International Journal of Advances in Engineering and Management (IJAEM)
Volume 2, Issue 9, pp: 236-243 www.ijaem.net ISSN: 2395-5252

Devaluation of Indian Rupee against other Currencies

Dr. Varsha Agarwal, Sahilkanunga, Siddhi Jain, Dhruv A Kankariya

Assistant Professor, Center for Management Studies, Jain (Deemed to be University) INDIA
Student BBA, Center for Management Studies, Jain (Deemed to be University) INDIA
Student BBA, Center for Management Studies, Jain (Deemed to be University) INDIA
Student BBA, Center for Management Studies, Jain (Deemed to be University) INDIA

Date of Submission: 10-11-2020 Date of Acceptance: 24-11-2020

ABSTRACT: The devaluation of Indian currency has positive and negative impact on Indian economy. Devaluation means reduction of Indian Rupee in comparison to other currency the devaluation of currency is done by government. The rupee is devalued first in 1966 by 57% from Rs. 4.76 to 7.50 against US dollar. In the year 1991, the rupee was again devalued by 19.5% from Rs.20.5 to Rs.24.5 against the US dollar. In this paper, an attempt is made to review the probable reasons for the devaluation of the rupee and analyses the impact of currency devaluation on the various sector of the country.
have you ever observed that the rate of gold 10 years ago was(for 10gms) 16320 Rs and now as on 18th OCT 2020 is 52385 Rs ,one of the major reasons behind this is devaluation, due to devaluation a countries inflation rate increases hence resulting in increase in price of the commodities. This also makes the imports cheaper which is a disadvantage to Indian exporters hence are study mainly focuses on the reasons behind the devaluation of the currency and steps which can be taken to avert such devaluation

I. INTRODUCTION

Devaluation means reduction in the value of currency with respect to goods, services or other monetary units with which that currency can be changed. For example suppose the exchange rate between rupee and dollar is Rs 70 = 1$. If this exchange rate is fixed Rs 74 = 1$then it is called the devaluation of rupee. This is a monetary policy tool used by countries that have a fixed exchange rate or semi fixed exchange rate. A country may devaluate its currency is to combat trade balances. It means the exports are less expensive and more competitive in the global market and the imports are more expensive so that the people use the domestic products.

Devaluation is a term which is different from depreciation because the value of rupee is decreased by change in the demand and supply of currency. But devaluation is done by government to improve the balance of payment.

II. REVIEW OF LITERATURE

The Indian currency depreciated more than 20 per cent in 2008 and even breached the crucial 50-level mark against the greenback on sustained dollar purchases by foreign banks and a strong dollar overseas. There were several consequences of the falling Indian rupee with mixed effects on the Indian economy. While exports rose, so too did the costs of imported goods, capital-intensive projects and dollar loans taken by companies, which increased the foreign debt. Overall, economic growth slowed down as interest rates rose and foreign institutional investment flows ebbed. This paper studies the real implications of the depreciation of the rupee on the Indian economy and shows that in the long run, the Indian economy has more to lose and less to gain from a weaker rupee (Singh, 2009).

Persistent weakness in the rupee and increasing volatility has reduced the benefits of borrowing overseas. Over the past one year, the rupee has consistently depreciated against the dollar. Since January 2013, the rupee has lost more than 20% of its value, making it the worst performing currencies in Asia. The depreciating rupee will add further pressure on the overall domestic inflation and since India is structurally an import intensive country, as reflected in the high and persistent current account deficits month after month, the domestic costs will rise on account of rupee depreciation. This paper reviews the likely reasons for this depreciation of the rupee. It also reflects on the policy options to help prevent the depreciation of the Rupee (Naranag, 2014).

From the early 1980s the International Monetary Fund (IMF) has projected devaluation as a potential solution for developing nations that are constantly spending more on imports than they earn

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on exports. A lower value for the home currency will raise the price for imports while making exports cheaper. Fall in value of rupee can lead to a reduction in citizens' standard of living because their purchasing power is reduced when they buy imports and when they travel abroad. It also can add to inflationary pressure. Devaluation can make interest payments on international debt more expensive if those debts are denominated in a foreign currency, and it can discourage foreign investors. The present paper aims to explore the real implications and causes of the depreciation of the rupee on the Indian economy. Moreover; it estimates that the Indian economy has more to lose and less to gain with depreciation of rupee in long run Singh, 2013).

Edwards (2000) investigated the dynamic association between exchange rate regimes, capital flows and currency crises in emerging economies. The study draws on lessons learned during the1990s, and deals with some of the most important policy controversies that emerged, after the Mexican East Asian, Russian and Brazilian crises. He concludes that under the appropriate conditions and policies, floating exchange rates can be effective and efficient. This means that the money supply within the country and the supply of credit to firms are tied directly to international reserves. So if the country gets capital inflows, the supply of money and credit increases, leading to a substantial increase in domestic prices.

Harberger (2003) studied the impact of economic growth on real exchange rate. He found that there is no systematic connection between economic growth and real exchange rate. Husain (2004) found in their study that little access to international capital is available for the weaker and less developed countries, so low rate of inflation and higher level of durability is associated with fixed exchange rate regime in those countries. However, they found no robust relationship between economic performance and exchange rate regime in the developing economies. They also found that advanced economies may experience durable and slightly higher level of growth rate without higher level of inflation in flexible exchange rate regime.

Kanika Arora (2014) studied the real implications of the depreciation of the rupee on the Indian economy and shows that in the long run, the Indian economy has more to lose and less to gain with weaker rupee. The study concluded that the Indian Rupee has depreciated significantly against the US Dollar marking a new risk for Indian economy. Grim global economic outlook along with high inflation, widening current account deficit and FII outflows have contributed to this fall. RBI has responded with timely interventions by selling dollars intermittently. But in times of global uncertainty, investors prefer USD as a safe haven. To attract investments, RBI can ease capital controls by increasing the FII limit on investment in government and corporate debt instruments and introduce higher ceilings in ECB’s. Government can create a stable political and economic environment.

Taylor (2001) discusses the failure of liberalized policies in Argentina. He says that Argentina has failed in maintaining the liberalized policies about capital flows and a firm currency. Argentina had anti-inflation program based on freezing the exchange rate in the early 1990s. This means that the money supply within the country and the supply of credit to firms are tied directly to international reserves. So if the country gets capital inflows, the supply of money and credit increases, leading to a substantial increase in domestic prices.

Luis-Felipe Zanna (2006) told Fighting against currency depreciation, macroeconomic instability and sudden stops also in this paper they showed that, in the aftermath of a currency crisis, a government that adjusts the nominal interest rate in response to domestic currency depreciation can induce aggregate instability in the economy by generating self-fulfilling endogenous cycles.

III. RESEARCH METHODOLOGY

The data for this research was collected through secondary sources. The qualitative data is used for this research as this research is a descriptive study. The sources for the study are collected based on the needs for the study. The sources include journals, findings from past researchers; the official data are collected from the websites of the government organisations and government institutions, articles, abstracts from the books and research papers. The research covers studies from the US, UK, and India. The study was conducted in Bangalore, Karnataka, India.

IV. DATA ANALYSIS AND INTERPRETATION

OBJECTIVES OF DEVALUATION

• Devaluation is done for correcting the balance of payment.
• For increasing the exports, devaluation is done.
• For decreasing imports, devaluation is done.

HISTORY OF RUPEE

India got freedom from British rule on August 15, 1947. At that time the Indian rupee was linked to the British pound and its value was at par

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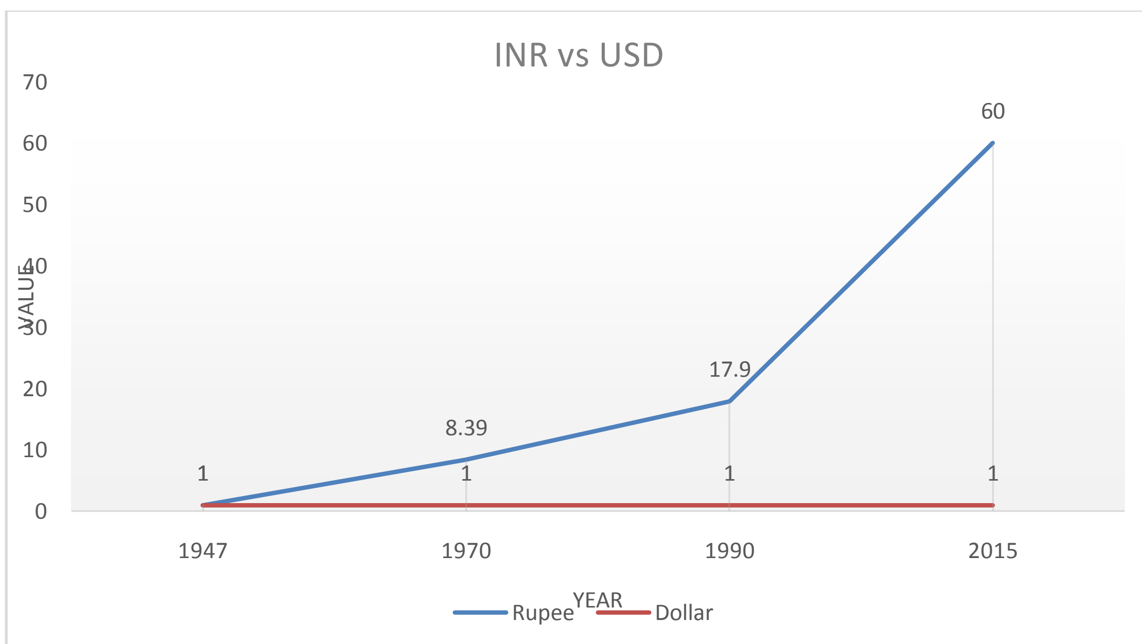
with the American dollar. As shown in table, in year 1947 the value of rupee is equal the dollar. But slowly, due to many reasons the value of rupee is decreased.

Historical Indian Rupee Rate

Year	Exchange Rate
(INR vs. US $)	
1947	1.00
1948	4.79
1965	4.79
1966	7.57
1971	8.39
1985	12.0
1991	17.9
1993	31.7
2000	45.0
2013	60.0
2016	67.63



1966 Financial Crises

Since 1950s India suffered in negative balance of payment. The main reasons of devaluation are huge trade deficit, India – Pakistan war and draught in 1965. So for improving the trade deficit, India devaluate its currency at first time in 1966. And this devaluation is done by Lal Bahadur Shastri in June 1966.

1991 Financial Crises

Since 1985 – 1990, India found itself in a serious economic trouble. In 1991 India faced large government budget deficit. For decreasing the budget deficit, government devalued its currency by 18 to 19%. The main reasons of devaluation are huge gross fiscal deficit, inflation and rise in oil prices etc.

Causes of devaluation17.

- High fiscal deficit – High fiscal deficit is regarded as the main reason of devaluation of currency. Fiscal deficit is the difference between government income and expenditure. In case of high fiscal deficit government may use foreign reserve to finance the deficit. Due to this, the reserves are reduced. And this problem encourages the government to devalue its currency.

Budget Deficit as Percentage of Total Government Expenditure

Year	Overall Deficit	Primary Deficit	Interest Payments
1960	21.05	12.37	8.68
1965-1970	25.75	16.46	9.29
1970-1975	23.14	14.17	8.97
1975-1980	22.62	14.07	8.55
1980-1985	30.23	20.34	9.89
1985	32.13	20.57	11.56
1986	35.06	23.21	11.85
1987	33.49	20.34	13.15

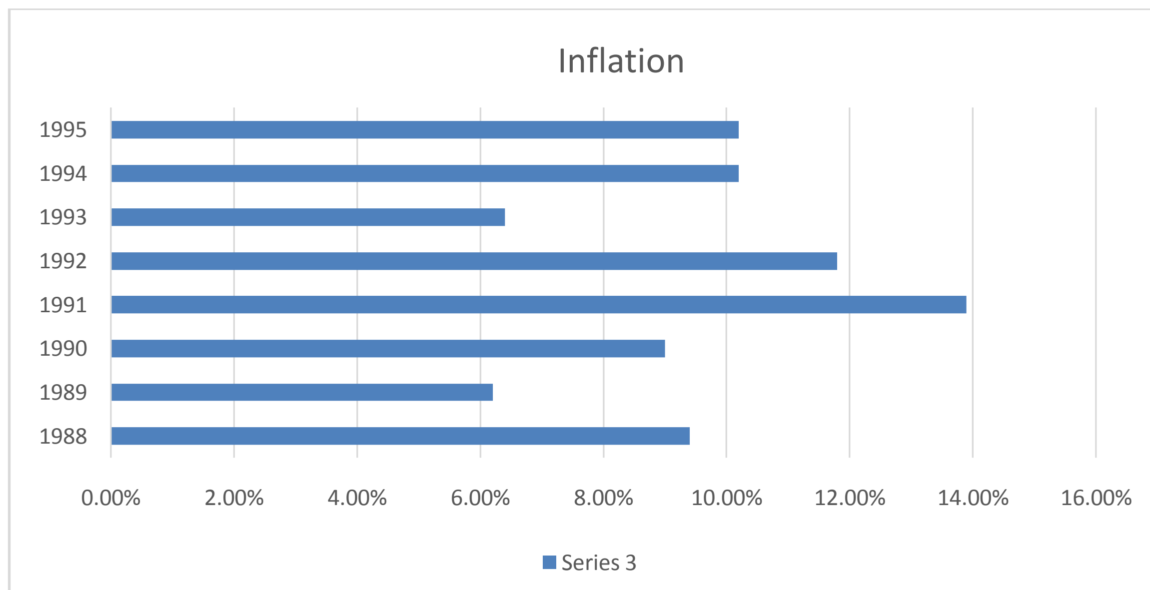
Source: Foundations of India's Political Economy, pp. 192

• Current account deficit – It is the difference between the import and export in a country. This gap between income and expenditure keeps a downward pressure on the value of rupee. In the year 1990, the current account deficit is US $9.7 billion. The wider CAD creates demand for dollar which is the reason of devaluation of rupee.

• Inflation 1980 – Inflation means continuously rise in prices. From 1966 to 1980, the value of rupee is constant. But after this, the value of money is decreased. And it decreases the purchasing power of money. Due to this there is a decline in demand of the goods and this is cause of devaluation of currency.

Inflation in India

Year	Inflation
1988	9.4%
1989	6.2%
1990	9.0%
1991	13.9%
1992	11.8%
1993	6.4%
1994	10.2%
1995	10.2%



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• Indo – Pak war 1965 – At the time of war US and other countries friendly with Pakistan and withdrew foreign aid to India. Because of this reason, the value of rupee is devalued by 57% in 1966.

• Drought of 1965/1966 - In 1965 – 1966, India faces many problems due to natural calamity draught and the prices of goods are increased because of this. So it is necessary for the government to devalue the currency.

• Trade deficit – Since 1950s India face the problem of huge trade deficit. So India devalued its currency in 1966. But again the balance of trade deficit is increased in 1990 was US $ 9.44 billion. Because of this deficit India again devalue its currency in 1991.

Year	Exports	Imports	Deficit
1950	947	1025	78
1951	1106	1379	273
1952	873	1002	129
1953	813	855	42
1954	918	998	80
1955	922	1024	102
1956	977	1423	446
1957	1001	1633	632
1958	903	1424	521
1959	1008	1515	507
1960	997	1768	771
1961	1033	1718	685
1962	1069	1783	714
1963	1241	1927	686
1964	1282	2126	844
1965	1264	2194	930
1966	1153	2078	925
1967	1193	2008	815
1968	1354	1909	555
1969	1409	1567	158
1970	1524	1624	100

Source: Data of export and import are from India and International monetary management.

• Gulf war – India also face a problem because of gulf war. It leads to increase in the prices of oil. So the imports of India are higher. For controlling this situation, devaluation is done by government.

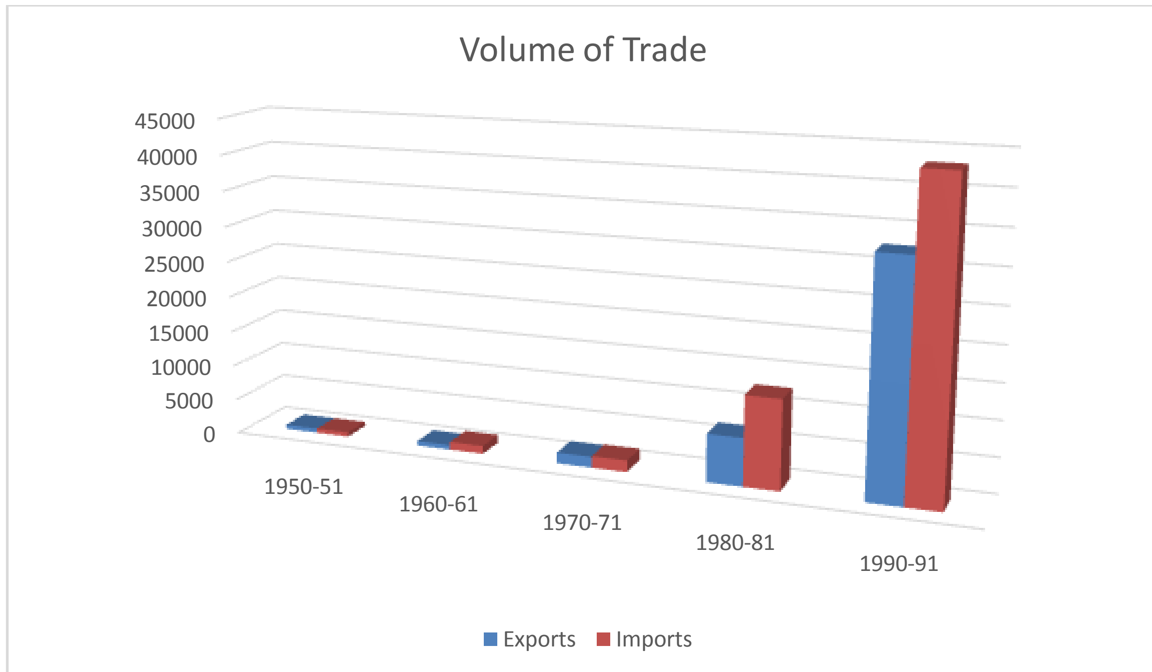
• Defence spending – Defence spending in 1965/1966 was 24.06% of total expenditure which is very high. So this is another factor which affects the value of currency.

• Political and economic instability – Another main reason of devaluation of rupee is political and economic instability. Before 1966 devaluation, in three years three persons (Nehru, Shastri, and Indira) were the PM of India. Different PM have different strategies. So this situation encourages the government to devalue its currency in 1966 and 1991.

• Increasing imports – In 1965 – 1966, Indian exports had increased up to 20% while the imports had increased up to 131.3%. So for increasing exports and decreasing imports, Indian government devalue its currency.

Volume of Trade (1950-51 to 1990-91)

Year	Exports	Imports
1950–51	606	608
1960-61	642	1122
1970-71	1535	1634
1980-81	6711	12549
1990-91	32553	43198



PRO's of Devaluation on Economy

• Exports cheaper – A devaluation of the currency will make exports more competitive and cheaper to foreigners.

• Imports expensive – Because of devaluation of rupee, the petrol, food and raw material will become more expensive. This will reduce demand for imports.

• Improvement in current account – Current account deficit is the difference of exports and imports. Because of devaluation the imports are decreasing and exports are increasing. These situations reduce the current account deficit.

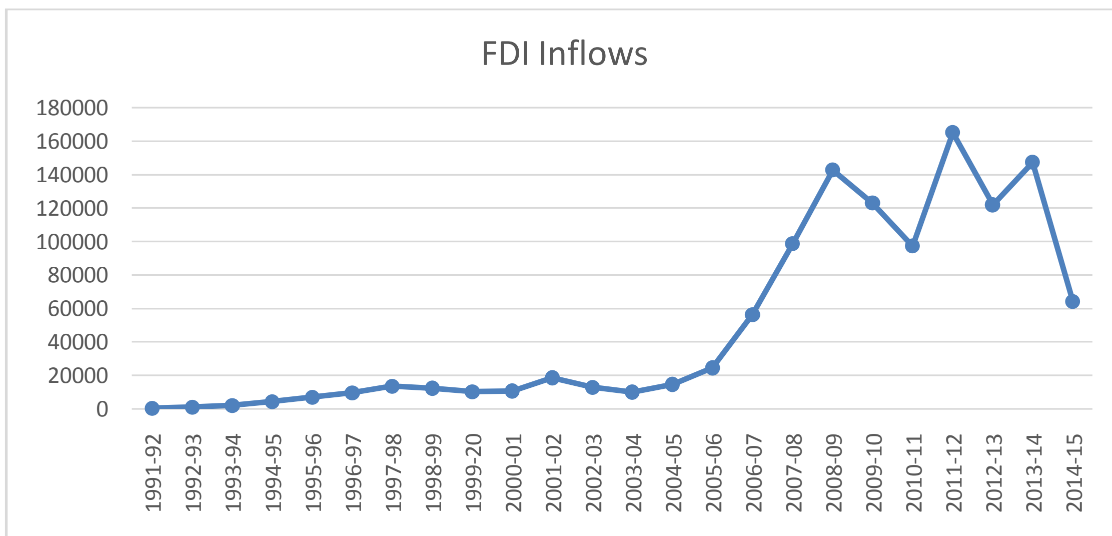
• Impact on agriculture – Devaluation of rupee has positive impact on agriculture. India is world's largest producer of wheat. So fall in the value of rupee increase the profit of Indian wheat exporters and similarly the export of sugar, rice, cotton and edible oil etc. are increased.

• Impact on Foreign Direct Investment – After the devaluation of currency the inflow of foreign direct investment is increased. As we seen in table after the devaluation of rupee in 1991 the inflow of FDI is increased from 409 crores to 64,193 crores.

Inflow of FDI in India: Period 1991 to 2015

Years FDI inflow in India
(Rs. In Crores)
1991-92 409
1992-93 1094
1993-94 2018
1994-95 4312
1995-96 6916
1996-97 9654
1997-98 13,548
1998-99 1,2343
1999-00 10,311
2000-01 10,733
2001-02 18,654
2002-03 12,871
2003-04 10,064

2004-05	14,653
2005-06	24,584
2006-07	56,390
2007-08	98,642
2008-09	142,829
2009-10	123,120
2010-11	97,320
2011-12	165,146
2012-13	121,907
2013-14	147,518
2014-15	64,193



Source: Various issues of SIA Publication

CON's of Devaluation on Economy

• Impact on common man – There would be a higher burden on the common man because of devaluation of currency. For example – the prices of fuel, imported goods and fees of abroad universities etc. Are increased and trips becomes costlier.

• Impact on infrastructure – The devaluation of rupee has negative impact on the infrastructure sector. It increases the cost of projects by increasing the cost of raw materials like steel, cement and price of construction equipment's.

• Impact on real estate – Devaluation of currency increases the cost of projects by increasing the prices of raw material, transportation, import of construction equipment, wages and salary of labour etc.

• Impact on foreign investors – Foreign investors bear a loss when the value of currency is devalued.

• Impact on Economic growth – The devaluation of rupee can only increase the short term economic growth. But it has negative impact on the long term economic growth. Because of devaluation, there is a loss of confidence in International and domestic investors. Long term economic growth is affected by reduction in investment.

• Impact on Inflation – Due to devaluation, the prices of goods are increased because of imports are more expensive and exports are cheaper. So more money is pay for the same products for which less money is paid before devaluation. So this situation increased inflation.

V. CONCLUSION

This research paper helps to find out the causes and effect of devaluation of Rupee. Almost all the countries of the world have devalued their currencies at any time with a motive of achieving certain economic objectives. So India also devalued its currency in 1966 and 1991 .The main objectives were: - Economic stabilization, correcting the unfavourable balance of trade, to raise the national income and per capita also. However devaluation also affects the many parties in positive and

negative manner also. So the Govt. and RBI take the step of devaluation of Rupee.So in the end it is concluded that devaluation is a good step for the boost of the economy for the short term as one can export more and more foreign direct investment can be increased as more money will inflow and the current trade (deficit) will be reduced. But it devaluation isn't good for the long term as the prices will rise and this will increase the inflation which will result in increase in prices of fuel etc and will also reduce the confidence in the foreign investors.

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