III

CURRENCY EXCHANGE AND FINANCE

LURING

THE SECOND WORLD WAR

GENERAL

In September, 1939, the Second World War broke out. Following were the salient features of the war economy. It was found that war had automatically solved many past economic problems, but in their place new problems no less difficult had cropped up. "Let us give our Martian leave of absence (fortunate fellow) for the grim war years, and summon him back for another look round in the early months of 1947. He will find some pre-war trends reversed and others accentuated". The war had at least solved the problem of falling prices, unemployment, economic stagnation and other evil consequences of economic depression. There were already signs of recovery before the war had started. Because war was expected to be a prolonged one there was stock piling of essential war materials.

The war economy was a planned economy. The sole aim of any state at the time of war is to win it and as such

all economic resources are mobilised for that purpose. Idle capacity for production is fully utilised, civilian consumption and wastage are reduced to the minimum. Production and supply of goods are not left to free forces of competitive market. There is very little replacement of capital which is subject to wear and tear.

In a period of war, the state has to spend more than what it can raise through loans and taxes. Though all governments try to raise some additional revenues through more comprehensive taxes and loans, the rise in revenues can not keep pace with war-time expenditure, so that there are always huge deficits in the budgets. These deficits in most of the countries during the Second World War were met by currency expansion. In the U.S.A. during the war years, there was an increase in taxation and borrowing, but these together could not help the Federal Government to balance its war-time budgets. "These collections were so inadequate that the total deficit for the period (1940 - 46) amounted to more than $136 billion. This deficit was partially met by borrowing from individuals and business, and this also having proved inadequate, a considerable part of the federal debt was in effect paid for with money newly created by the Federal Reserve and commercial banks".  

Financing the war-time deficit budgets through increased note issue caused inflation. Most of the countries which were either directly or indirectly affected by war were caught in the whirl wind of inflation. Even those countries which were not involved in either of the way found their internal prices rising during the war years. "The notorious examples of paper currency inflation during the eighteenth and nineteenth centuries and also after the two World Wars were connected with budgetary deficits". The starting point of inflation was therefore budget deficits, to meet which there was an expansion in currency issue, which consequently led to an increase in prices. In a period of inflation, there is an increase in the velocity of circulation of money, because people prefer to retain real goods and get rid of money as soon as they can. The prices of properties and real goods thus go on increasing and the value of money diminishes. But in India on account of certain reasons - which we will study at the appropriate place - the velocity of circulation of money declined during the war years.

Inflation later on developed into hyper-inflation in some of the countries during or after the I and II World Wars. In Germany, after First World War, inflation developed into hyper-inflation. Prices started rising by leaps and

1. Dr. Paul Lindig: Inflation, p. 68.
bonds every day and as Prof. Muranjan has stated, in Germany after World War I a person had to pay for a pair of laces even more than what he paid for a pair of shoes a week ago. 1 The same was the condition in Hungary and China after the II World War. People in these countries either exchanged for goods and services or all transactions were made in foreign currencies. Hyper-inflation is a rare occurrence.

In the course of war, countries had to raise huge loans and therefore to keep down the interest charges, many Governments resorted to cheap money policy. The cheap money policy also helped in the maintenance of price stability of government securities in the market. The following were the average rates of interest on national debt in different countries during one of the war and pro-war years. 2

TABLE 9

AVERAGE RATES OF INTEREST ON NATIONAL DEBT IN DIFFERENT COUNTRIES

<table>
<thead>
<tr>
<th>Country</th>
<th>1938-39</th>
<th>1943-44</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.A.</td>
<td>1.5%</td>
<td>1.9%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3.0%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Canada</td>
<td>3.5%</td>
<td>2.6%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3.5%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>3.6%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Australia</td>
<td>3.5%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Sweden</td>
<td>3.7%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Union of South Africa</td>
<td>3.8%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Germany</td>
<td>5.0%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Brazil</td>
<td>5.4%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Argentina</td>
<td>4.4%</td>
<td>4.1%</td>
</tr>
</tbody>
</table>

There was a state of full employment in many countries of the world. Even retired hands were called for employment and people were sent to work even before they completed their courses of study. Working hours were increased and holidays were reduced. The labour unions were not permitted to declare strikes. In many countries such unions had ceased to be active.

The cost of living having gone up on account of inflation, there was much dissatisfaction amongst the workers. The state and other employers, had therefore, to gradually increase the wages of their employees in the shape of increased dearness allowances. But wages could hardly in any country rise equal to the rise in cost of living.

War-time increase in prices deprived the fixed income group of a large part of its real income, whereas the big land owners, industrialists and businessmen gained. It has therefore been observed that inflation has been the cause of social injustice.

In the beginning of the war, very few countries took any concerted action against price rises. In India, the Government in the earlier stages of it even denied that there was any inflation in the country. But, as the war years rolled on, prices continued to rise continuously so that the Government had ultimately to take action to counter its evil effects. There was price control, rationing and regulation
of exports and imports of almost all commodities essential for war purposes. The poorer section of the population was given many necessary commodities at subsidised prices. The rents of houses were also controlled by the Government. As there was rationing and price control of food articles and other essential commodities in short supply, there was large scale blackmarketing in these commodities. Amongst the Western countries blackmarketing was rampant in France, Italy and Greece during and after World War II.

There was also foreign exchange control during the war. It was aimed at better utilisation of scarce foreign exchange resources for war purposes. "In hardly any sphere of activity has intervention been adopted so wholeheartedly as in the matter of foreign exchange".¹

With very few channels left over for the consumption or for investments of one's savings, people were mostly forced either to lend their savings to the Government by making investment in Government bonds and Treasury bills or to keep the savings in the banks or to hoard the same in cash.

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¹ Dr. Paul Hinsö: Exchange Control, p. 2.
INDIAN CURRENCY AND EXCHANGE DURING WORLD WAR II

The Indian economy had three major financial problems at the inception of the war — (i) the 1 s. 6 d. rate controversy of the Indian Rupee; (ii) the outflow of gold from India and (iii) the low prices of our agricultural products. War had automatically solved these problems, but had brought some new ones.

No sooner than the war had started, the Government of India passed the Defence of India Rule, and assumed very wide powers. It gave the Government many economic powers as well.

The initial victory of Germany in the beginning of the war, was responsible for the Indian peoples' loss of faith in the Government of India.

There was a rush for the conversion of paper currency into silver coins. "People's faith in currency authorities began to stagger. Notes were converted into coins and rupees hoarded by the people". Between September 3, 1939 and June 21, 1940, the Reserve Bank converted Notes worth Rs. 41 crores into silver rupees. In order to put a stop to the hoarding of silver coins the Government of India by various ordinances replaced all silver coins by token coins and its one rupee notes. Along with an increase in the demand for silver

rupees for boarding, there was a greater demand for such purposes of silver coins of smaller value. These coins were also gradually replaced by the coins of cheaper metal.

Immediately on the commencement of hostilities by Germany, the Government of India also declared war against the Axis powers. All the later economic hardships that India suffered from was an outcome of this. As the Indian people could not prevent the rulers from declaring war, so also they could do nothing against the war-time economic policies of the Government of India.

On the 9th November, 1939, the Government of India entered into a financial agreement with the British Government about the division of defence expenditure between the Government of India and the Government of Britain. It was agreed on principle that the Government of India should bear the expenses of its own defence and the expenses of wider Imperial strategy were to be borne by the British Government. An additional amount of 50 crores had also to be provided in the Government of India's annual Defence Budget for Indian troops stationed abroad as its own liability.

On account of the extension and intensification of the war, the defence expenditure of the Government of India

1. Dr. K.N. Raj : Monetary Policy of the Reserve Bank of India, p. 139.
started mounting up. Upto March, 1940, the additional expenditure due to war was only 2.4 crores. The following statement gives an account of the total defence expenditure on Revenue and Capital Accounts.  

**Table - 10**

**TOTAL DEFENCE EXPENDITURE ON REVENUE AND CAPITAL ACCOUNTS**

<table>
<thead>
<tr>
<th></th>
<th>1940-41</th>
<th>1941-42</th>
<th>1942-43</th>
<th>1943-44</th>
<th>1944-45</th>
</tr>
</thead>
<tbody>
<tr>
<td>On Capital Account</td>
<td>...</td>
<td>-</td>
<td>52.51</td>
<td>37.46</td>
<td>62.83</td>
</tr>
<tr>
<td>On Revenue Account</td>
<td>73.61</td>
<td>103.93</td>
<td>214.62</td>
<td>398.40</td>
<td>395.49</td>
</tr>
<tr>
<td>Total</td>
<td>73.61</td>
<td>103.93</td>
<td>267.13</td>
<td>398.40</td>
<td>458.32</td>
</tr>
</tbody>
</table>

Percentage of Defence expenditure (Revenue Account) to total expenditure... 64.5 70.6 74.3 61.1 79.6

To this defence expenditure must be added the additional civil expenditure incurred by the Central and Provincial Governments in consequence of the war. These two added together would give an exact assessment of the war-time expenditure. The total expenditure on defence measures from April, 1939 to March, 1945

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was as follows:\(^1\)

\[\text{In crores of Rupees}\]

1. Central defence expenditure
   (including expenditure on
   Capital Account)  \[\ldots \ldots \ldots \ldots \ 1346.71\]

2. Central civil expenditure
directly attributable to
war  \[\ldots \ldots \ldots \ldots \ 178.41\]

3. Provincial expenditure
directly attributable to
war  \[\ldots \ldots \ldots \ldots \ 275.68\]

The total amount of expenditure incurred on account of wider Imperial strategy was never included in the Central Budget. This amount can be roughly estimated from the Sterling payment made on this account by British Government to the Government of India. Such payment of Sterling for the war period - upto 31st March, 1945 was valued for \[\approx 1292\] crores. The total recoverable war expenditure from the British Government from 1939 - 40 to 1945 - 46 was \[\approx 1739.73\] crores.\(^2\)

FINANCING THE WAR FROM TAX REVENUE

In order to meet the rising expenditure on account of

\[\text{1. Dr. L.K. Malhotra : History and Problems of Indian Currency,}\]
\[\text{p. 116.}\]

\[\text{2. Reserve Bank of India : Annual Report on Currency and}\]
\[\text{Finance, 1946 - 47, p. 85.}\]
war, the Government of India raised the tax rates and introduced fresh taxes. At the beginning of the war the Government of India, could only get 11 per cent of its income from direct taxes, amongst which Incometax and corporation tax were the most important. In 1939 - 40, the income of the Central Government from direct taxes was only 15 crores, but in the year 1945 - 46, it went up to as much as 149 crores, so that the proportion of direct taxes in the revenues of the Central Government increased from 11 per cent in 1939 - 40 to 34 per cent in 1945 - 46.

The Government of India Act of 1935 provided that the collection of Income tax would be the responsibility of the Central Government, but the tax collected by it would be shared by it with the provincial governments. However, the Central Government could levy surcharge on income exclusively for itself. "Therefore, the emphasis during the war was on increasing the surcharge rather than increasing the basic tax". A surcharge of 25 per cent was for the first time imposed by the Central Government on all taxes on income by the Supplementary Finance Act of 1940. With the increase in Central Government war expenditure, this rate was increased to 66 per cent on the basic rate of Income tax in 1943. In the Budget for 1940 - 41 an excess profit tax was levied at the rate of

2. Dr. K.C. Chako: The Monetary and Fiscal Policy of India, pp. 170 and 171.
50 per cent on all abnormal war profits. It was raised to 66\% per cent in March, 1941. The ordinance XVI issued in 1943, prescribed that \frac{1}{5}th of the excess profit tax was to be kept as a deposit with the Government. In 1944, the proportion was raised to 19/64. "The effect to this was to immobilise as deposits the whole of the excess profits remaining after excess profit tax had been paid on them and income tax and super tax had been paid on the balance".  

The income from Corporation tax which was 2.2 crores in 1938 - 39, increased to 8.83 crores in 1944 - 45. Direct taxes during the war period increased faster than indirect taxes, because these taxes were productive and flexible. During the war period i.e., 1938 - 39 to 1944 - 45, the proportion of indirect taxes in Central Revenue fell from 36 per cent to 28 per cent.  

But all the increases in the existing tax rates and the introduction of new taxes fell short of its expenditure. The percentage of the revenue to the total expenditure was gradually declining. In 1938 - 39, the total revenue of the Government of India to the total expenditure was 99.3 per cent. But the same declined to 34.6 per cent in 1944 - 45. It was therefore, necessary for the Government of India to find out other means.

WAR FINANCE THROUGH LOANS

Within a few months of the commencement of war, the prices of Government securities began falling. The first Defence Loan operation called Indian Defence Saving Movement, was put into effect from June 4, 1940. Initially it did not succeed as the people's faith in the Government was at a low ebb.

After the fall of France, the market in Government securities virtually collapsed. The Reserve Bank took timely action. It undertook small-scale market operations in January, 1940, in the shape of buying bills from the market. With the beginning of the slack season, the Reserve Bank's intervention became more pronounced, so that the Government of India could raise more fund from its Defence Loan issue of August, 1940. The loan operations of the Government of India hereafter and for the remaining period of war were on the whole a success. The success of the loan operations of August, 1940 was not solely on account of the efforts of the Government of India and that of the Reserve Bank of India. It was on account of some additional purely circumstantial reasons. This success was not because of, but in spite of the efforts of the authorities. It was due to the rapid expansion of currency and closing down of all investment opportunities on private account. Commodity prices had nearly stopped rising and the investment market was nearly blocked. It left the gilt-edged
market as the most attractive open-market". 1

The period from September, 1939 to August, 1940 may be called the first period of war-time Loan Operations. Hereafter, starts the second period, which ends with the end of the war.
"During the second period, the preceding debt management policies were intensively used". 2 And the success of the Loan operations of the Government of India during the second period was mainly due to the same reasons as attributed to the success of the Loan Operations in the first period. The total amount subscribed to all Defence Bonds and Loans, the Defence Savings Bank Account, unfunded debts, Treasury Bills and other obligations between April, 1939 to March, 1945, was of the order of Rs. 861.46 crores. 3 Out of this amount, short-term loans in the shape of Treasury Bills amounted to Rs. 40.40 crores.

It has been metaphorically said that the war was financed by a 3 per cent loan. The Reserve Bank of India and the Government of India adopted a cheap money policy during the war years and most of the Government's long-term loans were raised at 3 per cent interest. "As all the major loans were raised at 3 per cent, it is sometimes referred to as 'a three per cent war'". 4

2. Ibid., pp. 157 and 158.
4. Dr. K.C. Chako: The Monetary and Fiscal Policy of India, p. 194, also see Dr. J.D. Sethi: Monetary Policy in an Under-developed country, p. 165.
Cheap money policy was followed for two reasons —

(1) In order to keep the total burden of interest charges on war-time loans low and (2) to maintain the prices of Government securities high in the market. But this policy had one adverse reaction on the money market. It gave the commercial banks, the capacity to convert their holdings of Government securities easily and without loss into liquid money. This increased liquidity position of the commercial banks made them less susceptible to Reserve Bank's credit control. Credit expansion of the commercial banks were, therefore, unrestrained. Its limit was the demand for credit.

LEND LEASE

India had to meet the expenditure on her own war efforts, some of the war expenditure of the Government of U.K. and had also to help the war efforts of the U.S. Government through reciprocal aid programme. The Government of India through the British Government obtained goods from U.S. under the war-time Lend-Lease programme. Under this programme, India got from the U.S. Government, machinery, air-craft, steel and such other materials. Under the reciprocal aid agreement, the Indian Government had to pay in rupees for the expenses incurred by the U.S. forces stationed in India. In addition to that the Indian Government paid for the raw materials the U.S. Government purchased in India. Of the Lend-Lease goods valued at 2.650 crores received in India from the United States
partly for India's own purposes and partly for purposes of His Majesty's Government's war measures, the amount for which India could assume liability is placed at ₹200 crores. The value of the reciprocal aid rendered by India to the United States in the shape of supplies and services was also estimated at ₹200 crores. In view of the approximately equal benefits received by the United States and India from this mutual aid, it was agreed by an agreement arrived at in Washington on May 16, 1946, that all obligations arising out of Lend-Lease and reverse Lend-Lease be balanced against each other and be therefore cancelled.¹

EXPANSION OF CURRENCY

We have so far discussed the attempts the Government made to collect additional means to meet the enlarged budget expenses for financing the war. All such measures like increasing existing tax rates, imposing new taxes, borrowing from the public and savings drive were not adequate to meet the total defence expenditure incurred by the Government of India. It has been calculated that the additional income derived from such war-time measures by the Government was adequate only to meet her own defence needs but they fell short of meeting the war expenses incurred by the Indian Government on behalf of the British Government.

The British Government could not pay the Indian exporters in goods and services during the war and therefore the payment was made in Sterling. The Reserve Bank of India Act 1934, authorised the Bank to issue notes on proportional Reserve system. Not less than 40 per cent of the Reserve was to be comprised of gold, gold coins, gold bullion and foreign securities. The Sterling securities thus obtained from the British Government enabled the Reserve Bank of India to issue notes in India over this paper currency, to the Government of India who made payments out of it to the Indian exporters. "Thus, all that the British Treasury had to do was to keep in readiness the requisite quantities of the Sterling securities and whenever necessity arose, lodge the right assortment of them with the Bank of England to the credit of the Reserve Bank of India. On receipt of the advice, that this had been done, the latter would release to the nominee of the Imperial Treasury equivalent currency in India and the time taken for doing so need not exceed that involved in cabling the advice".¹

Thus the payment to Indian exporters could be made smoothly by printing of Sterling securities in £ sterling and rupee notes at Nassik. The following table on the next page would give a clear picture of the extent to which the Sterling securities were increasingly used to support note issue in India during the war.

¹ Dr. G.R.P. Gupta: The Reserve Bank of India and Monetary Management, p. 232.
## Table - 11

### Assets and Liabilities of the Issue Department of the Reserve Bank of India

(1939 - 40 to 1945 - 46)

(Rupees crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Liabilities</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Notes in circulation</td>
<td>Gold coin</td>
</tr>
<tr>
<td></td>
<td></td>
<td>in the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bankmg Deptt.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Total notes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>issued)</td>
</tr>
<tr>
<td>-------</td>
<td>-------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>1939-40</td>
<td>209.22</td>
<td>19.79</td>
</tr>
<tr>
<td>1940-41</td>
<td>241.41</td>
<td>17.26</td>
</tr>
<tr>
<td>1941-42</td>
<td>307.68</td>
<td>12.21</td>
</tr>
<tr>
<td>1942-43</td>
<td>513.44</td>
<td>11.80</td>
</tr>
<tr>
<td>1943-44</td>
<td>777.17</td>
<td>10.50</td>
</tr>
<tr>
<td>1944-45</td>
<td>968.69</td>
<td>10.93</td>
</tr>
<tr>
<td>1945-46</td>
<td>1,162.64</td>
<td>16.41</td>
</tr>
</tbody>
</table>

### Source:

The Sterling securities which were worth ₹78.63 crores in 1939-40 swelled up, to the extent of ₹1,061.26 crores in 1945-46. The Sterling assets of the Reserve Bank, just after the war started increased at an average rate of about ₹1 crores per week.\(^1\) Thus, with every increase in the Reserve Bank's Sterling assets, it could successfully expand its paper currency. From ₹226.01 crores worth of notes issued in 1939-40, the notes issued went up to as high as ₹1,179.05 crores in 1945-46. The increase in note circulation led to a rise in prices which caused undue hardships to the Indian people. Had Britain been required to pay for the goods imported from India in goods or services, it would have given rise to an acute shortage of them in its own country. If Britain had to acquire such goods and services from her internal resources, her capacity to impose taxes being limited after certain extent, she would have been required to increase her own currency in circulation. And thus there would have been a more severe type of inflation in Britain, than one that she faced during the war. It may therefore be said that Britain shifted the hardship that would have befallen its own people on account of currency inflation, to the Indian people. "Thus inflation was kept at bay in England and unleashed in India".\(^2\)

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1. Dr. G.K. Gupta: Monetary Policy of the Reserve Bank of India, p. 233.

When we try to find out the velocity of circulation of money in any country, we in fact do not make an attempt to find out the total number of hands each unit of cash and credit money has changed in its life time. The most we try to find out is to have a rough idea about the speed at which the currency changes hands. It has been most common to calculate the velocity of circulation of bank deposits and from this to make out an idea of the velocity of circulation of the total money in the country. Moreover, "that, however, the statisticians try to measure is not the absolute velocity of circulation of bank deposits, but changes in this velocity". 1

If the value of all cheques passing through the clearing houses are divided by bank deposits, we get the velocity of circulation of bank deposits and can make out an approximate idea of the velocity of circulation of total money. The velocity of circulation of bank deposits in India can be derived, if the total of cheques cleared through the clearing houses is divided by the total of deposits of the Imperial Bank, Exchange banks, the Joint stock banks and the Co-operative banks. The velocity of circulation of bank deposits during the war years was lower than that of the pre-war years, and also that the rate of velocity of bank deposits was gradually declining in each successive year.

1. C.Dell Cole: Money, Trade and Investment, p. 64.
### Table - 12

**Velocity of Bank Deposits (1938-39 to 1944-45)**

(Rupees crores)

<table>
<thead>
<tr>
<th>Period</th>
<th>Average Demand Deposit</th>
<th>Total Clearing House Returns</th>
<th>Velocity Number of times 3/2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938-39</td>
<td>123.8</td>
<td>1,929</td>
<td>15.6</td>
</tr>
<tr>
<td>1939-40</td>
<td>132.6</td>
<td>2,211</td>
<td>16.7</td>
</tr>
<tr>
<td>1940-41</td>
<td>155.6</td>
<td>2,019</td>
<td>13.0</td>
</tr>
<tr>
<td>1941-42</td>
<td>201.9</td>
<td>2,569</td>
<td>12.7</td>
</tr>
<tr>
<td>1942-43</td>
<td>306.3</td>
<td>2,773</td>
<td>9.1</td>
</tr>
<tr>
<td>1943-44</td>
<td>456.3</td>
<td>4,349</td>
<td>9.5</td>
</tr>
<tr>
<td>1944-45</td>
<td>584.6</td>
<td>5,279</td>
<td>9.0</td>
</tr>
</tbody>
</table>

Out of the many reasons that were responsible for a decline in the velocity of circulation of money, the most important was the desire of the people to board rupees and small coins on account of the uncertainties created by the war. The next important reason for the decline in the velocity of money circulation during the war years was the preference of the people and the banks to hold liquid money in the shape of idle cash balances. The people and the banks had their money holding in idle cash balances instead of making their constant use for investments, on account of their being very small scope for gainful investment during the war years. A fall in the velocity of money circulation had an anti-
inflationary effect on the Indian economy. "It would be
difficult to deny that the fall in the velocity of circula-
tion (of money) noted during the war period to some extent
as an inflation dumping factor". ¹

INFLATIONARY PRICE RISE IN INDIA

Compared with the rate of increase in the issue of
currency notes, the increase in the rate of agricultural and
industrial production during the war years, was very insigni-
ficant. As we have already stated, note issue increased
from Rs.228.01 crores in 1939 - 40 to Rs.1,179.05 crores in
1945 - 46, that is by about 500 per cent, whereas the index
of rice, wheat, cotton, jute, sugar-cane and ground-nut
production moved from 100 in 1938 - 39 (base year) to only
113.4 in 1943 - 44. The general average rate of production
of pig-iron, steel-ingots, finished steel, cotton-twist and
yarn, sugar, paper, cotton piece goods and Matches moved from
100 in 1938 - 39 to 125.3 in 1943 - 44. As stated by the
Department of Economic Affairs of the United Nations, "The
increases in output of basic commodities (in India during
the war years) were on the whole relatively small". ²

we have already marked that the prices had been rising
even before the war had started. This was due to an

1. Dr. L.K. Malhotra : History and Problems of Indian Currency, p. 176.
2. U.N. Department of Economic Affairs, Series - A, No.2,
Survey of Current Inflationary and Deflationary
Tendencies, September, 1947. Inflation in under-
developed countries : India I, p. 63.
anticipation of the war which had caused stock piling of essential war materials. War caused a sudden spurt in prices. Prices rose more than what they should have on account of an increase in demand. This unusual increase in prices was on account of speculative dealings in such commodities. Prices suddenly dropped down in January, 1940 and continued falling. They fell very low after the fall of France.

In August, 1940, the prices recovered and continued to increase for the next twenty one months. This steady increase in prices during this period was on account of an increased demand due to war and the large scale purchase of Indian goods by the British Government. It was also on account of shortages of some goods, the hoarding of certain types of goods and the fall in our imports on account of shipping difficulties.

After May, 1942, the prices started rising at a very high rate due to an enormous increase of currency coupled with the hoarding of and speculation in many essential goods.

As a result of a series of measures taken by the Government to tighten its price controls and to remove the loopholes in it, prices started falling after September, 1943 and continued to fall upto April, 1944. From May, 1944 to March, 1945, the prices were more or less steady with a slightly declining trend. The following table gives an idea
of the price increased in India and some other countries during the war.

**TABLE - 13**

**INDEX NUMBER OF WHOLESALE PRICES AND COST OF LIVING IN INDIA AND CERTAIN OTHER COUNTRIES**

(1939 to 1945)

<table>
<thead>
<tr>
<th>Year</th>
<th>India Calcutta</th>
<th>India Bombay</th>
<th>U.K.</th>
<th>U.S.A.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>... 109</td>
<td>102</td>
<td>106</td>
<td>103</td>
</tr>
<tr>
<td>1940</td>
<td>... 121</td>
<td>108</td>
<td>140</td>
<td>120</td>
</tr>
<tr>
<td>1941</td>
<td>... 141</td>
<td>120</td>
<td>157</td>
<td>130</td>
</tr>
<tr>
<td>1942</td>
<td>... 167</td>
<td>151</td>
<td>164</td>
<td>130</td>
</tr>
<tr>
<td>1943</td>
<td>... 211</td>
<td>223</td>
<td>167</td>
<td>129</td>
</tr>
<tr>
<td>1944</td>
<td>... 292</td>
<td>229</td>
<td>171</td>
<td>151</td>
</tr>
<tr>
<td>1945</td>
<td>... 292</td>
<td>227</td>
<td>174</td>
<td>152</td>
</tr>
</tbody>
</table>

? = wholesale prices

C = Cost of Living

It is clear from the above table that the price rise was much higher in India than that in some other important countries of the world. Not only in U.K. and U.S.A., but also in Canada and Australia, price increases were less than

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that in India. An increase in prices above the low pre-war level was most welcome in India, but such an abnormal increase in prices that took place during the war period was most uncalled for.

After the outbreak of the war, as soon as prices started rising, the Government of India under the Defence of India Rules assumed powers to control prices and distribution of some essential commodities and delegated the same to the Provincial Governments by Notification No. 20 of 1939. The idea for price control at this stage was to protect the consumers against profiteering in such commodities. Most of the provinces started publishing wholesale and retail price-lists for public information.

The problem of increasing prices was not so acutely felt before July, 1941, because the general price level had started declining after an initial rise. After July, 1941, the prices of essential articles specially food started rising. Black-marketing in controlled commodities became rampant and this caused hardship to the people. All the measures the Government took at this period like regulation of prices and distribution of essential articles, anti-hoarding and anti-profiteering regulations, failed to bring down prices of essential commodities and eliminate their scarcity. There was particularly an acute scarcity of food. Lakhs and lakhs of people died in the Bengal Famine of 1943. There was an acute food shortage in Bihar and South India also. This was
further aggravated by transport difficulties. The Central Government became alive to the situation and started taking more firm steps to control prices and issued a series of ordinances, directions and instructions. Cotton cloth and yarn control order was passed in June, 1943, to regulate the prices of cloth. The measure was further consolidated by appointing a Textile Commissioner. In October, 1943, Boarding and Profiteering Prevention Ordinance was promulgated "to herald the first comprehensive and serious effort to deal with chronic evil of price ballooning by traders and profiteers". The policy of controlling the prices more rigidly adopted in 1943 continued in the next year with some additional measures. In July, 1944, the consumers' goods (control and distribution) order was passed with the object of regulating supplies, distribution and prices of consumers goods produced at home or imported.

Though there was a halt in price rise in 1943 due to the various measures taken by the Government and also on account of the chances of Allied victory becoming more certain, the policy of price control in India was as a whole a failure. While preparing price index the Government took into consideration the controlled prices, but if black-market prices were taken into consideration, the price index would have been

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found much higher than that disclosed by the official figures.

As scarcity of essential commodities increased, most of the people had to get something or the other from the blackmarkets. Price and distribution control of essential commodities was also not all pervasive as in many areas of the country particularly in most of the rural areas there was no control on most of the essential articles like food grains etc.

The principal reason for price increase in the country and the inability of the Government to control it, was the Government's delay in taking action in this matter. The best time to take comprehensive action to control prices was between January, 1940 to October, 1941, when the price situation was easy. In Britain, the Government had taken suitable action regarding price and distribution control of essential commodities at the very inception of the war when price and supply position of such commodities was easy. But in India, action was taken quite late when the situation had become acute. Another mistake, the Government committed, was in fixing the prices, without making serious efforts for the procurement and distribution of controlled commodities. Price control policy of the Government suffered from many defects. Whereas there was a control on the prices of wheat, no such control was imposed on the prices of other grains like barley, gram, millets, etc.
Price control is not the only panacea for the rise in the prices of essential commodities. An increase in production is the only permanent cure for price increase. The Government did take some measure to increase the production of essential goods but without much success.

The price control in India was found to be ineffective because the increase in currency during the war period was abnormally high. "It remains both true and important that too great ease of supply (of money) can lead to perilous inflation".¹

Inflation in India benefitted the industrialists, the businessmen and the big landowners at the cost of the salaried people, the pensioners and the small cultivators. Writing about the war-time loans that India had to offer to U.K. and which was the main reason for inflation in the country, Dr. Muranjan wrote, "This loan to England was not offered in the main by those who made or owned large incomes during the war but was extracted in the main from those of the middle and lower classes who had the misfortune to live on relatively fixed incomes".² In fact, the real income of which the fixed income group was relieved of due to price rise was offered to the British Government as loans.

² Dr. S.K. Muranjan: Economics of Post-war India, p. 93.
Besides having evil effects on the economy, the inflation demoralised people and gave birth to black-marketing in essential commodities. The economic aspect of black-marketing is quite apparent to most of us. It raises prices and makes it difficult to prepare a true index number of prices. The black-marketeers dodge income tax and the profit made out of such deals are retained in liquid money. This enables people to artificially raise the price of any commodity whose scarcity they may apprehend.

War-time inflation caused a great deal of suffering to the small farmers and landless agricultural labour. The village artisans who live on traditional wage rates had also to suffer. In some parts of the country, cash wages replaced wages in kind.

Inflation in India had also some beneficial effects, though its bad effects outweighed such benefits. Inflation gave a general push to the pre-war declining agricultural prices. It opened up wider opportunities of employment in the country and stimulated industries, trades and banking. The debt liabilities of the cultivators were also reduced. But the most of the benefits due to inflation were confined to a very small section of the people in the country.

War-Time Exchange Control

The idea of exchange control is not something new. It is quite an old idea. The first legislative evidence of
exchange control in England is found in the statute of Stepney of 1299, which banned the export of coins. In the pre-war years, exchange control was in vogue in a number of European and non-European countries. It was practiced in Germany, which forced outsiders to sell their goods in Germany at lower prices. The payments for such sales were also deferred. Exchange control was also practiced in pre-war Britain to stop all flights of capital and to check fluctuations in the exchange rate of sterling. Multiple rate of exchange was practiced in Argentina and Germany.

At the outbreak of the war, Exchange Control was imposed in India in order to - (i) preserve India's foreign exchange resources for essential needs, (ii) as an instrument to keep down India's imports from Britain and other countries, because such import would have curtailed the supply of such goods to Britain and (iii) as a weapon of economic warfare against the enemy countries i.e., as an instrument against the dealings of the Indian people with the enemy countries.

During the war years the supply of goods to India from abroad was very limited as almost every country from which we imported was directly or indirectly involved in war and as such had very little to export. It was therefore necessary for us, under such circumstances to make the most judicious

1. Dr. Paul Einzig: How Money is Managed, p. 298.
use of our foreign exchange resources. Secondly, it was
not possible for Britain to permit us to import all the goods
we needed, as that would have deprived her of much of the
essential goods needed for her own war purposes. These were
the reasons for the imposition of exchange control in India,
though the amount of foreign exchange in the reserve of the
Reserve Bank of India was mounting and we had nothing to fear
from an adverse balance of trade and payments for years to
come. According to Part XIV of the Defence of India Rules
issued under the Defence of India Act of 1939, restrictions
were placed on all dealings in foreign currencies, securities
and gold. The administration of Foreign Exchange Control was
entrusted to the Reserve Bank of India. The Reserve Bank
opened a new department called the Exchange Control Department
and entrusted it with the implementation of the foreign
exchange regulations. The Foreign Exchange Department of the
Reserve Bank licensed dealers dealing in foreign exchange and
made them act under its general directions and control. No
other person or institution was permitted to deal in foreign
exchange.

Remittances within Sterling Area — which comprised
the whole of British Empire excepting Canada, New Foundland,
Hong Kong and the Mandated territories — were free. Congo,
Iceland and Force Island, Syria and Lebanon and Madagascar were
also within the Sterling Area. Remittances outside Sterling
Area were strictly controlled.
Remittances of foreign exchange were divided into the following categories:

(i) Payments for imports made under import licence; (ii) petty private remittances to relations and friends; (iii) travelling expenses. Travelling outside the sterling area, which involved foreign exchange was severely restricted. From the 17th July, 1943, any person proceeding outside India had to obtain a written permission from the Reserve Bank; (iv) other trade purposes which included freight, profits, royalties etc. The remittances of profits and royalties by companies to foreigners outside sterling area was regulated by license from October, 1941. During 1943-44, when dollar position became easier, remittances of American firms' profits to U.S.A. was freed from restrictions; (v) capital remittances. While capital remittances were severely restricted, general permission was accorded to authorised dealers to sell foreign currencies for genuine requirements of payments for imports.

FREE STERLING

Prior to March, 1940, the Bank of England purchased and sold at fixed rates, various foreign currencies, notable amongst them were the U.S. dollar and some other currencies like Swiss Francs, Dutch Guilder and Belgian Francs, which were convertible into U.S. dollars. The rates quoted by the Bank of England for these currencies were operative in
U.K. and other Empire countries. Dealings in Sterling in New York and other money markets were not restricted. The rates of exchange of Sterling outside the Sterling market in area called 'free' market fluctuated widely. Sterling prices in such markets were quoted at a discount.

In the early months of the war therefore two dollar - Sterling exchange rates were quoted - one the official rate of the London Exchange Control and the other the Free Rate of the Free Market. The Free Sterling Rate was lower than the official rate. Indian goods were sold in the U.S.A. at the official rate. That is the exporters of goods from India to U.S.A. could get payments of $4.02 for goods worth £1 or £11-11-4 p. whereas the rate in the Free Sterling Area was £3.50 for £1. It generally so happened that the Indian exporters to U.S.A. after they had received payment at the official rate, converted the dollar into Sterling in the Free market and thereby gained an additional 12 per cent in terms of Sterling or Rupees.

Rupee - Dollar transactions at rates other than official London rates were soon forbidden and by an agreement with the American banks the Rupee rate in New York was quoted at par with that of dollar in India and no free market in rupees was allowed to function.

WAR-TIME EXPORT AND IMPORT CONTROL

Soon after the war started, the Government of India
issued a series of export control orders. The export control was intended — (i) to compel the exporters of Indian goods to U.S.A. and other hard currency areas to surrender their foreign exchange earnings to the Reserve Bank or its authorised agents; (ii) to secure the maximum amount of foreign exchange from our exports and (iii) to utilise all foreign exchange resources, earned by the country, according to the approved policies of the Reserve Bank of India.

In March, 1940, the Bank of England issued certain orders which forbade any export of goods from U.K. to the 'Free Sterling Area'. Similar orders were passed in India and other Empire countries, so that export of goods to the 'Free Sterling Area' from U.K. or its Empire was stopped. From June, 1940, exporters of goods from India to U.S.A. and Switzerland were to work under the Exchange Control orders of the Government of India. In June, 1941, Exchange Control Scheme included all commodities which were exported to Canada, New Zealand and all such countries with which U.K. had entered into a special payment agreement.

The Import Control Policy was implemented from May, 1940. Under this policy, sales of foreign currencies were severely curtailed and these were supplied to those who had received import licences from the Government. Originally, 68 commodities were licensed for import. The list of commodities was gradually enlarged to cover the import of all
goods from foreign countries, excepting for some goods from Canada. Some relaxation of these restrictions was made in 1944 - 45 to permit larger import of consumers' goods.

It may therefore be stated in a nutshell that the aim of the Government of India during the Second World War was to channelise all the export and import trade of the country and utilise its foreign exchange resources in a way that would help the British and Allied Government in war efforts. The economic well being of the country was subordinated to this consideration.

In December, 1940, the Government of India under the Defence of India Rules acquired all the dollar holdings of the British Indian subjects and equivalent amount in Rupees was paid to them. Similarly in March, 1941, the Government of India took over the U.S. dollar securities of the residents of India at the ruling rate of the securities in New York on the previous business day.

To prevent the evation of Export Control Regulation, the Government of India imposed restrictions on the export of gold, jewellery and cash out of India excepting for jewellery and cash in limited amount.

In order to check the smuggling of Bank of England notes into the enemy territories, restrictions were first imposed in 1940 and further tightened in 1941. From September, 1943, import of all currency notes other than those of the
Reserve Bank of India were restricted and from January, 1944, even the import of Reserve Bank's currency notes was prohibited.

On the 28th July, 1941, the Government of India issued a notification under which dealings in Japanese assets in India were allowed only with the permission of the Reserve Bank of India. In terms of the Notification, a general order was issued by the Reserve Bank to all banks in India freezing the balances of all Japanese firms, companies and residents in India. All the Japanese accounts were taken over by the custodian of enemy property. In the beginning of 1942, the accounts of persons and firms resident of Japanese occupied territories were frozen and were not operated without Reserve Bank's permission.

Following the issue of the Notification, Freezing Japanese Accounts in India on the 30th July, 1941, another notification was issued which prohibited the operation of Chinese accounts in India excepting with the permission of the Reserve Bank. Whereas the object of freezing Japanese accounts was to close down Japanese trade and to retain Japanese assets in India as a set off against Indian assets in Japan, the object of the restraining any dealings in Chinese accounts in India was to assist China to conserve her foreign resources.

THE STEELING BALANCE

Section 33 of the Reserve Bank of India authorised
the Bank to issue notes on the basis of Sterling securities. This provision in the Act had enabled the Government of India to meet the expenses for Britain and the Allies' war efforts in India on behalf of the British Government. With the escalation of the war, there were very heavy exports of goods from India to U.K. The British Government found it difficult to meet the mounting demand for rupee bills tendered in London. The payment received for the Rupee bills issued far exceeded the amount of Home charges payable by the Government of India. The price of the Indian exporters' goods was therefore paid in Sterling in the Reserve Bank's account in the Bank of England, and on the basis of such securities deposited notes were printed by the Reserve Bank of India and handed over to the Government of India who paid to the Indian exporters out of this.

It was held by a number of eminent Indian economists that war-time currency expansion and consequent inflation in India was due to the Rupee being tied to the Sterling. Prof. B.R. Shenoy in his work 'The Sterling Assets of the Reserve Bank of India' expressed the view that the financing of Allied war expenditure was smoothened due to the Rupee being tied to Sterling. In the words of Prof. Shenoy, "The financing of rupee bills at London for Allied expenditure in India could easily be made by means of transferring Sterling securities to the credit of the Reserve Bank of India and on the basis of the same increasing the note issue in India."
The problem, however, was far from a serious one. The sterling exchange standard had long ago, provided for the solution. The Reserve Bank as was its predecessor, the Finance Department of the Government is obliged by law to issue rupees in India ultimately in exchange for sterling deposits to its credit at the Bank of England at the rate of $18\frac{3}{16}$ a. per rupee. It has no option or discretion in this matter.¹ It was the considered view of Dr. V.K.R.V. Rao that the main cause for war-time inflation in India was, the Reserve Bank's issuing notes on acquired sterling securities for Indian exports as the country's note-issue system was based on sterling exchange standard. To quote him - "If the Reserve Bank of India had not taken steps to increase the note-issue against the backing of sterling bills and thus made available the additional rupees required, the exchange of the rupee would undoubtedly have gone up very much above the $1 s. 6 d.$ rate and incidentally this would have had the effect of arresting the inflationary trend in Indian prices."²

It is quite true that the Rupee-sterling tie made it easier for the British Government to finance the war expenditure. But it cannot be stated that the Rupee-sterling link was the root cause of expansion of note-issue and

¹ Prof. A.R. Shenoy: The Sterling Assets of the Reserve Bank of India, p. 6.
² Dr. V.K.R.V. Rao: The Post-war Rupee, 1945, p. 9.
of increase in prices in India. An excessive note issue could have taken place even if the rupee was not linked to the sterling. The Government of India which was subordinate to the British Government could have simply issued fiat money, under instructions from the latter. The Government of India with suitable amendments to the Reserve Bank of India Act, could get notes of an equivalent amount for its own securities handed over to the Reserve Bank. "There is no natural or necessary relation between the growth of foreign assets and internal expansion or monetary inflation and the link between the two phenomena. Inflation may, and generally does develop without any growth in foreign balances, and foreign balances may in theory grow without causing a corresponding degree of inflation".  

There was another section of people in India, who considered the currency issued during the war as fiat money. To them these were worthless papers. A Manifesto was issued by twenty Indian Economists on April 12, 1943, which stated, "The inflation in India was a deficit induced fiat money".  

It was further argued in the manifesto that the most severe type of inflation which took place in India during the war was due to the peculiar system of war financing in India. Under this system, Allied purchases in India were made against

1. G.F. Reshman, Governor, Reserve Bank of India: Rotary Address, 31st August, 1943.  
2. Quoted by Mr. S.K. Ghose: Inflation in a Developing Economy, p. 61.
Sterling securities on the basis of which currency issue was increased.

but by all means the Sterling assets against which notes were issued were not useless papers and therefore the notes were not fiat money. Britain’s position in the financial world so far, was quite sound. She had neither denied on any occasion the payments for her own securities nor had ever the value of British securities or currency gone as low as in Germany after the First World War.

The accumulation of Sterling assets during the war enabled India to pay off most of her earlier Sterling debts and at the end of the war India emerged out as a creditor of the United Kingdom.

Prof. B.R. Shenoj does not believe that after the Second World War India emerged out as a creditor of Britain. Prof. Shenoj’s calculation of India’s indebtedness to Britain included the private debts also. According to him, India at the end of the war instead of being a creditor was still indebted to Britain to the extent of £1,252.24 million.¹

However, if we look to India’s position vis-à-vis Britain’s on the basis of each Government’s liabilities or assets in Sterling, it can unQuestionably be said that India at

¹ B.R. Shenoj: The Sterling Assets of the Reserve Bank of India.
the end of the war had not only paid off all her past sterling debts but had emerged out as a creditor of the United Kingdom. "Often unqualified statements like 'India became from a debtor to a creditor country' were made, which B.R. Shenoy and others hotly contested and attacked because these statements failed to take into account the indebtedness of India on private account. But on Government account, the change was colossal and explicit and therefore there could be nothing wrong if the above statement was appropriately qualified."

The following table on the next page will give a clear picture of the correlation between the accumulation of sterling assets with the Issue Department of the Reserve Bank of India and the increase in note issue.

---
<table>
<thead>
<tr>
<th>Year ended March</th>
<th>Notes in circulation (rupees crores)</th>
<th>Notes held in the banking department (rupees crores)</th>
<th>Total notes issued (rupees crores)</th>
<th>Sterling securities to total notes issued (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>182.36</td>
<td>28.28</td>
<td>210.64</td>
<td>66.95</td>
</tr>
<tr>
<td>1940</td>
<td>209.22</td>
<td>18.79</td>
<td>228.01</td>
<td>78.64</td>
</tr>
<tr>
<td>1941</td>
<td>241.41</td>
<td>17.27</td>
<td>258.67</td>
<td>129.92</td>
</tr>
<tr>
<td>1942</td>
<td>307.68</td>
<td>12.22</td>
<td>319.90</td>
<td>165.00</td>
</tr>
<tr>
<td>1943</td>
<td>513.44</td>
<td>11.80</td>
<td>525.24</td>
<td>319.11</td>
</tr>
<tr>
<td>1944</td>
<td>777.17</td>
<td>10.50</td>
<td>787.67</td>
<td>643.52</td>
</tr>
<tr>
<td>1945</td>
<td>968.69</td>
<td>10.93</td>
<td>979.61</td>
<td>863.74</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India: Banking and Monetary Statistics of India, p. 560.
Thus from a note issue of ₹210.64 crores in 1939, for which sterling securities worth ₹66.95 crores were held, the note issue went up to ₹979.61 crores for which reserve in Sterling assets worth ₹863.74 crores was held. The reserve worked out to 70.20 per cent total notes issued.

If India's contribution to Allied Defence expenditure is measured in terms of her accumulated war-time Sterling balance, it would be the highest. "These balances (i.e., Sterling balances of the Sterling Area countries held with the Bank of England as they stood on July 15, 1947) which were to a very large extent accumulated during the war, now amount to roughly £3,500 million; the largest holders being India and Egypt". ¹

The share of India in the total contribution to Allied war expenditure by the Sterling Area countries would thus be work out to half of the rest.

The contribution of India towards Allied Defence expenditure on the basis of the preceding principle was as given in the table on page 109.

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¹ International Monetary Fund: Annual Report of the Executive Directors for the Fiscal Year ending June 30, 1947, pp. 37 and 38.
<table>
<thead>
<tr>
<th>Year</th>
<th>Increase in Sterling Assets of India</th>
<th>Increase in the Sterling Assets of rest of Sterling Area</th>
<th>Percentage of Col. (2) to Col. (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>September, 1939 to December, 1940</td>
<td>95</td>
<td>270</td>
<td>35</td>
</tr>
<tr>
<td>1941</td>
<td>70</td>
<td>180</td>
<td>33</td>
</tr>
<tr>
<td>1942</td>
<td>146</td>
<td>420</td>
<td>35</td>
</tr>
<tr>
<td>1943</td>
<td>282</td>
<td>565</td>
<td>50</td>
</tr>
<tr>
<td>1944</td>
<td>294</td>
<td>575</td>
<td>51</td>
</tr>
<tr>
<td>1945</td>
<td>317</td>
<td>594</td>
<td>53</td>
</tr>
<tr>
<td>September, 1939 to December, 1945</td>
<td>1204</td>
<td>2,604</td>
<td>46</td>
</tr>
</tbody>
</table>

1. J.D. Verma: India's Membership of Sterling Area, Chapter III, Tables III and IV. Quoted by J.D. Sethi: Monetary Policy in an Underdeveloped Economy, p. 165.
As the war years progressed, India could accumulate Sterling assets of considerable amount. It was, therefore, possible for the country to pay off all her past Sterling debts. The redemption of Sterling debts by India had actually started two years before the war. In 1937 – 38, debt to the extent of £ 3.05 millions was repatriated through purchase of the title of such debts in the open market. There was no such repatriation in 1938 – 39. It was again started in 1939 – 40. The total of Sterling debt of India including Railway debentures and Railway annuities in 1936-37 was worth £ 476.41 crores. In March, 1945, this amount was reduced to £ 63.98 crores. That is Sterling debts to the extent of £ 412.43 crores were paid off.

The Sterling debts of India were paid off according to the following three schemes — (1) Open Market purchase; (ii) A number of compulsory schemes and (iii) A licence scheme. Under the open market scheme which was introduced in 1937 – 38, Sterling debts of the value of £ 2.99 million were paid by being purchased at £ 3.04 million. It was subsequently stopped for the next two years. In 1940 – 41, the scheme was revived. Under the scheme the Reserve Bank purchased non-terminable securities in open market out of its accumulated Sterling balances held with the Bank of England.

The securities were then transferred to the Government of India who cancelled them. From 1937 - 38 to 1943 - 44, the total amount of Sterling debts paid under this scheme were worth £ 52.49 million. In 1944 - 45, there were no open market purchases of non-terminable securities. The licence scheme was introduced on the 22nd February, 1940. Under the scheme, the holders of Sterling securities could convert their holdings into Rupee securities. The Rupee counterpart securities for such securities were created and the holders of Sterling securities could transfer their holding from Sterling securities with the Bank of England to the Rupee Register of the Reserve Bank. Thus under the second scheme, payments could be made for Sterling debts, without paying for them in cash, as was done in the first case. The methods of repayments of Sterling debts under the third scheme was divided into two parts. The first, compulsory scheme was introduced on the 18th February, 1941. The British Treasury issued an order under which all the residents of U.K. were asked to surrender their holding of India's terminable Sterling loans at the prices ruling on the 7th February. Simultaneously the Government of India issued a notification by which residents of British India were asked to surrender their titles to such Sterling loans, for which they were offered payment in Rupee counterparts.

Under the second compulsory order issued on 24th December, 1941, certain other non-terminable Sterling loans not covered by the first scheme were repatriated.
### TABLE - 16

**Repayment of Sterling Debt of India - Annual (1937-38 to 1944-45)**

<table>
<thead>
<tr>
<th>1937 - 38</th>
<th>Face Value £ million</th>
<th>Purchase Value £ million</th>
<th>Rupees counterparts created (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open Market Purchases</td>
<td>2.99</td>
<td>3.04</td>
<td>4.05</td>
</tr>
<tr>
<td>1938 - 39</td>
<td>16.54</td>
<td>22.05</td>
<td>22.79</td>
</tr>
<tr>
<td>1939 - 40</td>
<td>75.24</td>
<td>100.32</td>
<td>94.86</td>
</tr>
<tr>
<td>1940 - 41 Total</td>
<td>71.29</td>
<td>94.86</td>
<td></td>
</tr>
<tr>
<td>Open Market Purchases</td>
<td>9.22</td>
<td>8.52</td>
<td>11.36</td>
</tr>
<tr>
<td>Licence Scheme of 22nd February, 1940</td>
<td>2.02</td>
<td>2.69</td>
<td>2.69</td>
</tr>
<tr>
<td>1st Compulsory Scheme of 8th February, 1941</td>
<td>62.05</td>
<td>86.27</td>
<td>80.07</td>
</tr>
<tr>
<td>1941 - 42 Total</td>
<td>92.28</td>
<td>123.04</td>
<td>93.58</td>
</tr>
<tr>
<td>Open Market Purchases</td>
<td>12.11</td>
<td>12.36</td>
<td>16.48</td>
</tr>
<tr>
<td>1st Compulsory Scheme of 8th February, 1941</td>
<td>13.08</td>
<td>18.85</td>
<td>17.44</td>
</tr>
<tr>
<td>2nd Compulsory Scheme of 24th December, 1941</td>
<td>73.85</td>
<td>87.71</td>
<td></td>
</tr>
<tr>
<td>1942 - 43 Total</td>
<td>119.00</td>
<td>161.67</td>
<td>82.62</td>
</tr>
<tr>
<td>Open Market Purchases</td>
<td>10.48</td>
<td>10.40</td>
<td>14.00</td>
</tr>
<tr>
<td>1st Compulsory Scheme of 8th February, 1941</td>
<td>1.45</td>
<td>1.13</td>
<td>2.02</td>
</tr>
<tr>
<td>2nd Compulsory Scheme of 24th December, 1941</td>
<td>5.22</td>
<td>6.12</td>
<td>2.30</td>
</tr>
<tr>
<td>Redemption of 3½ per cent Sterling Stock 1931 or after</td>
<td>56.21</td>
<td>74.95</td>
<td>67.95</td>
</tr>
<tr>
<td>Railway Debentures</td>
<td>46.58</td>
<td>40.07</td>
<td></td>
</tr>
<tr>
<td>1943 - 44 Total</td>
<td>52.06</td>
<td>40.07</td>
<td></td>
</tr>
<tr>
<td>Open Market Purchases</td>
<td>1.60</td>
<td>1.63</td>
<td>2.17</td>
</tr>
<tr>
<td>1st Compulsory Scheme of 8th February, 1941</td>
<td>0.16</td>
<td>0.16</td>
<td>0.22</td>
</tr>
<tr>
<td>2nd Compulsory Scheme of 24th December, 1941</td>
<td>0.32</td>
<td>0.28</td>
<td>0.37</td>
</tr>
<tr>
<td>Redemption of 3½ per cent Sterling Stock 1931 or after</td>
<td>0.71</td>
<td>0.71</td>
<td>0.94</td>
</tr>
<tr>
<td>Railway Debentures</td>
<td>1.33</td>
<td>1.29</td>
<td>1.72</td>
</tr>
<tr>
<td>1944 - 45 Total</td>
<td>0.41</td>
<td>0.37</td>
<td>0.49</td>
</tr>
<tr>
<td>1st Compulsory Scheme of 8th February, 1941</td>
<td>0.09</td>
<td>0.09</td>
<td>0.12</td>
</tr>
<tr>
<td>2nd Compulsory Scheme of 24th December, 1941</td>
<td>0.28</td>
<td>0.21</td>
<td>0.28</td>
</tr>
<tr>
<td>Redemption of 3½ per cent Sterling Stock 1931 or after</td>
<td>0.03</td>
<td>0.03</td>
<td>0.04</td>
</tr>
<tr>
<td>Railway Debentures</td>
<td>0.04</td>
<td>0.04</td>
<td>0.05</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>322.84</strong></td>
<td><strong>320.92</strong></td>
<td><strong>428.91</strong></td>
</tr>
</tbody>
</table>

Source: Reserve Bank's - Banking and Monetary Statistics of India, p. 883
As we have already discussed, the Sterling Debts of the Government of India were paid by two processes. Under the first, a part of such debts — whose titles were held by British people — were paid in Sterling out of the Sterling balances India had acquired during the war. The second method of repayment consisted of paying them in Rupee counterparts in India. The Indian title holders of India's Sterling debts were paid by the second method.

The Sterling required by the Government of India for the purchase of Sterling securities in open market was provided by the Reserve Bank of India from its accounts in London. When these Sterling securities were transferred to the Government of India, the Treasury issued counterpart Rupee securities to the Reserve Bank. Therefore an amendment was made in Section 33 (3) of the Reserve Bank of India Act. In the original Act, it was laid down that Rupee securities in the Reserve of the Issue Department were not to exceed 1/5th of the total assets or 50 crores whichever be greater. The amendment to the Act authorised the Issue Department to hold 3/5th of the Reserve for notes issued in Rupee securities.

It was stated by a section of people that the Government of India should have taken over the whole of private British investment in India in addition to the Sterling debts repatriated, against her Sterling balances accumulated during the war. This was not possible because the Government of
India was subordinate to the British Government. And also this step would have discouraged the flow of private capital in this country.

It was also stated by the critics that the repatriation was made at not a very favourable time and we paid more than the face value of the loan. No doubt we paid more than the face value for some of the debt titles, but not for all. Moreover, it must be kept in mind that the accumulation of Sterling was gradual and not sudden. And as such repatriation operation could not be undertaken all at a time. We, therefore, could not avail ourselves of the chances to purchase the titles to such loans at lower value, before or in the beginning of the war. We repatriated them only after we had accumulated sufficient amount of Sterling Assets.

Anyhow, the accumulation of Sterling Balances changed the position of India from a debtor to a creditor of the U.K. But this was possible at the cost of untold hardships to the Indian people.

INDIA AND THE EM. IRE DOLLAR POOL

Even before the Second World War, the Sterling Area countries did not hold in their stock any foreign currency other than Sterling. The general practice was, that these countries used to sell their foreign exchange earnings in London and obtained Sterling for them. But in the 30's it was always possible for the Sterling Area countries to convert
their Sterling holdings into Dollar or any other hard currency whenever they wanted.

During the war period, dollar became scarce on account of large payments Britain had to make in dollar for the purchase of war materials. The supply of dollar was also reduced on account of the limited export to U.S.A. by Britain and other members of the Sterling Area. It, therefore, became necessary that the distribution of dollar which was in a short supply should be made on an equitable basis amongst those who earned it. The 'Empire Dollar Pool' was thus created to which the Sterling Area countries surrendered all their dollar possessions and withdrew from the pool according to their needs. "The significant charge which occurred in 1939 was not that dollars were pooled, but that drawings from the pool were restricted — not in a rigidly formal sense until near the end of the war and then only for certain countries but under informal gentleman's agreements". 1

Since the beginning of the war up to 31st March, 1946, India earned U.S. dollars worth Rs. 405 crores while it spent dollars worth Rs. 240 crores only. Thus its credit balance with the 'Dollar Pool' was Rs. 165 crores. During the first

1. Philip W. Bell : The Sterling Area in the Post-war World, p. 32.
four years of the war India contributed more to the Fund than that she had drawn. But from 1944, India's balance of trade with U.S.A. was unfavourable and the pool's resources were utilised to meet the dollar deficit.

Although in terms of dollars alone India contributed a net surplus of dollars worth Rs.165 crores to the pool, her overall withdrawal of all the hard currencies including those of Canada, Sweden, Switzerland and Portugal amounted to Rs.41 crores more than her contribution.