 6 . . . . .	...	70
" 7 . . . . .	...	21
" 8 . . . . .	35	...
" 9 . . . . .	3	...
" 10 . . . . .	19	...
" 11 . . . . .	24	...
" 12 . . . . .	10	5
	26	2,22

A net loss of 1,26 lakhs in 1927-28.

15. For the year 1928-29, the net loss of 21 lakhs referred to in paragraph 5 would be converted into a gain of 20 lakhs, and the total net loss would be reduced to 85 lakhs. Thereafter, as conditions gradually adjusted themselves, the loss would be reduced progressively and any attempt to forecast the ultimate effect on the revenues must be largely guess-work. So many factors beside price-variations have affected the course of trade in the past that it is very difficult to isolate the effect of any particular factor, but it may, perhaps, be instructive to compare trade in 1913-14 with trade in 1925-26. Imports have increased in value from 183 to 226 crores and exports from 249 to 385 crores. Assuming a rise in the level of prices of only 50 per cent., it will be seen that whereas the volume of exports has remained at about the same figure, the volume of imports has fallen by about 20 per cent. It may fairly be inferred that the recovery of the import trade from a permanent increase in prices, whether it be a direct price-variation, or the indirect result of high duties or an alteration in exchange, is a slow process. In any case, the effect on specific duties will always operate to set off a part at least of what may be gained by the levy of *ad valorem* duties on higher priced goods.

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