The Case Against Devaluation

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Even granting that the demand for our non-traditional exports is price-elastic, the values of price-elasticities will vary a great deal and, accordingly. different rates of subsidy will he called for. Devalution, being essentially a blanket measure, cannot take care of this.

True, fixing the appropriate rate of subsidy for each commodity is a difficult task. But then, deciding upon the necessary extent of devaluation would be more difficult still. There is besides the problem that bringing the domestic price-structure in line with the international price-structure through exchange rate depreciation 'may leave the adjustment short of what is required for some commodities and carry it too far for others.

WHEN at the beginning of the Second Plan we found ourselves in the midst of a serious foreign exchange crisis, some people cried themselves hoarse for devaluation arguing naively that the rupee was overvalued. Now once again when our chronic payments difficulties have assumed threatening proportions, we hear the familiar cry for devaluation, albeit in a more sophisticated form.

Jagdish Bhagwati *(The Economic Weekly,* August 4, 1902) argues that the Government's present policy of (indirectly) subsidising exports is cumbersome and at times self-defeating, that the Government's implicit admission of the price-elasticity of foreign demand for our non-traditional exports removes one of the traditional arguments against devaluation and that the inflationary dangers of a devaluation are. under the existing circumstances, entirely illusory.

It is difficult to understand, however, how devaluation can secure anything that cannot be ensured by a system of selective taxes and subsidies. As I have argued elsewhere *(The Economic Weekly,* Special Number. July 1962). in view of the installed capacity in many engineering, chemical and other industries lying underutilised for shortage of imported materials and equipments and in view[7] of the availability of structurally unemployed domestic labour at a very low social opportunity cost each additional unit of foreign exchange earned and spent on maintenance imports may increase domestic production several times its value tone can easily work out some sort of a 'multiplier' here. but one feels a bit hesitant in multiplying the 'multipliers' in economic literature); and in this context, the case tar Export subsidies and for taxes on imported equipapart from infant-industry or external-economies arguments) One might .say that the same argument may hold good for devaluation too. But the difference is that while taxes and subsidies can be discriminatory both in coverage and rates, devaluation will be unnecessarily pervasive.

Even if one grants that the demand for our non-traditional exports is price-elastic, the relevant values of price-elasticities (however measured) will conceivably vary from a little above 1 (neglecting signs) to far above it, and accordingly different rates of subsidy may be called for. Devaluation, being essentially a blanket measure. can hardly take care of this. True, fixing the appropriate rate of subsidy for a commodity is a tough job. But then, deciding about the proper extent of devaluation is tougher still, and added to that remains the problem that bringing the domestic price-structure in line with the international price-structure through exchange rate depreciation may carry the adjustment too little for some commodities and too much for others.[1]

Then again, while devaluation will attract widespread notice in the international money market, possibly shaking the already dwindling confidence in the Indian rupee, discriminatory taxes and subsidies can easily wear thin disguises without inviting much international retaliation or GATT disapproval". That the existing subsidy measures are 'cumbersome', nobody will dispute. But that is no reason why one should not try to make them more efficient. Similarly, if "under the current system, the Government pays out money to the exporters by way of effective subsidies but does not pick up an equal amount from the importers"., the next step is certainly not to argue for outright devaluation but to tighten our tariff system.

Jagdish Bhagwati has certainly a point when he demolishes the contention that a devaluation would be inflationary,[3] but inflation is *not* "the only argument which can possibly be cited against a devaluation"' (even if one admits that the foreign demand for our non-traditional exports is price-elastic). As a matter of fact, at the present moment "the central obstacle to a devaluation" is not that it might cause, inflation but that it is unnecessary. The onus of proving that devaluation would be better than a system of selective taxes and subsidies is still on Jagdish Bhagwati.

[1] Jagdish Bhagwati recommends a devaluation that would be offset by export taxes on some of our (price-inelastic) traditional exports. But one wonders if our traditional exports are price inelastic even for price rises although they may plausibly be so for price falls. One may conceive of a Sweezy type 'kink' in our export demand functions. In that case, export taxes may adversely affect foreign exchange earnings.

Any devaluation will also be in the nature of a once-for-all change for quite some time, but taxes and subsidies can be. more flexible in response to changing requirements.

[1] In case of imported essential consumer floods directly entering the cost of living index, the effect of a higher rupee cost will be tantamount to that of an indirect tax on consumers, mainly of the poor and lower middle classes. Although such indirect taxes do not generate inflationary pressures in the 'Keynesiarr sense (assuming, with Jagdish Bhagwati, that trade unions are ineffective in securing a wage-push), it is not clear why further indirect taxation on the poorer classes has to be imposed (without ensuring that the other classes are paying their dues according to their ability)', or why the rates of such indirect taxes have to be uniform for all typer, of imports (as would automatically be the ease after devaluation, if nothing else is done about it). If one wants indirect taxation to impinge on purchasing power, a tariff system with suitable rates and exemptions would be more efficient.