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Chapter 10

The Political Response to the Devaluation

Despite the overvaluation of the rupee and the chaotic and inefficient pattern of subsidization that had developed in that situation, the 1966 devaluation was to run up against intense political reaction. This was to make it nearly impossible for the government to gain either real political support for the measure *ex-ante* or a rational appraisal of its success *ex-post.* An analysis of the factors underlying this outcome is necessary in order to learn lessons, not merely for Indian policy-making, so that some of the pitfalls can be avoided the next time around; there are more general lessons for the policy-makers elsewhere too.[1]

The political impact of a devaluation, and hence the alignment of pressure groups, is usually conceived of in terms of the following factors: (1) opposition parties can be expected to play upon issues of national prestige as well as on the theme that government policies have led to this "debacle"; and (2) a devaluation that improves the payments imbalance may be expected to draw support from the export sector and to be resented by importing interests.

The Indian devaluation, both economically and politically, was a more complex phenomenon, but it was not entirely an unusual phenomenon for a developing country attempting to liberalize its payments regime. Among its important features were:

1. The government was energetically pushed into devaluation by the aid consortium which made large-scale significant resumption of aid practically conditional on India's changing the parity.[2]

2. The government was in a pre-election year and also relatively weak

in having a new Prime Minister (Mrs. Indira Gandhi) whose leadership of her party was not yet consolidated.

3. The government's long-standing refusal to devalue, which was overcome in part by a consortium offer to increase the (pre-suspension) level of annual commodity aid from about $400 million to $900 million, had led for a number of years, and in particular during the preceding year 1965–66, to strenuous propaganda that stressed the alleged demerits of devaluation. On the other hand, with the exception of a few economists, there had been no convincing and sustained argumentation in support of a devaluation; hence the public stage had been occupied almost exclusively by the opponents of devaluation, largely official.

4. Finally, the devaluation, as we have noted in Chapter 6, was accompanied by simultaneous changes in export subsidies and import duties. This implied that the objectives of the measure were, for the most part, those of merely "rationalizing" the existing system rather than of seeking a large "net" devaluation; this was little understood and was a major source of confusion and misdirected criticism. It also implied that the *objections* to the devaluation were likely to come from those hurt by these accompanying changes. At the same time, the substantial increase in commodity aid promised by the consortium meant that the *supporters* would include those benefiting from increased, liberalized imports.

The remarkably unfavorable political reception accorded the 1966 devaluation in the period immediately after its announcement is readily explained once the following factors are taken into account.

1. The government failed to elicit significant support from its own (Congress) party, either in Parliament or from the party's Executive Committee members; in fact, several senior Congress party members openly expressed criticism or skepticism. Some of the flak came from members who were clearly worried about the oncoming election and found the measure risky, as all governments seem to do, in that the government might lose prestige or be blamed for unpopular price increases. Others were offended at the secrecy and at not having been consulted on such an important decision, forgetting that secrecy is inherent in such a decision. This group included senior members of the Congress party who had maneuvered successfully to make Mrs. Gandhi the Prime Minister and feared that she was becoming independent, and also others (such as a former Finance Minister) who had long opposed devaluation. Yet others, essentially on the left in the Congress party, who had welcomed the succession of Mrs. Gandhi to premiership against a right-wing contender as promising a turn to the left in Indian economic policy, thought that the devaluation that they characterized as a "surrender" to the consortium's demands, signified that they had been wrong and wanted to serve notice of their displeasure rather than support the government of their

own party. In short, the relative weakness of Mrs. Gandhi's position in her own party, the failure of her new government to project a clear political image and the impending election made the prospect of getting broad-based support from her own party very dim indeed. As it turned out, only a handful of Cabinet Ministers who had been consulted on the final decision were to be articulate in their support of the devaluation, the contributions of other prominent members of the Congress party being one of lukewarm defense or, more generally, that of mild skepticism ranging up to outright criticism.

2. Three circumstances combined to convert the customary tendency of most opposition parties to denounce devaluation as a "defeat" of the government and an "admission" of its failures into a concerted denunciation in stronger tones: (a) For some years preceding the devaluation, in response to frequent rumors based on alleged World Bank and IMF recommendations to that effect and in response to the writings of some domestic economists, the government had indulged in strenuous propaganda against devaluation; this was particularly the case with the annual reports of the Ministry of Commerce and of International Trade. (b) Supporters of a more realistic exchange rate policy had opted out of the debate on the question since the early 1960s. This meant that the largely spurious arguments put out by official agencies against an adjustment in the exchange rates were left unanswered. (c) Finally, these two facts, in conjunction with the financial inducement and pressures by the consortium, led to a situation where public opinion was generally receptive to the notion that the devaluation was *economically unsound* and was imposed on the country for "non-economic" reasons.[3]

Two factors therefore became critical in determining the overall response to the devaluation: (a) resentment at foreign influence itself, accentuated in turn by the notion that India could no longer control her own policies in her own interest; and (b) the widespread feeling that the devaluation had to be judged ultimately by what it signified beyond itself in broader political and economic terms.

3. Thus, the minority that supported (or did not oppose) the devaluation was confined to (a) economists who chose to assess the measure within its own terms, (b) several industrial groups which saw the measure as signifying an impending move toward a larger role for private enterprise and less "socialism," (c) a few isolated exporting groups whose benefit from the devaluation outweighed their loss from the simultaneous elimination of the earlier export subsidies and (d) producer groups that saw sufficient profits resulting from the raw-material-import liberalization that would follow from the grant of significant aid after devaluation.

4. These were, however, outweighed in political terms and in articulation by the critics. The alleged economic demerits of the decision and the perceived economic need of having succumbed to foreign pressure were the major focal

points of criticism from political parties on the left as well as the right, in Parliament and in the press. (Only the laissez-faire and industry-oriented right-wing Swatantra Party was schizophrenically positioned for reasons spelled out in the preceding paragraph.) In addition, the parties of the left were particularly articulate about their fear that the devaluation represented the turning point for progressive sacrifice of socialist policies regarding private foreign investment and private domestic enterprise. The critics also included the overwhelming majority of exporters who saw that the major thrust of the devaluation was aimed at reducing reliance on the *ad hoc* and selective export subsidies which had indeed proved very lucrative to the influential exporters.

All in all, therefore, the devaluation ran into an unusually hostile reception. The political lessons seem particularly pointed with regard to the use of aid as a means of influencing recipient policy, even if, in some objective sense, the pressure is in the "right" direction. The Indian experience is also instructive for the political timing of a devaluation: foreign pressure to change policies, if brought to bear when a government is weak (both for internal-structural reasons and because of an impending election, which invariably prompts cautious behavior), can be fatal. Mason and Asher, in their study of the World Bank, characterize the Indian case as "perhaps the most striking example of attempts by the Bank to use 'leverage' to bring about changes in a borrowing government's 'performance' " and one which "did not leave the Bank's relations with India unscathed."[4]

To say that there should be no "performance conditioning" in providing aid is not to suggest that there should be no evaluation of aid utilization. We think, however, that such evaluation and subsequent pressure for policy change, if any, must also recognize that economic analysis is rarely so compelling as to command universal approbation—even if one does not quite take the cynical attitude that where you have six economists, you get seven opinions. Indeed, there is much to be said, if the aid relationship is to be mature and relatively free from the frictions of the preceding decade, for the donors' influence to take the form of advice rather than prescription. In this regard, it is well worth noting that the Soviet practice of confining scrutiny to the performance of aid-financed projects, and not attempting to evaluate and influence the whole plan or set of economic policies of the recipient country, has helped to avoid the kind of adverse reaction the Western donors have provoked, however well intentioned their pressures may have been.[5] Here we again have that paradox of political economy: that a program approach, which makes much sense from an *economic* point of view (given substitution possibilities), makes little sense from a *political* point of view.

We also do not share the view that pressure to change major policies by foreign donors, especially of the type applied to India in 1966, is helpful because it "strengthens the hands" of those who, within the recipient country, want the "right" policies adopted. It is the opinion of nearly all of those few who had argued for a devaluation in the Indian context during the period preceding June 1966 that the external role at the time of devaluation compromised their political viability.[6]

NOTES

1. The following analysis and conclusions are based on an extensive examination of the relevant documents such as newspapers, journals, Lok Sabha proceedings and Rajya Sabha proceedings. The reactions and pronouncements of politicians (in and out of office), political parties, newspaper editorials, influential magazines and journals, industrial and business groups, and economists were examined. The analysis is thus confined to the so-called "elite groups"; besides it is primarily a medium-run response analysis, though there is little reason to think that anyone really changed his position on the policy option exercised by the government in June 1966, in light of longer-run developments. The only exception is the Prime Minister herself (who is reported to have been less than enthusiastic about the policy changes in light of the tremendous opposition that they elicited). Our full-length analysis (with K. Sundaram) has been published in three parts in *Economic and Political Weekly*, September 2, 9 and 16, 1972.

2. Note, however, that PL 480 food aid was continued throughout this period and that aid already in the pipeline was not halted either; only fresh commitments were held up by the U.S., though even here two new loan agreements were signed by the U.S. with India between October 1965 and June 1966. Note that aid to both India and Pakistan had originally been suspended during the war of October 1965.

3. This widely accepted view failed, of course, to recognize that the economic aspects of the problem had been discussed at length for several months prior to the decision to devalue. The Finance Ministry had before it an extensive report on the current export subsidies and the merits of a devaluation, which it had commissioned from J. Bhagwati, then at Delhi University, during mid-1965. Besides, other economists had also written in support of a new parity. Most of the major contributions on the subject have been reprinted in *Devaluation of the Rupee and its Implications* (New Delhi: Institute of Constitutional and Parliamentary Studies, 1966). In addition, see K. N. Raj, "Food, Fertiliser and Foreign Aid," *Mainstream*, April 30, 1966; C. N. Vakil, *The Devaluation of the Rupee* (Bombay: Lalvani Publishing House, 1966); and B. N. Ganguli, *Devaluation of the Rupee* (Delhi: Ranjit Printers and Publishers, 1966).

4. Edward S. Mason and Robert E. Asher, *The World Bank Since Bretton Woods* (Washington, D.C.: The Brookings Institution, 1973), p. 197. This study also stresses what the authors consider to be the disappointing features of India's economic performance that led the Bank, with the strong support of the United States, to press for reform of India's balance of payments and agricultural policies in particular.

5. Note, however, that we do not mean to imply that Soviet aid has been entirely without friction. For an interesting account and analysis of difficulties in the case of Soviet financing of the Indian steel plant at Bokaro, see Desai, *Bokaro,* especially Chapters 5–7.

6. In particular, the adverse political consequences of the 1966 experience may well have had a lasting impact on the ability of the official economists to argue for exchange rate flexibility in the future without being condemned as unwitting, if not willing, tools of

capitalist donors. In a country such as India, where the word "socialism" wins elections rather than loses them, as in the United States, an official's (as well as a Congress politician's) efficacy and possibly even his ability to get ahead in life depend significantly on whether he can operate within the broad framework of mild-to-strong left-wing politics. And one has only to examine the Indian response at the time of the Smithsonian parity changes (discussed in Chapter 11) to see the force of the point that, even in the long run, the ability of officials to press successfully for exchange rate flexibility was compromised by the 1966 experience.