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Gain on the swings, loss on the rounds

The exchange rate is one of the many factors which influence the competitiveness of our products, says Uttam Gupta

AFTER maintaining steady for about two years — it fell last in August 1995 — the rupee has once again commenced its downward journey. From around Rs 35.8 to a dollar at the beginning of September 1997, it has slided to Rs 36.5 in just about three weeks. This sounds tricky as all along during the current year, due to too many dollars coming in through various routes, i e FIIs, FDIs and GDRs etc, there was an upward pressure on the rupee.

Indeed, the RBI mopped up excess dollars from the market to prevent the rupee from strengthening. This even resulted in excess liquidity and would have been a problem for monetary authorities in containing inflation but for sluggish demand for credit by the industry. To a considerable extent, the huge appetite for borrowings by the government has provided an outlet for excess rupees.

Suddenly came the statement by deputy governor, RBI, like a bolt from the blue, that the rupee was overvalued. This was followed by the Prime Minister's statement — obviously on being briefed by ministry of finance — of the government's intention to put movement of exchange rate within a specified band. All this was accompanied by high voltage publicity (although, a little later, a contradiction was issued by the RBI that the government was not contemplating any such move, but it went unnoticed).

In effect, the government had pushed the panic button, made speculators active, apart from importers/manufacturers rushing to book advance dollars to meet their requirements. Result? Slide of the rupee despite a fairly comfortable supply of dollars. Assuming for a moment that supply was tight, what prevented the RBI from releasing dollars from its bulging kitty to meet the demand, keep the market cool and thus, prevent rupee from sliding down?

After all, unlike in early July 1991, when rupee had to be depreciated by a hefty 25 per cent due to huge imbalance in trade account and precarious foreign exchange availability, presently, the situation is fairly comfortable with reserves of about $29 billion. And yet, the fact that the rupee has depreciated — RBI interventions have been delayed and reluctant — clearly points towards the authorities having vested interest in the entire ballgame.

To understand this, one has to look at the export performance and gauge the mood of the exporting community. During 1996-97, growth in Indian exports was a record low of only 4 per cent as against over 20 per cent achieved in the previous year, i e 1995-96. During April-July 1997, growth has been 1.8 per cent over April-July 1996. For the whole year, i e 1997-98, the commerce ministry does not visualise a growth of more than 10 per cent against a minimum 18 per cent needed to reach the overall export target.

The view taken by the exporters — indeed, majority of them — is that our products are losing competitive edge in the world market to other developing countries, especially from South and East Asia, whose respective currencies have heavily depreciated in sharp contrast to Indian rupee remaining more or less steady.

Hence, the recipe recommended by them to the government that we too should depreciate to be able to maintain cost competitiveness. The latter willingly obliged by putting up a neatly orchestrated gameplan to achieve the desired [illegible] chronology of events amply demonstrates this.

The exporters' analysis of the situation and the government's reaction are oversimplistic and seriously flawed. No doubt, a favourable exchange rate is helpful. For instance, a change from Rs 35.8 to a dollar to Rs 35.5 gives exporter Rs 0.7 extra for every dollar worth of proceeds. All other things remaining the same, this, in turn, will improve profitability. Alternatively, he could possibly reduce the price of dollar to Rs 36.5 and yet, maintain realisation in terms of Rs 35.8. This may, perhaps, prevent erosion in his market share.

The exchange rate is, however, only one of the several factors which influence the competitiveness of our products. The latter includes cost of raw materials and components [illegible] for many export industries, these are imported — fuel, power, financing charges, transport cost, taxes and duties etc. In all these areas, our industries are at a substantial disadvantage, leading to high cost of production, handling and movement up to the ports which set the limit for minimum expected FoB realisation.

Ability to supply quality products in time holds the key to increasing exports. This is heavily constrained due to problems of infrastructure, i e power, rail transport, road, ports etc, and huge paraphernalia of approvals and clearances needed before the cargo can board the ship/aircraft. Very little has been done to improve the situation on these fronts.

There is no escape from tackling these fundamental weaknesses on a war footing as that alone holds the promise of bringing about substantial reduction in cost and ensuring timely execution of export orders. The commitment to meeting international quality standards and designing products to fully fit into consumer preferences in importing countries will be an added advantage.

Needless to say, that competitive edge gained by our exporters in this manner will be viable and sustainable, unlike the sop through rupee depreciation which may disappear any moment, depending on how the currencies of competing countries would behave in the next round, or other cost-reducing measures initiated in the latter.

In the temptation to make a quick buck through the depreciation route, exporters fail to see its negative effect in the medium to long run. During 1995-96 and 1996-97, the government had held out rupee depreciation as one of the major reasons for ballooning deficit in the oil pool account (OPA). And, to tackle the latter, prices of all PoL products, except kerosene, were increased sharply in July 1996, and now again in September 1997. The price of diesel which directly affects transport cost was increased by 15 per cent then and 24 per cent now. The inflationary spiral that it triggers off impacts the entire economy and exporters do not remain unaffected.

A substantial chunk of power generating capacity in the country is based on liquid fuels, e g naptha, fuel oil/LSHS. Increase in their prices is bound to raise cost of generating power which is loaded on to the industries.

Since tariff on supplies to farmers and households cannot be raised in tandem and state electricity boards/central power utilities' overall revenues have to be maintained, increases in rates to industries are disproportionately high. The exporters cannot escape the devastating effect of such hike on their cost and, therefore, export competitiveness.