CHAPTER- VIII

RUPEE-ROUBLE CONTROVERSY

Controversy on Rupee - Rouble exchange rate is considered to be a thorn in the smooth path of Indo-Soviet/Russian relation. After the disintegration of the Soviet Union, this controversy could not be resolved, as India is liable to repay its debt to Russia who has inherited this right from the former Soviet Union. The decision of the Soviet Union to trade with India in rupee and to help India set up her first steel plant at Bhilai was both a political as well as a historical one[1]. It was a political decision in the sense that when other western countries were unwilling to help India in the way of industrialization, the Soviet Union came forward with a helping hand that put the western countries in an awkward position. It was a historic decision because for the first time in the history of international trade, one developed nation did agree to open trade with an underdeveloped country after the Bretton Woods agreement, in the currency of the underdeveloped country. The implication of this system was that, assistance in the form of loans would be self-liquidated in export form to the giver country. India's trade relations with the western countries were through hard currency system, but with the Soviet Union, the economic relations were different. Because, all loans were repaid with the export of goods which provided a further impetus to industrial growth in India. The western countries used to assist India in hard currency and expected repayments also in hard currency. They never gave scope to India to earn hard currency by imposing different tariff barriers against India's goods.

The background of rupee-trade with the Soviet Union dates back to the time of the introduction of economic relations between the two countries. All trade transactions between India and the Soviet Union were being invoiced in rupee since 1954. It was clearly stated in Article IV of the 'Indo-Soviet Trade Agreement' signed on December 2,1953[2], "All payments between India and the USSR described in Article VII may be made in Indian Rupee. For this purpose, the State Bank of the USSR will maintain one or more accounts with one or more commercial banks in India authorised to deal in foreign exchange". Rupee funds were generated in this account when India exported to the Soviet Union and rupees were depleted from that country. There was no actual outflow of rupees and the rupee was simply a unit of account. Subsequently, in all trade protocols ending upto December 1992, the same type of statement was mentioned regarding rupee payment, and all transactions were concluded in rupees. Not only that, after Indo-Pak war of 1965, the Soviet Union, unlike the United States and Britain, went on supplying defence equipments. These defence supplies did not come to India as aid but on payment which was made on a long-term instalment basis and adjusted against the trade account of the two countries maintained in rupees[3].

There is a close similarity between the rouble and the rupee. Both the currencies were primarily used as legal tender for transactions within the country; and legally, they could not be taken out. The exchange rate vis-a-vis the dollar of these two currencies were generally fixed by the respective government. There was also a black market in currency in both countries.

The dissimilarities are there between the rouble and the rupee. The external value of the rouble had no impact on bonuses offered to the enterprises in Russia. But in India, the exchange of rupee played a very significant role in many sectors. Till 1990, the USSR was a highly centralized economy. The government used to set prices of all domestic items. The exporters had to purchase exportable items from domestic market at local prices and the imported items were sold also at local prices. So, the traders did not have any special interest regarding export-import business. But in India, the traders of export-import sector had, to some extend, freedom to set prices according to international market trends.

Upto 1989, rouble-dollar exchange rate changed several times. In 1961, Khrushchev introduced new rouble with a national gold standard of 0.987 gramme. When the dollar lost its gold moorings in 1971, the Soviet government started changing frequently the exchange rate of rouble with dollar and other hard currencies. The exchange rate of $/Rb. varied from 1.11 in 1970 to 1.58 in 1989.

In the initial stage, the rupee-rouble exchange rate was determined by the gold contents of the two currencies. For several years, the gold content of both currencies remained constant and so no question of exchange rate problems cropped up. According to agreements reached with all East European countries including the Soviet Union in 1974, the basis of the exchange of the rupee with the currencies of these countries was the 'gold content' of the currencies. The gold content of the rupee was fixed at 0.118489 fine grammes of gold[4]. This value was derived from the per value of the rupee in terms of the US dollar prior to August,1971 and in relation to the fixed price of gold at that time, namely 35 dollar for five ounce of gold. Though the basis of the gold content of the rupee was clearly defined, the "gold content" of the currencies of the East European countries was fixed unilaterally by them without a clearly defined basis. At the time of signing trade agreements, these countries prescribed a rate of exchange with the rupee supposedly on the basis of the gold content of their currencies[5]. But this gold content concept was nothing but an accounting fiction between two currencies. According to the Indian constitution, any alternation of the gold content of the rupee has to be approved by the parliament, but for the change in the exchange of rupee, such legislation is not required. So, the Reserve Bank of India from February,1969 revalued its gold holdings in terms of rupees which was ultimately approved by the parliament.

In the Indo-Soviet bilateral trade and payment arrangement,"though the unit of account is rupee, the East European countries are protected against devaluation, because the exchange value of the rupee is fixed in terms of its gold content"[6]. The outstanding balances of the bilateral accounts of the foreign concerns were settled by negotiation between the two countries. The change in the par value of the Indian currency caused the devaluation of Indian rupee by 36.5 per cent in 1966. This automatically revalued India's loans to the Soviet Union by 57.5 per cent and which ultimately increased India's debt in the ratio[7]. The rupee-rouble rate was changed accordingly and consequently, this influenced the pattern and volume of commodity exchange between the two countries over the years.

After 1971, with the collapse of the Breton Woods system, the official gold content of almost all the world currencies was converted into a "fiction"[8]. Because, the exchange rate between the two currencies set by their respective official gold contents was different from their operational exchange rate. Naturally, Indian rupee's gold content became meaningless. Equally, the gold content of the rouble was also fictitious. Before the breakdown of the Bretton Woods system, rouble was not a free currency which was traded on the world markets and it had a little relation with the official gold content and the Soviet Union used to fix the exchange rate for the rouble with other major world currencies arbitrarily to suit the exigencies of its foreign trade. So the cross rate between the rouble and the franc being worked out through the West German DM was different from what it was worked out through the pound sterling or the US dollar. The gold content of the rupee and the rouble became meaningless.

In 1974, the Soviet authority arbitrarily fixed rupee-rouble exchange rate like with all other currencies. As a result, in the first part of 1975, a two-week long discussions between the high-powered delegations of India and the Soviet Union on the rupee-rouble exchnge rate had reached a deadlock[9]. The then Finance Minister of India announced on the floor of the parliament of India on March 21,1975 that credit payments regarding commercial transactions with the USSR would continue at the official exchange rate determined by the respective gold content of the two currencies of India and the Soviet Union[10]. Almost 99 % of the commercial transactions between the two countries were made at the initially determined rate of Rs.8.333 to a rouble. Till November 25,1978 the rouble used to cost Rs.8.333[11]. The rate was based on the 'gold content' of currencies of the two countries. In the last part of 1970s, the Soviet Union wanted to change the rupee-rouble rate solely on the basis of defacto value of the rupee periodically calculated by the USSR State Bank by averaging the cross rates of the major currencies in the international market with the rupee. One Indian mission headed by M.G.Kaul visited the Soviet Union in mid-1976, when the rupee-rouble tangle could not be sorted out because of the Soviet rigidity.

Ultimately, in the later part of 1970s, India's exchange rate problem with the Soviet Union and other East European countries became a complex one, since neither the rupee nor the rouble was freely traded on exchange markets. The only way to settle an amicable exchange rate between the rupee and the rouble was through some third currency which was traded in the international exchange markets. The Soviet Union used to fix its exchange rate vis-a-vis the dollar, pound, sterling depending on the status of these currencies in the world money-markets. India followed two ways for fixing its exchange rate[12]: first, through the pound and sterling and secondly through a basket of currencies. So, when both the countries fixed their exchange rate in the same way, there should not be any problem in fixing the exchange rate between these two currencies. But India was not ready to accept this line, because it would have meant a sizable devaluation of the rupee against the rouble. India put forward two reasons[13]: first, exchange rate fixation by the USSR was not always on commercial grounds as the role of foreign trade in the USSR economy was not as same as in a market economy like India. Secondly, since India's outstanding obligations to the Soviet Union were normally denominated in rupees and the economic relations between the two countries were governed by rupee trade and payments agreements, so the simple logic of arriving at the cross exchange rate between the rupee and the rouble via third currencies was not acceptable to India. On the contrary, India advocated for a mutually agreed solutions between the two countries.

The Soviet Union was of the opinion that it was an accepted norm that every country would fix exchange rate within its own domain. The IMF also recognized it. But India raised questions regarding the method adopted by the Soviet Union in fixing its exchange rate with the freely traded world currencies which was reported to have been overvalued; and an overvalued exchange rate might lead to a lower trade volume as a number of potential export commodities got automatically priced out. But the exchange rate between the rupee and the rouble did not directly influence the trade volume under rupee payments arrangement. Only for invisible transactions and debt repayment purposes, this exchange rate was relevant. The main dispute between India and the Soviet Union was regarding the repayment obligations of India in respect of credits. The denomination of repayment obligations in terms of a commonly acceptable currency was one way to solve this problem. Another suggestion was to denominate the transactions in terms of the SDR, but the USSR neither accepted the SDR nor deviated from fixing its exchange rate against all traded currencies.

After a long tussle, one protocol was signed between the two countries on November 25,1978, which specified that, in future, the rouble-rupee rate would be determined on the basis of the exchange rates of an unknown multi-currency basket having US dollar, the pound sterling, the DM, the yen as the major currencies. From the date of signing this protocol, the exchange rate was changed to Rs.10 per rouble. This protocol made the rupee-rouble rate subjet to change from time to time depending on the value of the rupee relative to a specified setof currencies. This protocol exchange rate (fixed at Rs.10=1 Rouble) was to be applicable to[14]:

(i) existing rouble credits between the two governments;

(ii) existing commercial rouble contracts and commercial rupee contracts contain -ing a gold parity clause;

(iii) existing and previous deferred payments contracts containing a gold parity clause; and

(iv) existing service rouble contracts and service rupee contracts containing a gold parity clause.

This protocol clearly stated three things[15]: first, the extent of devaluation of the rupee against the rouble vis-a-vis its 1966 level was about 20%, whereas on the cross-rate basis, the devaluation should have been around 40%. Thus the extent of devaluation of the rupee and therefore the extent of upward adjustment of India's outstanding liability to the Soviet Union were less than what they would have been if one decided to arrive at the new rate via the freely traded currencies. Secondly,the Soviet Union agreed to the repayment of the enhanced part of India's obligation over a period of 45 years. Thirdly, repayment effected by India against past credits at the old rate were considered as final and no extra liability would arise on that account.

Regarding the relevance of the rupee-rouble exchange rate, different writers put forward their opinions from different angles. Arvind Vyas[16] said that in a bilateral relationship, the exchange rate served merely as an unit of account and had no operational significance. Hence the rupee-rouble rate for trading puposes had no real effects on the system. He illustrated this argument with the help of an example: during the mid-1970s oil and oil products had dominated the Indian import basket - the price of which was quoted in US dollar. This was then converted into NCR via the dollar-rupee rate. It therefore follows that the rupee-rouble rate was of no significance except in the case of repayments. Gidadhubli[17] was of the opinion that rupee-rouble was undoubtedly important for the repayment of credits that were denominated in roubles. But Debroy, Behland Mago[18] said that very few credits were actually denominated in roubles. Rouble denominations were important only for Indian imports of defence equipment and equipment for civilian projects. In all other cases, credits were denominated in rupees.

Mr.Pranab Sen[19] argued that the widely held view that the rupee-rouble rate was of no real significance was erroneous that even in a system of bilateral trade with a nonconvertible medium of exchange rate potentially should have substantial real effects. After the introduction of Perestroika in the USSR and New Economic Policy in India, the Indian rupee was steadily depreciated against rouble at an annual average rate of about 8.5 per cent. In a theoretical framework, Pranab Sen[20] considered some direct effects of devaluation of the Indian rupee vis-a-vis the rouble on the various trading agents on either side and on a commodity classification basis. He classified two effects: impact effect and real effect. He indicated that there would be no impact effect of the devaluation on the rupee prices of Indian exportables; since the NCR was the medium of exchange. Thus the Indian exporters would not be affected by any price change. But real effects would occur through changes in the Soviet demand for Indian goods; and the impact of rupee devaluation against the rouble on the Soviet importers would be to increase the profitability of importing from India. He also discussed the real and the secondary effects of devaluation of the rupee against the rouble regarding three types of goods: (i) 'Hard' goods from extractive industries; (ii) 'Hard' goods from non-extractive industries; and (iii) 'Soft' goods. The devaluation would have no effect at all on the Soviet export volumes of the first type of goods. In case of second type of goods, a devaluation of the rupee against the rouble would reduce the profitability of such exports to India. There would be a tendency to divert exports away from India towards countries whose currencies have not devalued against the rouble. As a result of this, protocol specified quantities would not be supplied and future protocol would be under pressure to reduce the committed quantities. This was termed as direct real effects. The secondary real effects would be a reduction in the rupee resource generation for the USSR from this category of exports. In case of third category, the rupee price charged by the Soviet exporters would increase by the same percentage as the devaluation of the rupee against the rouble. As a result, the Indian demand for the Soviet product would decline. The rupee resources generated from these products might increase or decrease depending upon whether the price elasticity of Indian demand was less than or greater than unity. This change would lead to secondary real effects through the Soviet import side.

The above analysis was done on the basis of implicit assumption that the rest of the world did not matter insofar as the bilateral trading relationship was concerned. The indirect effects arising out of a misalignment between the implicit cross exchange rates were potentially even more important and damaging than the direct effects. These indirect effects were shown by Sen with a number of numerical examples; and this became more pronounced with progress of Perestroika.

There were two commonly accepted principles for exchange rate determination in a situation of initially balanced trade: .

(i) By alignment of cross exchange rates; rupee was undervalued by 25.32 per cent in March 1990; and

(ii) by Purchasing Power Parity, the rupee was devalued in real terms by about 43 per cent in the same year.

There were virtually three exchange rates between the rupee and the rouble for different categories of transactions[21]. Debroy, Behl and Mago[22] mentioned the following three:

(a) rate for governmental transactions;

(b) commercial rate; and

(c) tourist rate.

Pranab Sen[23] distinguished these three exchange rates:

(i) the commercial rate: applicable to tourists, embassies, etc.

(ii) the protocol rate: used for recording trade transactions; and

(iii) the basket rate: applied to credit transactions.

In 1990, the following rates were prevailing: Rouble 1=Rs.29 for tourists, Rs.20 for commercial transactions and Rs.16 for governmental transactions. Apart from these official exchange rates, market rates was Rs.4 or 5 per rouble. The Soviet policy-makers kept these artificially high official exchange rates which were beneficial for the USSR and were interested in converting rouble debt repayment into rupees at these high rates.

Regarding the rupee-rouble exchange rate, 1978 protocol had been acting a vital role for a long-time. After the protocol was signed, the rupee-rouble exchange rate was changed 44 times up to the time of disintegraion of the former Soviet Union.This is shown in the following Table-I.

TABLE-I

COMMERCIAL ROUBLE-RUPEE RATE

(Rs PER ROUBLE,1978-1991)

Effective	*date of change*	*Rate*
25 November	1978	10.000
16 June	1979	9.694
11 August	1979	9.997
5 April	1980	9.638
10 November	1980	9.341
26 February	1981	9.740
14 March	1981	9.419
22 March	1981	9.707
19 April	1981	9.414
10 September	1981	9.725
24 September	1981	10.026
25 June	1982	9.700
31 December	1982	10.018
13 February	1984	10.331
29 July	1984	10.673
25 October	1984	10.993
15 February	1985	11.334
13 July	1985	10.992
9 September	1985	11.434
10 November	1985	11.782
20 January	1986	12.153
6 February	1986	12.532
24 April	1986	12.958
17 July	1986	13.374
21 September	1986	13.867

4 December	1986	14.305
23 January	1987	14.792
1 November	1987	15.392
19 December	1987	15.862
5 June	1988	16.392
7 October	1988	16.897
24 October	1988	17.576
20 November	1988	18.112
9 July	1989	18.679
8 October	1989	19.241
16 December	1989	19.917
10 May	1990	20.552
3 August	1990	21.220
3 September	1990	21.864
24 September	1990	22.785
25 January	1991	23.501
20 April	1991	24.131
6 July	1991	29.936
17 November	1991	31.787

Source: BP; 29 January,1993 & Debroy, Behl, Mago(1991)

Regarding magnitude of changes, it was agreed that adjustments would be effected only if changes exceeded 3 per cent either way. The magnitude of the changes since 1978 calculated by Debroy, Behl and Mago[24] from Table-I is shown in Table-II.

TABLE-II

PERCENTAGE APPRECIATION/DEPRECIATION IN THE VALUE

OF THE RUPEE AGAINST THE RUOBLE, 1978-1991

Effective	date of change	% change
25 November	1978	- 20.00
16 June	1979	+ 3.06
11 August	1979	- 3.13
5 April	1980	+ 3.60
10 November	1980	+ 3.08
26 February	1981	- 4.10
14 March	1981	+ 3.29
22 March	1981	- 3.06
19 April	1981	+ 3.03
10 September	1981	- 3.30
24 September	1981	- 3.10
25 June	1982	+ 3.25
31 December	1982	- 3.28
13 February	1984	- 3.12
29 July	1984	- 3.31
25 October	1984	- 3.00
15 February	1985	- 3.19
13 July	1985	+ 3.11
9 September	1985	- 4.02
10 November	1985	- 3.04
20 January	1986	- 3.15
6 February	1986	- 3.05
24 April	1986	- 3.47
17 July	1986	- 3.22
21 September	1986	- 3.68

4 December	1986	- 3.16
23 January	1987	- 3.41
1 November	1987	- 4.05
19 December	1987	- 3.06
5 June	1988	- 3.34
7 October	1988	- 3.08
24 October	1988	- 4.02
20 November	1988	- 3.05
9 July	1989	- 3.13
8 October	1989	- 3.01
16 December	1989	- 3.51
10 May	1990	- 3.19
3 August	1990	- 3.25
3 September	1990	- 3.03
24 September	1990	- 4.21
25 January	1991	- 3.04
20 April	1991	
6 July	1991	
17 November	1991	

Source: Same as Table-I

It is shown in the above Table that only on November 25,1978, change was marked to -20.00 per cent; and in few cases, viz. February 26,1981; September 9,1985; November 1,1987; October 24,1988; and September 24,1990 - where percentage change touched figure 4. Some cases of appreciation in the value of the rupee were found upto July 13,1985. But since September 9,1985, there was a continuous depreciations. Regarding rupee-rouble tourist rate, before the disintegration of the Soviet Union, the depreciation in the value of the rupee against the other four currencies,viz. Pound, US dollar, Yen, DM. was taken into account.

It was viewed that the rupee-rouble rate did not distort the trade flows in a two-country frame-work. But presence of third country,e.g. the USA between India and the Soviet Union, changed the picture. Judging dollar-rouble parity and rupee-rouble parity, a number of conclusions was drawn[24]. First, because of the mismatch in the cross-rate, Indian export to the Soviet Union became artificially expensive and Indian imports from the Soviet Union became artificially cheap. Secondly, switch trade was encouraged. Thirdly, misaligned exchange rates and problem of deferred payment led to an artificial export subsidy on Soviet exports to India, and an export tax on Indian exports to the Soviet Union.

WEIGHTS

The rupee-rouble exchange rate was worked out on the basis of a multi-currency basket consisting of 17 - the US dollar, the pound sterling, the DM, the Japanese yen, the Swiss franc, the French franc, the Canadian dollar, the Dutch guilder, the Belgian franc, the Italian lira, the Norwegian kroner, the Austrian schilling, the Iranian rial, the Saudi Arabian riyal and Spanish peseta. The aggregation procedure was of the Cobb-Douglas form:

$$(\text{Rouble/Rupee}) = A.(\text{Dollar/Rupee})^{a1}.(\text{Pound/Rupee})^{a2}. \ldots\ldots\ldots(\text{Peseta/Rupee})^{a17}.$$

where a^i implies the elasticity of changes in the rouble/rupee rate to changes in the ith currency/rupee rate.

The restricted least squares were used with the stipulation that a1+a2+...........+a17 = 1 implying that the weights add up to unity. So,by substituting a1 = 1-a2-....-a17, this becomes-

$$(\text{Rouble/Rupee}) = A.(\text{Dollar/Rupee})^{1-a2-\ldots-a17}.(\text{Peseta/Rupee})^{a2}\ldots\ldots.(\text{Peseta/Rupee})^{a17}.$$

By simplification-

$$\frac{(\text{Rouble/Rupee})}{(\text{Dollar/Rupee})} = A.(\text{Pound/Dollar})^{a2}\ldots.(\text{Peseta/Dollar})^{a17}.$$

Taking log both sides-

$$\log\frac{(\text{Rouble/Rupee})}{(\text{Dollar/Rupee})} = \log A + a2\log(\text{Pound/Dollar}) + \ldots. + a17\log(\text{Peseta/Dollar}).$$

A regression exercise was done by Debroy, Behl and Mago; and according to their result about 94 per cent of the variation in the rouble-rupee rate was explained by changes in the exchange rates of four currencies,viz.the US dollar,the pound,the yen and the mark. The weights of the rouble basket were estimated to be the following, the remaining currencies possessing zero weight each:

US dollar-43.8%

Pound- 15.9%

Yen- 2.1%

Mark- 38.2%

When they introduced a time lag of one month, the result was slightly changed. More than 96 per cent of the variations in the rouble-rupee rate were explained by variations in exchange rates of seven currencies. New three currencies are the Swiss frac, the French franc and Austrian dollar.

Being based on these determined weights,t he real appreciation in the multi-currency basket was only at an exponential rate of 2.32% Assuming that the rates were at par on November 25,1978 when the new protocol was signed and the rate of Rs.10 to a rouble was established, this means that after 15 years in 1993, when official exchange rate was fixed at Rs.23.5009; that should have been fixed to Rs.14.1623.

Before the disintegration of the Soviet Union, the economic condition of the country deteriorated which was discussed earlier. In the open air of Glasnost and Perestroika, the Soviet restrictions on exchange transactions were eased. The rouble was openly changing hands at a rate far below its formal exchange rate vis-a-vis the US dollar and that in the black market, one dollar fatched more than ten, in some cases twenty roubles in the last part of 1990. In this circumstances, it was demanded to nullify the 1978 protocol, as it did not take into account the depreciation in the rouble[26]. Not only that India was not given the price advantage that was extended to the East European Warsaw Pact countries and also Cuba and Vietnam by the Soviet Union. In spite of all odds,India depended on the USSR for defence supplies and oil which consisted of almost one-third of its annual imports. Since the exchange rate was one that had overstated the value of the rouble, consequently, India had to pay higher prices than the world level for Soviet goods. Whereas the Soviet Union purchased Indian goods at considerably lower prices. This croped up the demand for nullification of 1978 protocol and introduction of new formula for rupee-rouble exchange rate. In September 1990, Dr.Badar Alam Iqbal[27] remarked, "The existing parity ratio is not favourable to India has been proved when a test of auction of the exchange showed the rouble-rupee ratio at 1 is to 1.6,while official rate is between Rs.26 to Rs.28 per rouble.

With the Soviet Union slowly moving over to a more realistic exchange rate rather than the nearly one to one parity with the dollar, now the rupee-rouble rate would also have to be revised to a more realistic value".

V.Skosirev[28] is of the opinion that among developing countries, India had the largest Soviet rouble debt of 8.9 billion in July,1990 and he did not agree with the Indian view point that Soviet debt would not be reduced due to higher rate of rouble vis-a-vis rupees. From the Indian side, efforts were made to arrive at an acceptable exchange rate through mutual working group discussions. In a press release issued in New Delhi on February 21,1990 India suggested to constitute a high level working group to discuss issues pertaining to the 1978 Protocol on Rupee-Rouble exchange rate[29]. Dr.C.Rangarajan,Depury Governor, Reserve Bank of India was nominated to lead the Indian delegation. This working group was constituted during the visit of 11-member Soviet delegation led by Mr.V.V.Sitnin,then Deputy Minister of Finance of the Soviet Union.

In this respect, M.D.Dewani[30] remarked a few months before the coup in Moscow in January,1991 that a wide disparity persisted between the official and unofficial rates of the rouble. On the one hand, the Soviet rouble depreciated at a faster rate than the rupee, on the other hand, the Reserve Bank of India made an upward revision of the rupee-rouble exchange rate from Rs.21.86 to Rs.22.78 to a rouble in terms of 1978 protocol with effect from September 24,1990. At that time, in the unofficial market, one dollar fetched about Rs.23. This implied that rouble was weaker than Indian rupee in the open unofficial market[31].

Foreign exchange auction held in the Soviet Union gave us a clear picture about market-determined dollar-rouble parities[32]. The October 1990 auction exhibited rates of around 22.6 roubles to 1 US dollar. A market-determined parity could thus be in the neighborhood of 1 rupee to 1 rouble. The distorted exchange rate was intimately connected with the deterioration in the terms of trade. The Indo-Soviet terms of trade has been discussed in separate chapter.

Rupee-Rouble Controversy After Disintegration of the USSR

After the disintegration of the Soviet Union, debate on the rupee-rouble controversy could not come to an end. The unrealistic rupee-rouble exchange rate became a serious problem for India in the changed atmosphere. Russia maintained multiple exchange rates. In the last part of 1991, the tourist rate was one rouble = Rs.43-48 and for commercial transaction Rs.30 = 1 rouble was applicable to Indian exports, imports and other payments. But the market rate was Rs.1 = Rl.1. After the failed coup of August 1991, the market rate of rouble fell sharply. But repayment of past Soviet credits was based on the inflated commercial rate fixed by 1978 protocol which led to a distortion in the rupee-rouble parity. From the auction rate in November 1991, one dollar equal to Rbl.110 forced the Russian foreign trade bank to increase the purchasing rate of one dollar from Rbl.32 to 48. In this situation, rouble got strengthened vis-a-vis the rupee which was highly unrealistic. Most interesting fact is that the Reserve Bank of India adopted Rbl.1 = Rs.30 as the commerial exchange rate and on the other hand, from August 1, 1991 the Soviet Union increased conversion co-efficient from 1.5 to 2 so that for the Soviet importing organisation, Rbl.1 became equal to Rs.21-22. This means that both the governemnts adopted different commercial rates[33].

In December,1991,the government of India decided to seek a downward revision of the value of rouble considering the real value of the currency which had been quoted at 190-300 roubles to a dollar in recent auctions. The official exchange rates for the tourists was pegged at 110 roubles to a dollar. But the market value of a rouble via the dollar route worked out to one fourth of a rupee[34]. This over-valuation of the rouble vis-a-vis the rupee inflated the volume of India's debt to the former Soviet Union. A black market was there, whereby roubles were converted into rupees. The rupees were smuggled to West Asia and converted into dollars through hawala transactions. The dollars were then taken back to Russia. The rates at these transactions used to be three-four rupees to one rouble[35]; and within a very short time period, it became three-four roubles to a rupee. But this time, official rate was around Rs.31 to a rouble. This official rate should have been 15 to a rouble. Because, Gosplan estimates show an inflation rate of around six per cent in the 1980s; and in India, in the 80s, the average inflation rate was about eight per cent. So the differcial rate of inflation was two per cent. If one wishes to preserve the same real exchange rate prevailed in November 1978, then rouble-rupee rate should have been Rs.15 in January,1992. This unrealistic rate was due to 1978 protocol. In March 1991, a negotiation was held between the two countries for a new protocol, but there was no fruitful result. It was also demanded in this time that a portion of the debt should be written off as was done in case of Mongolia's debt to the Soviet Union[36]. (Angola, Laos, Vietnam, Mozambique, and Nicaragua also obtained credit from the Soviet Union).

In May,1992 India and Russia switched to dollar trade. Addressing a news conference on 6th May,1992, the then Commerce Secretary, Mr.A.V.Ganesan said that the clearing mechanism between Russia and India signified a departure from trade in rupees to trade in convertible currency, and all exports would be through letters of credit[37]. In the first part of 1992, the massive rouble devaluation created an extraordinary favourable opportunity for India. At the new exchange rate, the value of Russian rouble credits to India was stated to have been reduced from Rs.38,000 crores to no more than Rs.500 crores. By this way, India's foreign debt problem would have been solved. But it was not; and India had to be soft. Four reasons were advanced for being soft on Russia[38]:

First, India must show gratitude for old Soviet favours.

Second, Russia is an important source of arms and missile technology that India must not antagonise.

Third, it would be unfair to take advantage of the rouble when the military hardware supplied under Soviet credits could as well have been designated in dollars.

Fourth, the rupee-rouble ratio was to be determined by a special formula independent of the new exchange rate.

But S.S.Anklesaria Aiyar[39] remarked,"the Soviet Union is dead and gone, and you can not show gratitude to a corpse. Russia may be a legal successor state, but from India's viewpoint, is emphatically not a political or economic substitute for the Soviet Union....India was not bailed out by the Soviet Union when the rupee depreciated, and New Delhi must bail out Moscow now that the rouble has depreciated".

On June 9,1992, the first round of talks, after the change of government in Moscow, on the contentious rupee-rouble issue, concluded without any fruitful result. Mr.Montek Singh Ahluwalia[40], leader of the Indian delegation and secretary in the Ministry of Finance said, "when the market reality is totally different how can we agree to these terms (1978 protocol)". According to him, the government of India felt that the terms of the 1978 protocol were "totally unsuitable and unrealistic". He argued that though the rouble had not yet acquired the status of a definitive currency, it had been traded (at rates much lower than the current rupee-rouble rate) over the last few years and could, therefore, be assigned a value compatible to market forces. The Indian government alternatively suggested to use IMF parity as Russia was, at that time, on the doorstep of IMF to become a member. After few days, becoming a member of the IMF, Russia unified the thousands of different exchange rates it had earlier for different purposes and floated the currency. This was quoted by the Central Bank on the first day of the new exchange rate regime at 125.26 roubles to the dollar. In the markets, the rate was 144 roubles to a dollar. At the new exchange rate announced by Moscow, India's debt would have been reduced by 20 per cent. But Russia wanted to keep the special formula of the 1978 agreement in tact regardless of its new exchange rate. Russia unified its many exchange rates and became a member of the IMF in order to qualify for $24 billion dollars worth of aid from the West, including a $6 billion fund for the stabilisation of the new rouble rate. India did not force Russia in this way. India had to borrow money from the IMF in order to give Russia anything more than its current exchange rate which was viewed to be the height of commercial stupidity[41].

In October 1992, India decided to approach Russia to come to an agreeable rupee-rouble exchange, because at one time in that year, the rouble was valued at 25 paise. But,in government level, there were at least three proposed exchange rates[42]. First proposed exchange rate was aired in the official sources to be Rs.14 to a rouble. Second, the Finance Ministry, with the backing of the Ministry of Commerce, External Affairs and also the Prime Minister's office wanted that the exchange rate should be about Rs.6 to Rs.8 to the rouble. Third, the Defence Ministry and the Planning Commission were in favour of about Rs.25 to a rouble, with the arguing that its problem of acquiring spareparts from Russia and for this a favourable rate needed to be offered. The Planning Commission was in favour of the Defence Ministry's recommendations because it was involved in the process of obtaining huge Soviet credits at a very concessional rates to India's power sector.

In the first half of January,1993, Russia's First Deputy Minister for Foreign Economic Relations, Mr. Vladimir Shibayev, on his return to Moscow from New Delhi, categorically said that Russia would not write off India's debts[43].

On January 20,1993, the Deputy Chairman of the Council of ministers of the Russian Federation, Mr.V.F.Shumeiko visited India in order to prepare for the visit of the President Mr. Boris Yeltsin in last part of that month. According to him, Russia sought an alternative to the exchange rate formula for re-evaluating the debt owed to it by India[44]. The most interesting part was that India had been seeking a revision of the exchange rate by rectifying 1978 protocol for a long time. This time, Russia, coming one step advance, sought the revision. Diplomatically, being the first mover in this lap, Russia categorically said that India must settle down to pay 80 per cent of Rs.38,000 crore owed to Russia. But the Indian government maintained that it was willing to pay about 45-50 per cent of the total debt. Mr. Shumeiko felt that such re-evaluation should be based on some other formula and in the perspective of long-run economic cooperation between the two countries. Indian Finance Minister Mr. Manmohan Singh had reiterated India's position that the exchange rate imbalances in the 1978 protocol had to be corrected so as to reflect the strength and weakness of both the rupees and the rouble[45].

Just before settling down the problem of rupee-rouble debt, some Indian writers[46] remarked that India overlooking the long enduring relationship between the two countries, should not take chance to reduce its debt burden to crisis-striken Russia. It was viewed that exports to rupee payment areas had plummeted by 50 per cent in 1991-92 and again by 60 per cent between April and November in 1992-93. The composition of exports was such that it was not possible to switch the exports to different countries. Consequently, manufacturers of hosiery woolen garments, light engineering products, drugs and pharmaceuticals and even tea sugar and handicrafts had suffered. All these could have been avoided if India would build upon its special bilateral trade relationship with Russia, as Austria and Finland did. For this purpose, four measures were suggested:

(i) All trade should be undertaken in dollars.

(ii) The debt should be fixed in dollars after settling the rouble-rupee parity.

(iii) Russians should either forego all interest payments on this debt or should charge at the current global dollar rate which was between 3-4 per cent; and which was yet to be fixed.

(iv) The exchange rate should be fixed at rates which would reflect pre-1990 condition.

Later on, on January 27,1993 Russian President Boris Yeltsin came to India for a three-day state visit; and during this visit, this old problem of rupee-rouble rate and debt repayment problem was solved in such a fashion that the long-enduring relationship between the two countries was not hampared. The issue had to be settled not by the officials, but by an intervention by President Yeltsin and Prime Minister Rao. The political will that was missing in earlier negotiations in order to solve the problem, was finally provided by the two heads. Initially, the Russian side appeared to have arrived at an amount based on rupee-rouble parity as on 1st November,1990. According to this formula, the total debt was worked out to be over Rs.25,000 crore. India suggested formula by which the rouble debt was worked out amounting to Rs.17,000 crore. At last, the long standing rupee-rouble dispute was settled on 28 January,1993 with Prime Minister P.V.Narasima Rao and President Boris Yeltsin agreeing on an exchange rate Rs.19.90 per rouble which was described as a political dicision of the two countries[47]. The total Indian debt to Russia stood at Rs.24,250 crore - which was 32 per cent lower than the earlier estimate of Rs.36,675 crore. As the 1978 protocol was signed after a prolonged tussle of over six years, similarly, the 1993 protocol was also the result of a tussle of over six years. In the last part of 1986, the Soviet Union started insisting the Indian government on shifting to the new five-currency SDR basket from 16-currency basket. But India did not agree to that proposal, because this type of shift would then tantamount to a depreciation of the rupee which would lead to a increased debt liabilities for India. Regarding the cut-off point,there was also a controversy. India's suggestion was January 1,1987 as the cut-off point when exchange rate was Rs.14.30 to a rouble. But Russia advanced November 1,1990 having exchange at Rs.22.70 to a rouble. Finally,the 1993 protocol accepted 1st January,1990 as the cut-off date with exchange rate Rs.19.90 per rouble which was close to the Russian demand.

Significantly, at the prevailing rouble-dollar and dollar-rupee exchange rate in January,1993, the value of the rupee worked out to rouble 19,which was just the reverse of the exchange rate at which the debt had been settled. At this point of time, one dollar could fetch 558 roubles, but it commanded only 30 rupees. On this basis, India's debt would stand reduced sharply to a mere Rs.1,877.63 crore, (but it was settled at Rs.24,250 crore). On this settlement, Indian side expressed happiness. A spokesman of the External Affairs Ministry said this would give India a "net advantage" of 32 per cent in its debt repayment which was estimated by Russia at $10 billion[48]. It was decided that the calculation of the applicable exchange rate would be based on the rate existing on January 1,1990, which the package would be implemented from April 1,1992. The parity was calculated at Rs.19.90 to a rouble as on January 1,1990 and Rs.37.57 per rouble from April 1992.

The repayment norms were finalised on January 29,1993. Economic Affairs Secretary Mr.Montek Singh Ahluwalia told reporters that the two sides had agreed that 63 per cent of the debt would be paid in accordance with past protocols at the rate of Rs.19.90 per rouble[49]; and 37 per cent of the debt totalling rouble 9871 million was agreed to be rescheduled. The debt amounting to Rs.11,450 crore was settled to be repaid over 45 years without interest and for a period of five years, there would not have any fluctuation in the value of the rupee. Thereafter it would be indexed to the SDR if the annual average depreciation of the rupee exceeded 3 per cent over that five year period; and in the non-rescheduled portion, the debt worked out to over Rs.19,600 crore to be repaid in 12 years[50].

This settlement of the problems of rupee-rouble parity was vehemently criticised by a number of experts, on the ground that this agreement was a sell-out of India's interests[51]. It was argued that while credits extended by the Soviet Union were protected against a weakening of the rupee over time, but the weaking of the rouble was taken into account. Russia had had the last laugh in signing the rupee-rouble parity agreement with India[52]. This is the second, in this way it was criticised, that India has had to suffer a major setback in arriving at a political settlement of the Rupee-Rouble parity; the first being in 1978 protocol that provided for taking into account the devaluation of the rupee vis-a-vis the then basket of currencies from time to time; on the other hand it assumed the roubles to be free from exchange rate fluctuations.

Mr.M.S.Alhuwalia, Economic Affairs Secretary denied the charge that it was a sell-out but evaded a reply when asked whether at the prevailing market rates one rupee was equivalent to rouble 19[53]. He said that India had entered into trade agreements with the erstwhile Soviet Union when both the rouble and rupee were not tradable currencies. So, it would be unfair to say that the debt should be calculated at the prevailing exchange rates, he said. Mr.Boris Yeltsin told Tass in an interview that the exchange rate agreed during his five hours of talks with Prime Minister Narasimha Rao was not to the detriment to Russia's interests but that he was not fully satisfied with it[54]. 'The Patriot'[55] remarked that the issue of exchange rate itself was a legacy of a period when both India and what was then the USSR had been guided more by geopolitical considerations than hard economic logic in giving shape to their external trade policies. Since this era and the 'special relationship it had brought about between the two countries was irreversibly gone, it was surely time to exorcise its ghost for ever.

Some observers wanted to judge this settlement from some different angle[56]. During this visit, President Yeltsin offered India unstinted support on the Kashmir problem and on the space technology issue which was considered to be a major diplomatic victory for India. Regarding defence equipments and spare parts, some assurance was also given bu Russia. Mr.Boris Yeltsin also indicated that if ever the issue of India's permanent membership at the Security Council did come up, he would say 'yes'. Some prominent Moscow-watchers like Prof. Jayashekhar conceded that while Russia's support for India on such vital concerns was indeed welcome, it could not be seen apart from her own domestic political concerns. The Russian Military Industrial Complexes are highly labour-intensive and currently politically anchored with the opposition in Russia. For sustaining such a huge apparatus, new and growing markets were crucial and the Russians view India as one such market.

Mr. A.V.Rajwade[57] advocated for the settlement of the Rupee-Rouble controversy and said that Rupee-Rouble pact was not a sell-out. First, he mentioned about the legal position of India. According to 1978 protocol, Russia, as the successor state to the Soviet Union was entitled to insist on repayment at the rate worked out by the protocol. Added to the legal weakness of the Indian side was the dependence on Russia for defence related and space technology imports.

It was remarked that the 'historic' political agreement between India and Russia over the rupee-rouble exchange rate to estimate the total debt to be repaid to the latter might lead to a revival of switch trading[58]. Many Russian companies obtained expensive consumer goods and technology from the west at cheap rates via India. Some Indian companies purchased either technology or components from the west in hard currency and then assembled and sold it to the Soviet Union in rupees, causing a heavy drain on Indian foreign exchange reserves. In 1990, the V.P.Singh government took steps to curb this practice and in 1992 Russian government began to issue import licences to stop switch trading. It was apprehended that this agreement might even legitimate switch trading.

In June,1993, India and Russia sorted out the vexed issue of interest payments on the revolving funds placed with the Reserve Bank of India as part of the loan repayment arrangement between the two countries. They also agreed on a one-time indexation of each annual instalment of debt repayment[59]. In September in the same year, India and Russia exchanged letters facilitating purchase of Indian goods and services by Russia under a new debt-repayment arrangements. The Indian government would make available annually a swing credit of upto Rs.300 crore beginning 1994 to facilitate the smooth utilisation of funds available against repayment of state credits for purchase of Indian goods[60].

Since the beginning of 1994, Russia has been considering rupee auction as a measure to avail of accumulating rupee funds at the rate of Rs.3000 crores per year. The problem cropped up because the Russian government was unable to workout a mechanism for the utilisation of these rupee funds which India had to pay for debt repayment. Detailed discussion of this issue will be made in the next chapter.

REPAYMENT FORMULA

The repayment mode of the debt was calcualted in two ways[61]:

(i) The outstanding debt converted at the exchange rate of Rs.19.9169 ruling at the beginning of 1990 (effective from 16/12/1989) would be repaid over the next 12 years as per the original agreement with interest at 2.4 per cent per annum. Total debt at this exchange rate stood at Rs.19,643 crore.

The second component was the differential between the exchange rate of Rs.19.9169 used for the first component and the last announcement rate under the 1978 protocol,viz. Rs.31.7874 effective from 17th November,1991. This amounts to Rs.11,700 crore and is to be repaid free of interest over 45 years.

The first part of the debt, in value terms at February,1993 was quantified at SDR 3.7 billion, the discounts rate being 10 per cent. The second part was quantified at SDR 0.4 billion. The rupee amount would be varying in accordance with the rupees' exchange rate against the SDR . Out of the second cpmponent, the first five years' repayment would be in nominal rupees unlinked to the SDR. This portion, using a discounting rate of 15 per cent per annum of rupees, worked out to equivalent of SDRs 0.2 billion; and total debt worked out to the equivalent of SDR 4.3 billion.

(ii) India's debt to Russia as on April 1,1992, was estimated at rouble 9.871 million. At the last announced exchange rate as per the 1978 protocol at Rs.31.7874, the principal debt on trade held in New Delhi on October 12,1995, two high-ranking Russian officials demanded a revision of certain key clauses of the 1993 agreement[64]. They sought repayment of India's debt to the former Soviet Union in hard currency dollar instead of in rupees. The arguements advanced was that since India had made its currency fully convertible on the current account and had accepted the obligations under Article VIII of the International Monetary Fund, it should denominate its debt repayment to Russia in dollars. New Delhi rejected the demand outright. India felt that the Russian demand would amount to reneging on the agreement. According to an international trade expert, the Russian game plan was to get the annual repayment of Rs.3000 crores converted to the US dollar using the current rupee-dollar parity. In this way, Russia, otherwise hard pressed for foreign exchange, hopes to garner roughly $ 1 billion a year in hard curency. It was reported that Russian demand was totally against the letter and spirit of the 1993 agreement which explicitly provided for repayment in rupees by export of Indian products as permitted under the export-import policy in force.

But on October 16,1995, addressing a press conference in New Delhi, Mr.P.Chidambaram said that India had made it clear to Russia that the Indo-Russian agreement on debt repayment of 1993 was in tact, and it would like to stick to this route for debt-repayment[65]. He also said that both sides had expressed their desire to abide by the 1993 agreement and that there was no need to depart from it. Mr.Chidambaram said during his visit to Russia the whole gamut of Indo-Russian trade came for detailed discussion and both sides also discussed the working of the agreement. He also stated that the rupee debt allocation for the year had been fully utilised.

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