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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

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CURRENCY DEVALUATION: A STORY FROM 1966 TO 2013

REKHA RANI
GUEST FACULTY
DEPARTMENT OF COMMERCE
PGDAV (EVE) COLLEGE
UNIVERSITY OF DELHI
NEW DELHI

ABSTRACT
This research paper is related to the devaluation of rupee in India. After 1947, India has faced two major financial crises and two consequent devaluations of the rupee. These crises were in 1966 and 1991 and now in 2013 the situation is also parallel and very destructive, as I plan to show in this paper, they had similar causes. The price of 16 Ananas is 1 rupee in 1947. The demand for decimalization existed for over a century. Sri Lanka decimalized its rupee in 1869. The Indian Coinage Act was amended in September 1955 for the adoption of a decimal system for coinage .it, however, was now divided into 100 'Paisa' instead of 16 Ananas or 64 Pice. In 1947 the value of rupee was one against the US dollar and in 1966 was 7.5, and in 1990 was 17.01 but it is 63.54 at November 2013. The Indian rupee touched a lifetime low of 68.85 against the US dollar on August 28, 2013. The rupee plunged by 3.7 percent on the day in its biggest single-day percentage fall in more than two decades. There is no denying that India is not the only emerging market experiencing a rapid decline in its currency's value. Since January 2013, the rupee has lost more than 20 percent of its value, the biggest loser among the Asian currencies. In this research we will learn about the reasons, causes and effects, and suggestions to evaluate the impact of the falling rupee on the Indian economy.

KEYWORDS
Crisis, Devaluation, Distortions, Economy, Exchange.

INTRODUCTION
Devaluation means- "one country's currency is reduced in value in comparison to other currencies" A currency devalues when its value declines in relation to one or more other currencies. Let's say that on Monday $1 bought five rubles and that today, after the devaluation, it buys 10 rubles (not actual figures). Under this scenario, the ruble has devalued by 50%.

Why do countries let their currency fall in value? Well, some do it on purpose, usually to try to boost their exports and decrease their imports. How does that work? Let's imagine I'm a Russian vodka exporter and I charge 100 rubles per bottle. On Monday, one bottle cost foreigners $20 (100 divided by five). Today, at the new exchange rate, one bottle costs $10 (100 divided by 10). In theory, Russia sells a lot more vodka and other goods because they are cheaper in dollar terms -- and exports go up.

Currency depreciation is the loss of value of a country's currency with respect to one or more foreign reference currencies, typically in a floating exchange rate system. It is most often used for the unofficial increase of the exchange rate due to market forces, though sometimes it appears interchangeably with devaluation. Its opposite, an increase of value of a currency, is currency appreciation.

The depreciation of a country's currency refers to a decrease in the value of that country's currency. For instance, if the Canadian dollar depreciates relative to the euro, the exchange rate (the Canadian dollar price of Euros) rises: it takes more Canadian dollars to purchase 1 euro (1 EUR=1.5 CAD → 1 EUR=1.7 CAD).

The appreciation of a country's currency refers to an increase in the value of that country's currency. Continuing with the CAD/EUR example, if the Canadian dollar appreciates relative to the euro, the exchange rate falls: it takes fewer Canadian dollars to purchase 1 euro (1 EUR=1.5 CAD → 1 EUR=1.4 CAD). When the Canadian dollar appreciates relative to the Euro, the Canadian dollar becomes less competitive. This will lead to larger imports of European goods and services, and lower exports of Canadian goods and service. A currency appreciates as a result of increased demand for that currency on world markets: its value in the world market increases.

TYPES OF DEVALUTAION
1. **Planned devaluation:** -Planned devaluations are brought about almost exclusively by government decisions to deliberately reduce the relative value of a currency, usually intended as a means to some improvement in the country's trading position.
2. **Market-driven devaluation:** -Formal recognition by a government, frequently during a monetary crisis, that the value of its currency relative to major world currencies—especially the dollar—has already depreciated through trading in the foreign exchange markets.

REVIEW OF LITERATURE
Fleming emphasize on the fact that the market of goods and services is always simultaneously in equilibrium with the money market. Their model emphases on the simultaneous equilibrium in the money market and the market of goods and services, enabling them to analyze under different exchange rate regimes the impact of alternative macroeconomic policies on the production possibility curve of a country after a change in monetary policy. Mundell and Fleming also insisted on the free movement of capital in the economy and on the fact that the economy is open, but never did they mention in their analysis that the effects of devaluation also depend on the nature of the elasticity of supply and demand of goods and services produced by an economy.

Rose and Yellen (1989) and Rose (1991), not only find that the trade balance does not improve after a depreciation, but also find no statistical relationship exists between the two variables. Rose and Yellen (1989), use data disaggregated on a bilateral basis, that is trade between the US and UK, between the US and Japan, and similarly for the rest of the G-7. Rose (1991) uses aggregate data and, similarly, finds no relationship between the exchange rate and the trade balance. While both of these papers employ cointegration techniques in estimation, they are potentially troubled by several problems. First, they use the technique attributed to Engle and Granger (1987), which involves a two step process. This method does not account for the simultaneity of income and the trade balance and can compound measurement error in the first stage. Next I will turn to the papers that find real currency depreciation has a positive impact on the trade balance, these include, Marwah and Klein (1996), Shirvani and Wilbratte (1997), and Marquez (1991). While these studies use different econometric techniques or different levels of aggregation, they all conclude that, in the case of the United States, real dollar depreciation will improve the trade balance.

NEED OF THE STUDY
There have been many objectives about the study:-

Economic Objectives: -When employment and per capital income in a country increase, the demand for its goods and services increases, along with demand for that country's currency in the local market.

Mobilization of savings: - When employment and per capital income in a country increase, the demand for its goods and services increases, along with demand for that country's currency in the local market.

Larger market for the financial system:-When a country's exports are high, the buyers of these exports need its currency to pay for those exports.

Sustainable livelihood:-If the bank provide at a lower rate of loan, the weaker section of society got some money in loan form they can start up their own business or they can support their education through which they can sustain their livelihood.

Political objectives: -When the country's central bank increases interest rates, people will want that currency to deposit in the banks to earn that higher interest rate.

OBJECTIVE OF THE STUDY

- Find the reasons of devaluation of money
- Find the Cause & effect of devaluation
- Find the changes from 1966 to 2013
- How to control the situation

RESEARCH METHOLODOGY

Research methodology is partly descriptive and partly exploratory. For this study Secondary data is used. The data and information has been collected with the help of Books, Magazines, Newspapers, Research Articles, Research Journals, E-Journals, RBI Report, and Report of CRISIL AND Websites etc.

EVALUATION OF THE RESEARCH

THE 1966 DEVALUATION

As a developing economy, it is to be expected that India would import more than it exports. Despite government attempts to obtain a positive trade balance, India has had consistent balance of payments deficits since the 1950s. From 1950, India ran continued trade deficits that increased in magnitude in the 1960s. The 1966 devaluation was the result of the first major financial crisis the government faced. As in 1991, there was significant downward pressure on the value of the rupee from the international market and India was faced with depleting foreign reserves that necessitated devaluation. There is a general agreement among economists that by 1966, inflation had caused Indian prices to become much higher than world prices at the pre-devaluation exchange rate. When the exchange rate is fixed and a country experiences high inflation relative to other countries, that country's goods become more expensive and foreign goods become cheaper. Therefore, inflation tends to increase imports and decrease exports. Since 1950, India ran continued trade deficits that increased in magnitude in the 1960s. Furthermore, the Government of India had a budget deficit problem and could not borrow money from abroad or from the private corporate sector, due to that sector's negative savings rate. As a result, the government issued bonds to the RBI, which increased the money supply. In the long run, there is a strong link between increases in money supply and inflation. So,

- Current account deficit of over 290 crore due to second five year plan
- Inflation has caused Indian prices to become much higher than world prices
- Budget deficit due to defense spending in 1965/1966 was 24.06% of total expenditure.
- Money supply increase
- Depleting foreign reserves
- The first was India's war with Pakistan in late 1965.

THE 1991 DEVALUATION

1991 is often cited as the year of economic reform in India. Surely, the government's economic policies changed drastically in that year, but the 1991 liberalization was an extension of earlier, albeit slower, reform efforts that had begun in the 1970s when India relaxed restrictions on imported capital goods as part of its industrialization plan. Then the Import-Export Policy of 1985-1988 replaced import quotas with tariffs. This represented a major overhaul of Indian trade policy as previously, India's trade barriers mostly took the form of quantitative restrictions. After 1991, the Government of India further reduced trade barriers by lowering tariffs on imports. In the post-liberalization era, quantitative restrictions have not been significant. While the devaluation of 1991 was economically necessary to avert a financial crisis, the radical changes in India's economic policies were, to some extent, undertaken voluntarily by the government of P V NarasimhaRao. As in 1966, there was foreign pressure on India to reform its economy, but in 1991, the government committed itself to liberalization and followed through on that commitment.

According to Srinivasan and Bhagwati, "Conditionality played a role, for sure, in strengthening our will to embark on the reforms. But the seriousness and the sweep of the reforms… demonstrated that the driving force behind the reforms was equally… our own conviction that we had lost precious time and that the reforms were finally our only option (IESI, pp 93)."In 1991, India still had a fixed exchange rate system, where the rupee was pegged to the value of a basket of currencies of major trading partners. At the end of 1990, the Government of India found itself in serious economic trouble. The government was close to default and its foreign exchange reserves had dried up to the point that India could barely finance three weeks' worth of imports. As in 1966, India faced high inflation, large government budget deficits, and a poor balance of payments position. At the end of 1999, the Indian Rupee was devalued considerably. So,

- The trade deficit in 1990 US $9.44 billion.
- The current account deficit was US $9.7 billion.
- The gulf war to higher imports due to the rise in oil prices.
- Cost pulls inflation.
- Political and economic instability.
- Depleting foreign exchange reserves.
- Gold is pledged to IMF by preceding government

THE 2013 DEVALAUTION

The Indian rupee touched a lifetime low of 68.85 against the US dollar on August 28, 2013. The rupee plunged by 3.7 percent on the day in its biggest single-day percentage fall in more than two decades. Since January 2013, the rupee has lost more than 20 percent of its value, the biggest loser among the Asian currencies.

Due to stagnant reforms, and declining foreign investment, rupee started depreciating in the early 2013. As a result, the Indian Rupee dropped to 68.80 per dollar. Various measures were announced by the Government prior to this drop to prevent it from dropping further. But, none managed to slow down the depreciation. After continued depreciation, and high inflation, the Prime Minister of India, Manmohan Singh, made a statement in the Parliament of India on the issue. He was of the view that, the present depreciation is partly led by global factors as well as domestic factors. He also asked the political parties to help his Government, tide over the crisis that the country was facing with rupee losing its value.

IMPLEMENTATION

In the period 2000–2007, the Rupee stopped declining and stabilized ranging between 1 USD = INR 44–48. In late 2007, the Indian Rupee reached a record high of Rs.39 per USD, on account of sustained foreign investment flows into the country. This posed problems for major exporters, IT and BPO firms located in the country who were incurring losses in their earnings given the appreciation in rupee. The trend has reversed lately with the 2008 world financial crisis as foreign investors transferred huge sums out to their own countries. Such appreciations were reflected in many currencies, e.g. the British Pound, which had gained value against the dollar and then has lost value again with the recession of 2008.In 1947 the value of rupee was one against the US dollar and in 1966 was 7.5, and in 1990 was 17.01 but it is 63.54 at November 2013. The Indian rupee touched a lifetime low of 68.85 against the US dollar on August 28, 2013. The rupee plunged by 3.7 percent on the day in its biggest single-day percentage fall in more than two decades. Since January 2013, the rupee has lost more than 20 percent of its value, the biggest loser among the Asian currencies.

FALL OF RUPEE 2013: CAUSES, IMPACT AND THE ROLE OF RBI

The fall of rupee vs. Dollar has created the same conundrum what the rupee appreciation caused in year 2007. However, the impact has reversed this time with exporters making appreciated revenues and the importers feeling the heat. The increased demand for dollars vis-à-vis the India rupee has led to a sharp

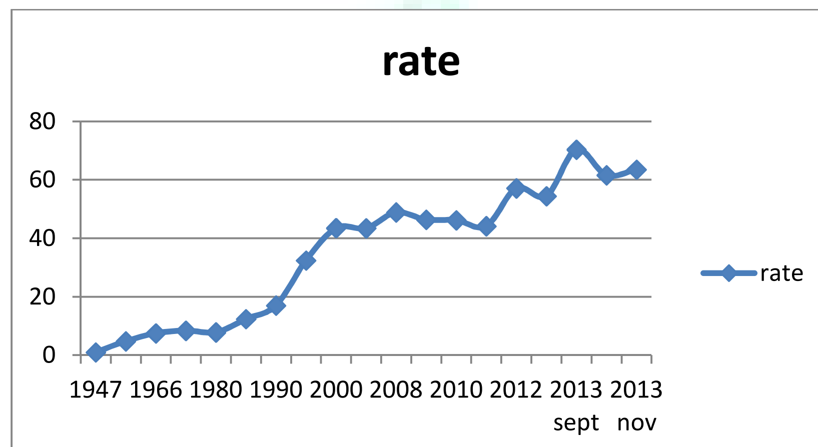
depreciation with rupee falling close to 18% from the Aug 2011 levels, and hitting an all-time low of 54.32/USD on 15th December 2011, making it the worst performing Asian currency of the year. Taking a closer look at these issues, the fall in rupee can be **attributed primarily to 3 broad factors.**

Firstly, the grim global economic outlook, essentially due to the European debt crisis. Due to turbulence in European markets, investors are considering dollars as a safe haven for their investments in the longer run. This led to an increased demand for dollars vis-à-vis the supply for rupee and thus the depreciation. The cumulative effect of these factors is leading to a shift in investor sentiments towards dollar market.

Secondly, the fall in rupee can be largely attributed to the speculations prevailing in the markets. Due to a sharp increase in the dollar rates, importers suddenly started gasping for dollars in order to hedge their position, which led to an increased demand for dollars. On the other hand exporters kept on holding their dollar reserves, speculating that the rupee will fall further in future. This interplay between the two forces further fuelled the demand for dollars while sequestering its supply from the market. This further led to the fall in rupee.

Lastly, there has been shift of FII's (Foreign institutional investors) from the Indian markets during the current financial year 2011. FII's leads a high inflow of dollars into the Indian market. As per a recent report, the share of India's FII in the developing markets has decreased considerably from 19.2 % in 2010 to 3.8% in the year 2011. As FII's are taking their investments out of the Indian markets, it has led to an increased demand for dollars, further leading to a spiraling rupee.

INDIAN RUPEE TO ONE US DOLLAR, 1947-2013



Source: www.x-rates.com, http://rtn.asia/1218_indias-crude-oil-bill-rose-40

WHY RUPEE CROSSED 65 AGAINST DOLLAR

As the figure shows that the rupee on Thursday hit a new low of 65 to the dollar amid investor skepticism about the policies of the Reserve Bank of India and the Manmohan Singh government. Traders said the sell-off was intensified by "policy flip-flops" from the RBI. On Tuesday, the RBI announced that it would inject over $1 billion into the markets, just days after saying it was working to tighten liquidity. India, however, is not the only country suffering from a weakening currency. Other emerging markets like Brazil, Indonesia, Russia, Turkey and South Africa are also witnessing huge currency volatility because of fears that US may end its quantitative easing by year-end. Since July last year, the Indian rupee has fallen by more than 27% against the US dollar, one of the biggest declines among Asian currencies. Reasons:-

- Huge trade deficit & Lower capital inflows
- High current account deficit
- Devaluation pressure
- Low growth and high inflation
- Rupee speculation

CAUSES

- Demand Supply Rule: The value of rupee follows the simple demand and supply rule of economics. If the demand for the dollar in India is more than its supply, dollar appreciates and rupee depreciates
- Dollar gaining strength against the other currencies: The central banks of Euro zone and Japan are printing excessive money due to which their currency is devalued. Hence, making the US dollar stronger against the other currencies including the Indian rupee, at least in the short term.
- Oil prices: Oil price is one of the most important factors that puts stress on the Indian Rupee. As the demand for oil or its price increases in the international market, the demand for dollars also increases to pay our suppliers from whom we import oil
- Volatile domestic equity market: Our equity market has been volatile for some time now. So, the FII's are in a dilemma whether to invest in India or not. Therefore, decrease in supply and increase in demand of dollars results in the weakening of the rupee against the dollar.

EFFECTS OF DEVALUATION

- Advantage to Exporters: Weakening of rupee gives up a huge advantage to the exporters. While exporting products, if the rupee devaluates, the exporter gets more money.
- Boom to tourism industry: Travel and tourism is a sector which will benefit from the depreciation of the rupee. If a tourist comes to India and the rupee devaluates then it would become cheaper for him.
- Imports become extremely expensive: A depreciating rupee would mean that the importers would have to pay more for their imports. So, this means that price of the goods or commodity which is being imported to India increases substantially.
- Reduction in Purchasing Power Parity: One of the outcomes of a depreciating rupee will be the rise in inflation in the economy. When the inflation rises, prices of goods and commodities shoots up. Therefore, the purchasing power of the rupee falls down.

HOW TO CONTROL THE SITUATION?

- Government should increase the limit of FDI in the existing sectors
- Government should create a stable political and economic environment in order to make India an attractive destination for foreign investments.
- Government should develop import-substituting industries in order to make India less dependent on imports.
- RBI should sell Forex reserves and buy rupees in an immediate action in order to arrest the further decline in the value of rupees.
- Government should raise import duty on gold in order to decrease the domestic demand for gold import.
- Delay import payments.

RESULTS

Clearly, there are many similarities between the devaluation of 1966, 1991 and 2013. All were preceded by large fiscal and current account deficits and by dwindling international confidence in India's economy. Inflation caused by expansionary monetary and fiscal policy depressed exports and led to consistent trade deficits. In each case, there was a large adverse shock to the economy that precipitated, but did not directly cause, the financial crisis. Additionally, from Independence until 1991, the policy of the Indian government was to follow the Soviet model of foreign trade by viewing exports as a necessary evil whose sole purpose was to earn foreign currency with which to purchase goods from abroad that could not be produced at home. As a result, there were inadequate incentives to export and the Indian economy missed out on the gains from comparative advantage. 1991 represented a fundamental paradigm shift in Indian economic policy and the government moved toward a freer trade stance.

It is easy in retrospect to fault the government's policies for leading to these two major financial crises, but it is more difficult to convincingly state what the government should have done differently that would have averted the crises. One relatively non-controversial target for criticism is the tendency of the Indian government since Independence towards large budget deficits. Basic macroeconomic theory tells us that the current account deficit is roughly equal to the sum of government and private borrowing. Given the fact that the household saving rate in India is quite high, most of the blame for India's balance of payments problems must rest with the government for its inability to control its own spending by borrowing from the Reserve Bank of India and, therefore, essentially printing money, the government could finance its extravagant spending through an inflation tax. Additionally, the large amounts of foreign aid that flowed into India clearly did not encourage fiscal or economic responsibility on the part of the government. In 1966, the lack of foreign aid to India from developed countries could not persuade India to liberalize and in fact further encouraged economic isolation. In 1991, on the other hand, there was a political will on the part of the government to pursue economic liberalization independent of the threats of aid reduction. These two financial episodes in India's modern history show that engaging in inflationary economic policies in conjunction with a fixed exchange rate regime is a destructive policy. If India had followed a floating exchange rate system instead, the rupee would have been automatically devalued by the market and India would not have faced such financial crises. A fixed exchange rate system can only be viable in the long run when there is no significant long-run inflation.

POLICY RECOMMENDATIONS

- Oil imports can be staggered.
- Encourage and increase the flow of foreign investments into India.
- Invite long term FDI in infrastructure sector.
- Government can consider temporary import compression.
- Gold imports should be restricted.
- Export promotion.

CONCLUSIONS

Foreign exchange reserves are an extremely critical aspect of any country's ability to engage in commerce with other countries. A large stock of foreign currency reserves facilitates trade with other nations and lowers transaction costs associated with international commerce. If a nation depletes its foreign currency reserves and finds that its own currency is not accepted abroad, the only option left to the country is to borrow from abroad. However, borrowing in foreign currency is built upon the obligation of the borrowing nation to pay back the loan in the lender's own currency or in some other "hard" currency. If the debtor nation is not credit-worthy enough to borrow from a private bank or from an institution such as the IMF, then the nation has no way of paying for imports and a financial crisis accompanied by devaluation and capital flight results. The destabilizing effects of a financial crisis are such that any country feels strong pressure from internal political forces to avoid the risk of such a crisis, even if the policies adopted come at large economic cost. To avert a financial crisis, a nation will typically adopt policies to maintain a stable exchange rate to lessen exchange rate risk and increase international confidence and to safeguard its foreign currency (or gold) reserves. The restrictions that a country will put in place come in two forms: trade barriers and financial restrictions. Protectionist policies, particularly restrictions on imports of goods and services, belong to the former category and restrictions on the flow of financial assets or money across international borders are in the latter category. Furthermore, these restrictions on international economic activity are often accompanied by a policy of fixed or managed exchange rates. When the flow of goods, services, and financial capital is regulated tightly enough, the government or central bank becomes strong enough, at least in theory, to dictate the exchange rate. There is no denying that India is not the only emerging market experiencing a rapid decline in its currency's value. Several emerging market currencies are also experiencing sharp depreciation over the prospect of imminent tapering of the US Federal Reserve's policy of quantitative easing (QE) program. The South African and the Brazilian are in real touched four-year lows against the US dollar in June 2013. Except the Chinese Yuan and Bangladeshi Taka, most Asian currencies have witnessed sharp depreciation since the beginning of 2013 However, despite these policies, if the market for a nation's currency is too weak to justify the given exchange rate, that nation will be forced to devalue its currency. That is, the price the market is willing to pay for the currency is less than the price dictated by the government.

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