The Post-war inflation in India was the legacy of the war-time conditions. In fact, it was merely an aggravation of the war-time inflation.

During war-time, inflation occurs as a result of the continued creation of artificial purchasing power in the form of currency and bank credit. When governments fail to raise the necessary finance for meeting their war expenditure by normal means of public finance viz., taxation and borrowing, they resort to the inflationary measures of finance. They may either directly take the help of printing press for securing necessary finance or may borrow heavily from the Central banks against securities. Both the methods have the effect of inflating the circulation of currency within the country which far outpaces the available supplies and the growth of the productive capacity.

Accordingly, in India, during the last war, the government followed the inflationary methods of finance which gave rise to a deficit-induced fiat money inflation. The government of India was forced to accept the obligation of financing the British and allied expenditure in India and, consequently, the government had to resort to the inflationary measure of finance. No effort was made to balance the budget. Of course, ingeniously the semblance of balanced budgets was kept.
up by excluding the war expenditure from the expenditure side of budgets. But that could not keep hidden the basic fact of the gap between its revenue and expenditure. That gap was an inflationary gap which was covered by the issue of rupee currency against rupee and sterling securities. The inflationary gap in Indian finances during the war period from 1939-40 to 1945-46 will be evident from the following figures:

(In crores of Rupees)

<table>
<thead>
<tr>
<th>Assets</th>
<th>From 1939-40 to 1945-46</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Government Revenue</td>
<td>1,461.97</td>
<td>2,283.13</td>
</tr>
<tr>
<td>Total Government Loans</td>
<td>1,235.95</td>
<td>2,235.91</td>
</tr>
<tr>
<td>Treasury Bills outstanding on 31st March</td>
<td>233.33</td>
<td>Recoverable war expenditure, holding etc.</td>
</tr>
<tr>
<td>Rupee financed directly raised by the Allies by gold sales (approximate)</td>
<td>135.00</td>
<td></td>
</tr>
<tr>
<td>Inflationary gap</td>
<td>1,079.55</td>
<td></td>
</tr>
</tbody>
</table>

The inflationary gap was about Rs.1,080 crores. Nearly the whole of it (Rs.1,033 crores) was sought to be covered by expending additional currency. Thus, total notes which stood at Rs.206 crores at the beginning of World-War II, increased to Rs.1154 crores at the end of the war.

1. N.V. Savani - Post-War Inflation in India, 1949, P.2
Now in order to get the necessary rupee-finance for meeting the war expenditure on behalf of the British and allied Governments, the Reserve Bank of India machinery was used by the government of India. The British government did not make payments in terms of gold or real goods and services but it paid in terms of sterling-securities which were credited to India's account in the Bank of England. These sterling securities were transferred from the Banking Department to the Issue Department of the Reserve Bank of India against which rupee-currency was issued in India. Sterling securities were merely paper promises to pay at a future date. In the Issue Department they recorded an increase from Rs.59.60 crores on the eve of the war to Rs.1,034.32 crores at the end of it.

Under such circumstances, various economic controls were introduced and as a result of this, the inflationary potential was prevented from becoming active and effective. No doubt, the price level began to rise up after December 1942. And the supply of currency was increasing rapidly during the war period. The spiral rise in prices was, however, checked to some extent by introducing controls. Thus, during the period from the middle of 1943 to the end of war in 1945, India was in a state of suppressed inflation.

There is another thing to note. Towards the end of the War it was expected that war-time inflationary forces—the high level of war-time-expenditure would cease to operate and a considerable slackening of the economic activity would ensue after the end of the war. It was believed that a depression would set in. Reasons for this conclusion
were; firstly, the small amount of pent up effective demand generated during the war was not likely to give rise to a boom; secondly, agricultural prices which had increased during the war due to inflationary pressures were likely to fall; thirdly, prices abroad would not rise and the over-valued Indian exchange rate would exert a downward pressure on Indian prices. Lastly there was likely to be a significant reduction in the total expenditure of the government of India and hence this was likely to bring recession in economic activity after the war. 

But the expectation proved to be erroneous. The government of India continued to finance the purchases of the British government even after the end of the war, thus adding to sterling balances and subsequently to currency in circulations. Further, in order to prevent the anticipated slump, the government of India drew up post-war reconstruction and development plans to keep the economic activity at a high level. It was decided to undertake schemes of capital expenditure, particularly of the nature of public works. As for this implementation the government of India promised substantial help to provinces. Certain concessions in the form of tax reliefs and other forms were granted to private enterprises. Concessions in the form of income-tax relief and abolition of the excess profit tax were granted. But they were responsible for the decline in the revenue.

Deficit financing in the postwar period:

It was further assumed that postwar reconstruction and development plans drawn up by the government would be financed from re-

venue surpluses and new borrowings. It was expected that during the five years following the termination of the war, the government of India and the provincial governments would have revenue-surpluses of about Rs.500 crores and Rs.200 crores respectively and that the government would have a net borrowing of Rs.500 crores. But, during the three post-war years, instead of any surplus, both central and provincial governments increased deficits of Rs.53 crores and Rs.11 crores respectively. And these large budget deficits were due to both a fall in the government borrowing and an increase in expenditure on current and capital accounts.

Now this fall in the government borrowing much below expectation was due to the inflationary pressures. For instance, during the period from 1946 the net borrowing of the government was Rs.20 crores only which was much below the expectation. Further, investment in government-securities became less attractive than investment in private business due to the relaxation of controls over commodity and capital markets. The result was the sale of government-securities and consequently there was the fall in security prices and rise in interest rates. However, this was checked to some extent by means of open market purchases of government-securities by the Reserve Bank of India. But this support, which meant expansion of currency by the Reserve Bank of India to the government-security led to inflation.

Let us explain the second cause. The increased in government expenditure firstly, on current and capital account, was due to uncertainties of the political and communal situation in the country. Secondly, after the partition of India, expenditure increased on defence services.
refugee-rehabilitation and on food subsidies, the last item of expenditure being necessary to meet the food-shortage within the country. Thirdly, expenditure also increased owing to post-war reconstruction and development schemes started by the government of India and provincial governments.

As a result of these increases in the government expenditure, there were deficits both on revenue and capital accounts. They were met partly from the cash-balances of the central and provincial governments and partly by the expansion of fresh notes by the Reserve Bank of India.

Thus, during the post-war period, the policy of deficit financing followed by the government of India and the use of the machinery of the Reserve Bank of India for creating additional currency in the country led to inflation which was more acute than during the war. Further, the expansion of additional currency, during this period, was done against rupee securities. The increase in rupee securities was mainly due to two factors, namely, deficit financing and open market operations. The Reserve Bank of India made heavy purchases of government securities to support the security market. This resulted in the expansion of currency in India.

Cheap money policy in the post-war period.

Another factor responsible for the post-war inflation in India was the inauguration of a cheap money drive. But it proved highly inopportune, since it had to work in the context of an economy which had large inflationary potentialities.
The main function of cheap money policy, in peace time, is to bring about an expansion in the supply of investable funds. The post-war conditions in India presented many difficulties in the way in realising this objective. For one thing Indian money and capital markets are not properly coordinated and integrated. Now, the cheap money policy influences only the organised money market of which its chief components are banks. In India, these touched only the fringe of the total investment process of the country. The small manufacturer, trader and the agriculturist were hardly benefited. Lower rates for government borrowing or lower bank rates practically left untouched and uninfluenced the general credit structure of the country. Moreover there was no well planned investment policy. Under such circumstances, the continuation of the cheap money policy, in the post-war period only led to inflation in India.

The inflationary pressures were aggravated by the adoption of the policy of decontrol in the latter half of 1947. In a security economy with redundant money, the policy of decontrol, quite naturally, led to severe speculation in the commodity market, thus intensifying the inflationary momentum. Again, contrary to the expectation that the policy of decontrolled would depress the price level, it resulted in a sharp rise in prices.
Rise in prices

The continuous increase of the whole-sale prices in India and of cost of living in Bombay will be evident from the following figures:

<table>
<thead>
<tr>
<th>Year</th>
<th>Whole-sal prices</th>
<th>Cost of living</th>
</tr>
</thead>
<tbody>
<tr>
<td>1944-45</td>
<td>244.3</td>
<td>225</td>
</tr>
<tr>
<td>1945-46</td>
<td>244.9</td>
<td>228</td>
</tr>
<tr>
<td>1946-47</td>
<td>275.4</td>
<td>252</td>
</tr>
<tr>
<td>1947-48</td>
<td>307.0</td>
<td>268</td>
</tr>
<tr>
<td>1948-49</td>
<td>376.2</td>
<td>297</td>
</tr>
<tr>
<td>1949-50</td>
<td>385.4</td>
<td>291</td>
</tr>
</tbody>
</table>

From the above figures it becomes distinctly clear that the general price level rose from 244.3 in 1944-45 to 385.4 in 1949-50, and the cost of living index in Bombay moved up from 225 to 291, i.e. by 66 per cent in the same period. Among the groups constituting the general index, the index of export and agriculture commodities rose to the maximum in 1946-47, but in 1947-48 and 1948-49 the highest increase was recorded by that of industrial raw materials. The index of agricultural commodities and export commodities rose from 265.4 and 243.9 to 315.8 and 296.8 respectively in 1945-46, and 1946-47 respectively.

Increase in the money supply.

On the monetary side, one of the main factors which had contributed to the aggravation of inflation there was the rise in the money supply.

This post war increase in money supply in India will be evident from the figures given below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Currency with the public (excluding small coins)</th>
<th>Deposit money with the public</th>
<th>Total money supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>1943-44</td>
<td>983</td>
<td>636</td>
<td>1619</td>
</tr>
<tr>
<td>1944-45</td>
<td>1188</td>
<td>734</td>
<td>1922</td>
</tr>
<tr>
<td>1945-46</td>
<td>1327</td>
<td>882</td>
<td>2209</td>
</tr>
<tr>
<td>1946-47</td>
<td>1383</td>
<td>839</td>
<td>2222</td>
</tr>
<tr>
<td>1947-48</td>
<td>1408</td>
<td>894</td>
<td>2293</td>
</tr>
</tbody>
</table>

It is clear that between September 1945 and June 1948, the note circulation increased by Rs.123 crores, of which Rs.150 crores are accounted for the post-partition-period of nine months.

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Anti-inflationary measures

In the early part of post-war-period, when monetary and non-monetary factors contributed to the accentuation of the inflationary pressure that was latent during the war time, on January 12, 1946, the government of India promulgated two ordinances, "the Bank Notes (Declaration of Holdings) ordinance" and the "High Denomination Bank Notes Demonetisation ordinance". The former was intended to help the government in making an estimate of the amount of notes of denomination of 100/- and above held by banks relatively to the total circulation. According to the provisions of the High Denomination Bank Notes Demonetisation ordinance, notes of the value of Rs. 500, Rs. 1000/- and Rs. 10,000/- ceased to be legal tender. In the opinion of Sir Archibald Rowlands, the then Finance Member - "the principal of Demonetisation ordinance was to strike at the black marketeers to rope in the tax-dodgers, to deprive public servants, who had betrayed their trust, of some of their ill-gotten gains and to bring under control a potential threat to a sound monetary system".

Provisions of the Demonetisation ordinance were more dramatic than economically effective. The immediate effect of the ordinance was far from deflationary. There was hardly any contraction in the total volume of currency but merely a change in its form. In this connection, Indian leading economists gave expression of their opinion in a joint statement which are as follows:

1. Mr. S.K. Basu Recent Banking Development, 2nd Edition P. 30
"The demonetisation ordinance cannot bear any important consequence as long as currency continues to be issued in large amounts week by week. It cannot check either speculative pressures on prices or the operation of black marketers. The ordinance does not directly reduce the volume of currency; it merely changes the form in which it is held. It will put those notes of high denomination out of circulation, holders of which do not present them for exchange within the specified time-limit. The declarations made by holders of high denomination notes will lead to an increase in the receipts from taxation of income and profits and this might also have some deflationary effect. The total result in this direction cannot, however, be expected to be large in relation to the total value of notes in circulation. On the other hand, the ordinance might lead to making active monetary hoards which were previously dormant."

These expectations of the economists fully came true. The total value of high denomination surrendered for exchange up to 31st March 1946 amounted to Rs.123,332,500 i.e. 85.6 p.c. of the total was surrendered up to that date. The total amount of notes of these denominations outstanding on 31st December, 1947, were Rs.3 lakhs in the case of Rs.500 denomination, Rs.1.12 lakhs of Rs.1000 denomination and Rs.21 lakhs of Rs.10,000 denomination as against 26 lakhs, Rs.113.37 lakhs and Rs.18.46 lakhs respectively on 31st December, 1945. At the same time the circulation of Rs.100 denomination rose from Rs.48,71 lakhs at the end of 1946 to Rs.84,11 lakhs at the end of 1947. Immediately after the

2. Report on Currency and Finance, Reserve Bank of India 1947-48 p.120
3. Ibid - p.120
promulgation of the Demonetisation-Ordinance, there was no doubt a small contraction of the total notes issued as will be evident from the figures of Rs.12,4576 lakhs on February 1 and Rs.12,4183 lakhs on February 15. But the total money supply increased from Rs.1922 crores in 1944-45 to 2,179 crores in 1945-46 and again to Rs.2,197 in 1946-47. It should be noted in this connection that there was increase in both currency with the public and deposit money. Expectation that the effect of the Demonetisation-Ordinance would be deflationary, was far from reality.

Slogan for "produce or perish".

Many, both officials and non-officials, held the view that an increase in production was the only effective remedy against inflation. The government of India raised the slogan, "Produce or perish". The authorities of the Reserve Bank of India held the similar view. According to the Central Board of the Reserve Bank of India, "the root of the trouble is not so much over-spending as under-production." Under-production means production below existing capacity. If there are unused resources under the pressure of rising prices, they ought to come into use and lead to increased production. But even then, if the resources remain unused under such pressure, it means that they cannot be used owing to some non-economic considerations, such as technical considerations. But the non-use of potential capacity due to technical

1. Reserve Bank of India Weekly Returns.
deficiencies or similar non-economic considerations, cannot be described as under-production. Inflation cannot exist where unused resources exist.

Mr. C.D. Deshmukh, the then governor of the Reserve Bank of India advocated that inflation should be fought by bringing a fall in prices "by a sizeable increase in the volume of production of goods and services." This argument seems to be confusing because it was difficult to achieve sizeable increase in the production of goods and services on account of the limitation of the productive capacity of our industries. The U.S.A. could not increase production more than 50 p.c. Much less can be expected of a poor country like India.

Control of Capital Issues.

The Capital Issues-Control-Order was originally promulgated on 17th May, 1943, under Rule 94-A of the Defence of India Rules, mainly as an anti-inflationary measure. In the light of the experience gained during the war-years, it was thought necessary to continue the control with a view to a secured "a balanced investment of the country's resources in industry, agriculture and the social services". The Control of Capital-Issues was continued first under the Emergency Provisions (continuance)-Ordinance, 1946, from 1st October, 1946 to 31st March, 1947 and finally under the Capital Issues (Continuance of Control) Act, 1947, the Control of Capital Issues became effective from 19th April, 1947 for three years.

1. Ibid p. 29
The most striking feature of the working of the control in the post-war period was a remarkable increase in the amount of capital both applied for and sanctioned as compared with the war. Whereas in the 28½ months of the war period the total capital sanctioned was Rs.260.56 crores, in the 18 months of the post-war period it was as much as Rs.379.96 crores. During the year 1948-49 the capital sanction of Rs.111.93 crores was given in respect of 348 companies as against 426 companies for an issue of Rs.162.99 crores in the previous year. Industrial issues predominated both in respect of the number and amount. As regards the distribution between the immediate and the long range schemes, the former accounted for the major share. This will be evident from the following figures, in the next page.

### Percentage Distribution, Group-wise

<table>
<thead>
<tr>
<th>Classification: From 17th May 1943: From 1st Oct.'45 From 1st April'48 to 30th Sept.1945 to 31st March’47 to 31st March’49</th>
</tr>
</thead>
<tbody>
<tr>
<td>no. of companies</td>
</tr>
<tr>
<td>sanctioned</td>
</tr>
<tr>
<td>1. Industrial</td>
</tr>
<tr>
<td>2. Agricultural</td>
</tr>
<tr>
<td>5. Other services</td>
</tr>
<tr>
<td>6. Total of non-Industrial</td>
</tr>
</tbody>
</table>

| Industrial & non-industrial | Immediate | 93.47 | 63.72 | 68.27 | 42.40 | 86.49 | 65.23 |
| Long range | 6.53 | 36.28 | 31.73 | 57.60 | 13.51 | 34.71 |

2. Ibid P.134
Reversal of the policy of decontrol.

In view of the fact that the policy of decontrol adopted towards the end of 1947, led to an activation of latent inflation, the government of India decided on a gradual reversal of the policy of decontrol. The Economic Adviser’s General Index touched 330 in July 1948, recording an increase of 29 per cent over the pre-decontrol level in November 1947. The rise was most marked in the case of decontrolled articles, especially in essential consumer goods including rice, wheat, cotton yarn, textiles and oil seeds. So in order to check a further deterioration in the situation, at the end of July, 1948 controls were reimposed on cloth and then cotton and foodgrains. And in September 1948 under the revised food policy, Provincial and State Governments also reimposed controls over prices, procurement and distribution in respect of major foodgrains. Further, in December, on the recommendations of the United Provinces and Bihar Governments, the Central Government fixed sugar prices at Rs.8 per mautd ex-factory as against Rs.35-7 in December, 1947.

Anti-inflation Programme.

Early in October, 1948, decontrol was followed up by the announcement of a comprehensive anti-inflation programme. The government of India’s anti-inflation programme was designed to counteract the inflationary pressures which were at the back of these price increases.
The measures adopted by the Government fall into two categories: (1) those intended to keep down government expenditure as well as to reduce excess purchasing power in the hands of the community and (ii) those intended to increase the volume of essential goods and services. The important measures falling under the first category included: (1) the balancing of budgets, Central as well as provincial, (2) a cutting down of capital expenditure by governments, (3) postponement from 9th October of repayments of Excess Profit tax and other deposits, (4) revival of the 1943 scheme of interest bearing deposits, on 18th Oct. (5) the issue from 15th October of treasury Deposit-Receipt, (6) the raising of the maximum which a person could hold in a post office Savings Deposits and National Savings Certificates and (7) limitation of dividends payable by public-limited companies. The second category comprised measures partly to stimulate production and partly to augment supplies by allowing a larger flow of imports. The concessions to industry included liberalisation of depreciation allowances, exemption from taxation of new industrial undertakings of specified categories for a specified period, reduction in import-duties on plant and machinery as well as essential industrial raw materials, reduction or abolition of duties on certain exports and top priority for transport facilities to essential key industries, namely steel, cement and textiles.

The effect of these various measures including those of recontrol was a downward tendency in the general price-level during the closing months of 1948.
The Economic Adviser's General index which had risen to 390 in July 1948 eased to 383 in August and remained more or less unchanged at around that figure till December 1948. After December, it declined steadily and stood at 370.2 in March 1949. The Bombay cost of living index declined 326 in December 1948, to 311 in March 1949. Prices of different commodities also declined with the exception of industrial raw materials. Food articles fell by 2.6 per cent, semi-manufactured articles by 4.7 per cent, manufactured articles by 11 per cent and miscellaneous by 4.1 per cent.

Notwithstanding the fact that there was a downward trend in prices, the general price-level did not fall below the pre-decontrol level of 302.0 in November 1947. This will be evident from trends of the general price level:

<p>| Base: Year ended August 1939 = 100 |</p>
<table>
<thead>
<tr>
<th>November</th>
<th>July</th>
<th>October</th>
<th>March</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>1948</td>
<td>1949</td>
<td>1949</td>
</tr>
<tr>
<td>302.0</td>
<td>383.6</td>
<td>331.7</td>
<td>370.2</td>
</tr>
</tbody>
</table>

But despite the adoption of both monetary and non-monetary measures by the monetary authorities and the government of India, inflationary pressures could not be checked in India in the post-war period.

2. Ibid p.167.
A case for selective instruments of credit control.

Let us now examine the question of the applicability of selective instruments of credit control under Indian conditions. The bullish activities in the Indian stock-exchange-market due to high prices of securities and the speculative enthusiasm of the Indian Banks to make huge advances in security loans and the subsequent banking crisis in India in recent years created a condition for introducing legislation on American lines enabling the Reserve Bank of India to regulate the margin requirements with regard to security loans made by Banks.  

In the United States, at the end of the Second World War, on account of highly inflationary tendencies, caused by war-time expansion of currency and of speculative excesses on the stock exchange, the Board of Governors of the Federal Reserve system fixed the margin requirements to 100 per cent in January, 1946. This step had stopped further flow of money into the stock markets. The use of selective instruments of credit control, has no doubt served the purpose of checking the speculative excesses on the stock exchange market in the U.S.A.

In India, the boom which was witnessed in the government securities market and the industrial share-market in the War-time continued unabated in the post-war period. Prices of government securities and industrial shares went on rising higher and higher. The Economic Adviser's index number of the prices of government securities and

1. Dr. G.K. Basu: Recent Banking Developments (Second Edition) P. 120.
of industrial securities (1927-28: 100) rose from 117.2 in 1943-44 to 122.8 in August, 1943, and from 229.7 in March 1944 to 399.9 in July 1946 respectively. The upward movement in the stock exchange was due to various factors, namely the procurement and distribution of food by the government, control of capital issues, the vigorous pursuit of the cheap money policy by the government, the abolition of the Excess Profit Tax and the prospects of greater profitability of industry and therefore of higher dividends. Therefore the bull movement continued uninterrupted and the speculative fervor was at the highest peak. Optimism and enthusiasm were so high that even small investors who had never before taken any interest in the stock exchange market were attracted to deal in the stock-exchanges. A large number of banks, mostly domestic banks, made considerable advances against speculative shares and invested heavily in them. This pressure of money seeking investment, and the accommodation granted by a number of banks for speculative purposes tended to bring about a rise in prices of government securities and industrial shares.

The boom in the stock-exchange market which developed after the presentation of the central government budget in February 1946 was arrested and a mild decline set in by the middle of August, 1946. This was followed in September by a violent break in prices, following the outbreak of communal disturbances in various parts of the country. The decline was accentuated by other factors, such as the political uncertainty, wide spread strike wave, the slump in Wall Street, and
the exception that the Interim Government might pursue vigorous anti-
inflationary and anti profiteering policies. Share prices declined to
abnormally low levels. The Economic Adviser's general index of securi-
ty-prices fell from 292.9 in August, 1946, to 222.0 in September and
265.5 in October. The first reactions were extremely panic-y. There
was heavy rush in Calcutta and the Bombay stock exchange markets for
liquidating scripts of all categories. The down-ward trend of the
market went a further heavy decline with the announcement of the new
taxation proposals in the central budget for 1947-48 and the markets
in Calcutta, Bombay and Madras had to be closed for some time to pre-
vent a crisis.

A large number of banks, mostly non-scheduled, which made
a heavy investment in speculative shares, had to face a serious banking
crisis. Signs of smaller banks in Bengal getting into difficulties were
noticed early in November 1946. When the speculative fervour in the stock
exchange market was in full swing in the middle of 1946, the Reserve
Bank cautioned all banks, scheduled and non-scheduled, against the
dangerous practice of making large loans against stock exchange
securities. By issuing the other circular, the Reserve Bank drew the
attention of the banks to the need for restricting advances against
shares to a reasonable proportion of their resources or total advances, and
the advisability of fixing maxima for advances per share in the case of
speculative sellers. At that time the Reserve Bank of India was con-
considering the desirability of introducing legislation for regulating
margin requirements on the American lines to curb unhealthy speculat-
ion.
The fixation of margin requirements by the Reserve Bank has got its place in the Banking Companies Act of 1949. Under section 21 of the Banking companies Act, the Reserve Bank has been given power to determine the margins to be kept in respect of secured loans.

Methods of selective credit control can be effectively used in a particular sector of economy by raising the margin requirements when inflationary tendencies are witnessed in that sector. But it would be a mistake to assume that they would be able to restrict credit all round. It is doubtful whether the depression would be cured by lowering the margin requirements as the depression is caused more by fundamental defects inherent in the economic system than by monetary factors. When a localised depression or depression occurs in a particular economic sector, in spite of the fact that trade as a whole is active, it may be possible to cure partial or localised depression and to bring recovery by lowering margin requirements if depression in that locality or in that economic sector is due to monetary factors. In India, selective methods of credit control could only be used to prevent speculative dealings in the stock exchange market in 1946-47.
The problem of the Dollar shortage and devaluation of the Rupee:

In September 22, 1949, the most momentous step taken by the government of India was the devaluation of the Indian rupee in terms of U.S. dollar from 30.225 cents to 21 cents and in terms of gold from 0.268601 grams to 0.186621 grams of fine gold. The official reason for the devaluation of the rupee was to correct India’s adverse balance of payments position with the hard currency area, particularly, the U.S.A.

During nine months from January, 1949 to June, 1949 the net dollar deficit was Rs. 57.9 crores while the deficit with the sterling area amounted to Rs. 76.9 crores. The decision of the government of India to devalue the rupee was not free from external influence. For the decision of the United Kingdom to devalue sterling was the signal for a general worldwide adjustment of exchange-rates in relation to the U.S. Dollar. When the United Kingdom devalued her pound-sterling in September, 1949 in terms of dollar by 30 per cent, most of the sterling-area including Indian Union depreciated their currencies proportionately. The value of the rupee in terms of sterling remained unchanged at 1s-6d. No doubt, India’s balance of payments improved temporarily after devaluation and by 1960, it showed a surplus of Rs. 61.5 crores compared to a deficit of Rs. 169.3 crores in 1949. But from the second quarter of 1951, the balance of payments showed a downward swing and the net deficit during the second quarter was Rs. 15.9 crores. By the last quarter of 1951, it rose to

1. The new rate of U.S. $2.80 was agreed for sterling.

2. Report on currency and finance, Reserve Bank of India 1950-51, p. 96
8 crores. Again, devaluation was in conflict with the anti-inflationary objective of the government of India. For, the impact of devaluation was a general rise in prices. The upward trend in prices since devaluation will be evident from the following figures:

<table>
<thead>
<tr>
<th></th>
<th>August 1949</th>
<th>October 1949</th>
<th>March 1950</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Food Articles</td>
<td>376.5</td>
<td>406</td>
<td>396.2</td>
</tr>
<tr>
<td>2. Industrial Raw</td>
<td>462.8</td>
<td>477.9</td>
<td>490.1</td>
</tr>
<tr>
<td>materials</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Semi manufactures</td>
<td>322.4</td>
<td>332.2</td>
<td>332.2</td>
</tr>
<tr>
<td>4. Manufactured</td>
<td>329.4</td>
<td>352.6</td>
<td>347.4</td>
</tr>
<tr>
<td>Articles</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Miscellaneous</td>
<td>515.2</td>
<td>588.8</td>
<td>630.6</td>
</tr>
<tr>
<td>6. All commodities</td>
<td>389.0</td>
<td>393.3</td>
<td>392.4</td>
</tr>
</tbody>
</table>

From the above figures it becomes clear that, in March 1950, the general index was above the pre-devaluation price by 19.7 per cent. Group indices also rose. In October, 1949 prices of food articles rose by 29.5 per cent, industrial raw materials by 15.1 per cent, semi-manufactures by 9.8 per cent, manufactured by 23.2 per cent and miscellaneous by 73.6 per cent. Thus devaluation failed to remove the economic malaise in India, on the contrary, it aggravated the inflationary pressures in India.

The aggravation of the inflationary pressure was more accentuated than before by the developments that followed the outbreak of the Korean War. The general price-level showed a fairly sharp rise,
the Economic Adviser's index of wholesale prices (base year ended in August 1939 = 100) rising from 398.4 in March 1950 to 456.8 in May 1951. Currency and credit showed unusual expansion. The money supply with the public rose by Rs.99.2 crores as against a decline of Rs.18.4 crores in 1949-50. The unusual expansion of bank credit, amounting to Rs.141.5 crores between December 1950 and March 1950 as against Rs.67.0 crores in the corresponding period of the previous year, was possible due to the heavy purchases of government securities in the open market.

1. Report on Currency and Finance, the Reserve Bank of India 1951-52, PP.44-45