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A NOTE ON DEVALUATION AND THE MEASURES BY WHICH IT SHOULD BE FOLLOWED

The economic collapse of which the devaluation of the currency is only one aspect is the cumulative result of the mistaken economic policies and planning of the Union Government over the last decade and a half. If the repeated warnings sounded by the Swatantra Party spokesmen, both in Parliament and outside, had not been ignored, the country would not today be in its present plight.

2. In order that the sacrifices entailed in the process of devaluation may not be wasted, the corrective effect of devaluation may operate fully and the economy may derive the fullest benefit, it has now become necessary for the Government to come forward with a Declaration of Policy on the following lines :

(a) A clear declaration that from now inflationary policies of every kind will be scrupulously eschewed and that, subject to whatever foreign assistance may be made available, the Indian Government will live within its means.

(b) Appropriate reduction in civil non-developmental expenditure of the Union & State Governments and the observance by the Union and State Governments of fiscal discipline by eschewing deficit finance and overdrafts. All further recruitment of the civil services to be stopped.

(c) The restriction of foreign loans on government-to-government basis only to such legitimate purposes as fall within the natural duties of the State like the laying of infrastructure (including the provision of irrigation, roads and communications and electric power) and, as a short-term measure, for maintenance imports; and the creation of conditions that would encourage indigenous and foreign capital to produce the goods that are required by the people.

At the beginning of the discussion, the Prime Minister indicated that the main reason that compelled Government to devalue the rupee at this stage was the need to sustain and stimulate the country's flagging exports.

We on our part started with the discussion by pointing out that where the Swatantra Party differed from all other Opposition parties was that it does not regard the act of devaluation to be an offence, but holds the Government responsible for its mistaken policies over a decade which had made a resort to devaluation necessary. The Party's main concern was to see that the benefits of devaluation were not lost and that the sacrifices made by the people were not wasted as a result of correct policies not being adopted even now.

(a) We urged that, while the long term measures we were suggesting would take some time to be implemented, an immediate declaration of policy indicating the direction in which the Government proposed to move was necessary.

The Prime Minister's initial reaction was that Government's policy would unfold as it took various decisions over a period of time. Later, however, she made the remark that after they had consulted the Planning Commission etc., they hoped to be able to state their policy by the time Parliament met on July 25.

(C) When told that her statement that, while the U.S.S.R. financed the State Sector, U.S. Aid financed the Private Sector was incorrect, the Prime Minister laughed and said that she had already received a long letter from Chester Bowles putting her right!

Mr. L.K. Jha asked why steel should not be an area for Government-to-Government loans? Our comment was that the only legitimate source~~s~~ of finance for any new Government steel plant should be the profits - as and when made - by Hindustan Steel Limited.

contd....2/-

(d) A postponement and recasting of the proposed Fourth Plan by dropping all new capital projects in the State sector (including the proposed Bokaro Steel project), except such as fall within the area indicated in (c) above.

(e) A sharp reduction in both direct and indirect taxes so as to increase the flow of national savings and thus make available a large supply of rupee finance for expanding production and lowering the cost of domestic goods.

(f) The complete dismantling of the structure of permits, licences and controls including import licensing, exchange control and Gold Control, so that the machinery of production and competitive enterprise comes under the direction and caters to theneeds of the common man instead of being manipulated arbitrarily by the planners and the Administration, as this is the only effective way of increasing production and bringing down prices.

(g) The commencement of negotiations with India's creditors designed to secure a reduction in the debt servicing charges on foreign debts already incurred.

3. These are long-term measure and it is realised they may take some time to be implemented. Pending their introduction and their beneficial effects materialising, the following measure should, however, be taken immediately to prevent dislocation of the economy and reduce hardship on those concerned:

(a) Orphaned industrial projects stranded in mid-stream should be helped out by easy loans from public financial institutions.

(b) An adequate supply of imported raw materials should be ensured to exporters of non-traditional exports who have lost their import entitlements.

2 (d)

When pressed to agree to the postponement of the Fourth Plan for a year or so until the country found its moorings, during which time we could proceed with an annual Plan, the Prime Minister objected that it would make it difficult to obtain foreign aid unless a Five Year Plan was presented. We argued that in fact the position would be exactly the reverse. The Prime Minister asked why we thought that the Plan came in the way of getting increased production and why a rupee in the pockets of the people/was more productive than in the hands of the Government. Our answer was that, by diverting the people's saving from more productive investment by them to Government enterprises, which took away 60% of the Plan outlay, production was being impeded. The Prime Minister was not prepared to agree that all new projects in the State Sector shouldbe dropped from the Fourth Plan and said the Government was trying to improve their efficiency instead. She made the remark that wherever they had a good man in charge of a State enterprise, it did well. They were trying to make State Enterprises more profit oriented. Our comment was that the only way to do this was to subject a State enterprise to free and equal competition with other priva enterprises and to abandon monopoly.

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When explaining 2 (e), we mentioned that if Government desired to guard against increased distribution of dividends as a result of tax reduction we would be quite prepared to support the creation of a re-investment fund in the assessees own hands.into which such savings could be deposited. The Prime Minister seemed to appreciate the need for tax laws to distinguish between income that reinvested in an enterprise and that which is expended on consumption.

Mr. L.K. Jha agreed that rupee finance was needed, but indicated that this could be mobilised by higher taxation. Our comment was that it would be the best way to demobilise savings and to put them out of effective productive use.

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On the subject of Controls, Mr. Jha indicated that the previous day's action in regard to import liberalisation was the first step in that direction. The number of industries that benefitted, namely, 59, would go up in the light of reexamination. The policy would be a pragmatic one of controls that proved to be necessary.

When attention was drawn to Mr. L. Sawhny's recent article, "The Conscience of Free Enterprise," in the Hindustan Times stressing the need for restoring free competition, it was obvious that neither the Prime Minister nor the P.P.S. had read the article.

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(c) The new export duties introduced with devaluation should be withdrawn, as they are likely to obstruct the corrective effect of devaluation by reducing the incentive to promote exports, hinder the necessary encouragement to a shift of production to the export industries and impede the solution of our difficulties in regard to the balance of payments.

(d) Import duties and surcharges and countervailing excise duties on raw and intermediate materials, fuels and spare parts should be completely abolished, in place of the present illusory reduction in import duties.

(N.G. RANGA)

(M.R. MASANI)

NEW DELHI
June 22, 1966

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This was taken care of by that morning's announcement regarding imports on an O.G.L. basis.

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The reply to Prof. Shenoy's criticism regardingnew export duties was that they were only on traditional exports and that other exports were left duty free. Prof.Shenoy's charge that only a small part of the incentive of devaluation now remained and that it would not be enough to stimulate the growth of exports would be examined. It was suggested to the Prime Minister that she would do well to call in for advice Prof. Shenoy, who had been vindicated by recent developments.

When asked whether Government would even now publish the Bell Report so that the people might know what it was all about and be educated in the process, the Prime Minister said she knew nothing about it. Mr. Jha said that the matter was handled by the Finance Ministry and mentioned that the permission of the President of the World Bank would be required. We suggested that this be obtained.

We mentioned that we would see little point in serving on the proposed Committee of M.P.s in regard to prices and other implications of devaluation as we do not believe that prices can be controlled by Ordinances and regulations so long as Government themselves resort to inflationary Plans and fiscal policies. We would therefore await Government's declaration of policy before we could respond to the Prime Minister's invitation. The Prime Minister indicated that no further action was contemplated before Parliament met, when this question could be discussed.

When Prof.Ranga drew attention to the fact that the Government had lost the people's confidence and did not possess the moral prestige necessary to get people to work harder and practice austerity and suggested that Rajaji's proposal that the Government should be one of all the talents irrespective of parties should be considered by her, the Prime Minister asked whether, in view of the wide difference of opinion that would prevail between the different members, such a Government would work? To that our answer was that once the Communists, who had their own fish to fry, were left out, as they should be, it would not be more difficult to achieve a consensus in such a national democratic leadership than it was for her to obtain a consensus within her present Cabinet and Party.

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