INDEPENDENCE AND PARTITION

THE ECONOMIC CONSEQUENCES OF PARTITION

The economic consequences of partition which came in the wake of independence have been very nicely put in a nutshell by Prof. C.N. Vakil in the following words, "we inherited from the British a shattered economy which had not yet recovered from the impact of the war, and which further received a severe shock from the partition of the country as a corollary to independence". The economic life of the country was dislocated due to migration of refugees in large numbers to and from both India and Pakistan and the communal disturbances. The mass influx of refugees within our country caused a heavy burden on the exchequer.

In the period from 1947 - 48 to 1950 - 51, the Central Government had to spend about 28.42 crores on refugee rehabilitation and a further sum of 29.4 crores was given as loan to them through the Rehabilitation Finance Corporation. It was feared that the large scale expenditure on refugee relief and rehabilitation would further aggravate the existing inflationary situation in the country.

1. C.N. Vakil: Economic Consequences of Divided India, p. 21.
The partition of the country had deprived us of the food surplus regions as well as of two commercial crops, jute and cotton. The jute area of Bengal had gone to Pakistan, whereas the jute mills remained in India. From the time Burma was separated from India, we had been facing food shortages, but the division of the country made the problem more acute as the country was still suffering from the strains of war.

THE INDO-PAKISTAN CURRENCY AGREEMENTS

Immediately after partition it was not possible for Pakistan to issue its own paper currency and as such the Reserve Bank of India notes were allowed to be used by the Pakistan Government as legal tender money in Pakistan. This was done by an Order dated the 14th August, 1947, issued by the Governor General of Pakistan. This order was called the Monetary System and Reserve Bank order of Pakistan. The Reserve Bank of India remained the monetary authority in Pakistan upto the 30th June, 1948. The State Bank of Pakistan was established in July 1, 1948 and took over central banking functions in Pakistan including management of currency and credit in the country. The currency notes with the word 'Pakistan' inscribed on them could be issued only after the 1st April, 1948. The Reserve Bank of India Act was amended in March, 1948 and accordingly notes of the denominations of 1, 2, 5, 10 and 100 with the word 'Government of Pakistan' inscribed on them were issued. One Rupee notes
and Rupee and subsidiary coins of distinctive design were issued by the Reserve Bank for circulation in Pakistan.¹

The Reserve Bank of India was therefore required to work as a banker to the Central and Provincial Governments of Pakistan for the management of public debts, the issue of new notes and exchange control operations up to the 30th June, 1948.

Before the Joint Indio-Pakistan Monetary Agreement was to come to an end on the 30th June, 1948, assets of an amount equal to the 'Pakistan Notes' issued by the Reserve Bank of India were to be handed over to the Government of Pakistan from the Issue Department of the Reserve Bank of India. The liability in respect of inscribed Pakistan Notes were taken over by the State Bank of Pakistan on the 30th June, 1948 and the Reserve Bank of India transferred assets valued at Rs. 51.57 crores from its Issue Department.

Upto the 30th June, 1949, the Pakistan Government had to accept Indian notes at par with its own notes. All such Reserve Bank of India notes circulating in Pakistan were to be ultimately returned to the Reserve Bank by Pakistan and in return it was to receive assets of equal amount from the Issue Department of the Reserve Bank. From this amount deductions had to be made for the Rupee Securities and

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Advances taken by Pakistan from the Reserve Bank of India. The amount of Indian notes (Reserve Bank of India) retired from circulation in Pakistan during 1st April to 30th June, 1948, amounted to Rs.44.98 crores.

The amount of 'Pakistan' inscribed notes in circulation in Pakistan amounted to Rs.51.57 crores on June 30, 1948. Indian notes withdrawn from circulation from Pakistan between April 1, 1948 to June 30, 1949 amounted to Rs.127.18 crores. Pakistan, therefore, made a claim of assets worth Rs.178.75 crores from the Issue Department of the Reserve Bank of India. The Reserve Bank of India transferred to the State Bank of Pakistan assets valued at Rs.133.77 crores. These assets were composed of Rs.4.40 crores in gold coins and bullion, Rs.89.55 crores in Sterling Securities, Rs.4.31 crores in Rupee coins and Rs.35.51 crores in Government of India securities.

A dispute had arose between the two Governments regarding the transfer of assets of the remaining value of Rs.45 crores. The Government of India with Sardar Patel as Home Minister was possibly in no mood to pay this amount to Pakistan. According to Shri C.B. Deshmukh, "Owing to the infringement of the Trade Stand Still Agreement by Pakistan — by the imposition of an export duty on jute — and her involvement in Kashmir, the idea that money should be given to her was repugnant to many people". However, on Gandhiji's insistence Shri Nehru had to announce that the Indo-Pakistan Financial

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Agreement would be implemented. It was decided that Pakistan would be paid an amount of Rs. 43 crores from the assets of the Issue Department of the Reserve Bank. From a study of the Reserve Bank of India Annual Reports on currency and finance for the years 1951-52 to 1963-64, it would appear that the final adjustment of this amount has not so far been made. For all these years the following foot-note has been continuously added to the statement of circulation and absorption of currency in India: "The return of about Rs. 43 crores of notes from Pakistan awaiting adjustment".

THE POST-INDEPENDENCE INFLATION

The post-war inflation continued in the post-independence period. During the post-independence era, it was accepted by all successive Finance Ministers that there was inflation in the country. The causes of inflation were non-monetary. They had all realised the fact that an increased production rather than monetary devices could check inflation in the country. As for example Shri C.D. Deshmukh addressing the 14th Annual General Meeting of the shareholders of the Reserve Bank of India on the 9th August, 1948, stated, "If our object was merely to bring down prices, it would be comparatively easy by applying the classical weapon of deflation of money supply. But such deflation may gather force and get out of hand resulting in diminished output and
employment. Our aim should be to bring about a fall in prices by a sizable increase in the volume of production of goods and services".1

However, the part that money supply played in aggravating inflation cannot be ignored, as the value of money like anything else depends on its demand and supply. During the period from the end of March, 1947 and March, 1948, the total money supply with the public increased by Rs.106 crores as against an increase of only Rs.18 crores during the same period in the preceding year. During the next two succeeding years, money supply with the public declined by Rs.43.3 crores and Rs.18.4 crores respectively. In 1950-51, money supply with the public showed a pronounced rise of Rs.99.2 crores. The inflationary effect of such an increase in money supply was further accentuated by the budgetary policies of the Central and Provincial Governments. There were deficit budgets during the years 1946 - 47 and 1947 - 48. There was a deficit of Rs.85 crores in 1946 - 47 and Rs.50.00 crores in 1947 - 48 in the Central Government budget. It was commented that, "they (deficit budgets) would create an increase in consumption demand".2

It was presumed by the Finance Minister, that if

tax concessions were granted to the private sector industries, it would stimulate production. This policy was adopted by the Central Government in 1948 - 49. As a consequence of such concessions granted to the industries in the private sector, the Central Government's revenue had fallen.

As an anti-inflationary measure, the Provincial Governments and the Central Government cut down their capital expenditure to bring about a surplus in their capital budgets. Many of the projects that were in their initial stages were closed down during the year 1948 - 49. The Provincial and Central Governments started a drive for economy in the expenditure of various departments.

In spite all these anti-inflationary measures of the Government, inflation remained unabated - rather inflationary pressure on prices was rising - and there was no increase in production.

In an under-developed economy like that of India, production is not very elastic. It is not possible therefore, to increase production by granting tax concessions alone.

We were facing budget deficits on revenue account and were forced to curtail capital expenditure. The money supply had increased while the production of some of the important industrial goods like manufactured jute and cotton goods fell during 1947 - 48 and 1948 - 49. There was also
a fall in the agricultural production during these years. The production of food grains declined from 44.39 million tons in 1947-48 to 44.26 million tons in 1948-49. Production of raw sugar declined to 4.99 million tons in 1948-49 from 5.83 million tons in 1947-48. In 1949-50, the output of Khariff crops suffered due to heavy rains in U.P., floods in Bihar and cyclone in Madras.

Labour unrest further aggravated the existing inflationary forces in the country. Strikes in 1947-48 alone caused a total loss of 16.6 million man days. It was estimated that this had caused a loss of 6 per cent in production.

DECONTROL: ITS INFLATIONARY EFFECT

In September, 1947, the Government of India appointed a Committee called the Food Grains Policy Committee under the Chairmanship of Sir Purshottamdas Thakurdas. The Committee submitted its interim report in October, 1947. The main recommendations of the Committee were as follows:

1) The country should be freed from dependence on imported food grains.
2) Food control should be gradually removed and
3) Finally, the Committee expressed the view that unless the Government initiated measures to decontrol the food, problem was not likely to be solved. The Committee was

confident that though the prices are likely to rise immediately after decontrol, such initial spurt will be short lived and the prices would soon come down. The Committee said, "The course we recommend is calculated to bring out and put into circulation stocks which at present are withheld from procurement agencies employed by Government".¹

The Government accepted the main recommendations of the Committee and decided to venture upon decontrol. On the question of decontrol, the Government's policy was based more on sentiment than on rational thinking, because Gandhiji's opposition to controls was well known.

In December, 1947, food grains were freed from control. This was followed by cotton cloth decontrol order in January, 1948. The Indian Finance in its issue of the 15th November, 1947, warned the Government of the dangerous consequences that were to follow the removal of controls. It stated, "There is a short-age of food and this gap cannot be quickly filled up. Decontrol will therefore be a dangerous gamble".²

Decontrol brought the suppressed inflation of 1945-47 to the surface. The Economic Adviser's General Index number which in November, 1947, stood at 302.0, advanced

². Indian Finance : November 15, 1947, Food Control.
continuously until it touched a new peak level of 389.6 in July, 1948 - an increase of 29 per cent. This rise was allround, as all the constituent group indices making general index had gone up. The rise in the prices of food articles, semi-manufactured goods and manufactured goods was 32.5 per cent, 33.0 per cent and 30.7 per cent respectively.

Decontrol thus made latent inflation active. Its reaction was severely felt by the poorer section of the people, as the rise in the prices of cereals in food group had gone up by 49.4 per cent between December, 1947 and June, 1948. The Government of India under such circumstances had to decide for a reversal of its policy of decontrol. A beginning in this direction was made towards the end of July, 1948. As the sharpest rise had occurred in cloth prices, control was reimposed on it. On the 24th September, 1948, a new policy was announced by the Government of India, which aimed at gradual reintroduction of control over prices, procurement and distribution of important food grains.

On October 4, 1948, the Government of India framed an anti-inflationary programme, which included monetary, fiscal and non-monetary measures to fight inflation. We have already discussed in parts some of the items in the programme. Here we discuss the principal features of the programme as a whole:

1) The gap between the revenue and expenditure of the
Central and provincial Governments was to be reduced as far as possible and attempts were to be made to make surplus budgets.

2) All unproductive government expenditures was to be minimised. New capital projects, which were not undertaken, were to be abandoned.

3) Control on the prices and distribution of essential goods was to be tightened.

4) To encourage the expansion of industrial production new undertakings were given higher depreciation allowances in income tax assessments and more liberal rebates were granted in custom duty on imported raw materials, plant and machinery.

5) To help the small saver the maximum permissible limits for investment in Postal Savings Banks and National Savings Certificates were raised.

6) To reduce the volume of purchasing power in the hands of the public, the amount distributed as dividends by public companies was not to exceed the average for two years ending 31, March, 1948 or 6 per cent on paid up capital which ever was more. The repayment of excess profits tax deposited, was to be postponed by three years.

7) Heavy import duties were levied on luxury goods.

The ground lost to inflation on account of the Government's policy of decontrol, could not be regained, even
after the controls were reimposed. In the words of Sir B. Rama Rau, "The Government were obliged to reimpose the controls, but a permanent increase in prices had already taken place. Even after the reimposition of control, prices remained well above the previous level." ¹

The Government could include some more items in its anti-inflationary programme like - (i) compulsory savings; (ii) raising of compulsory loans; (iii) the freezing of personal income and the incomes of individual companies and (iv) the demonetisation of notes of the denomination of Rupees hundred. ²

There was a net contraction of note circulation in the Indian Union to the extent of Rs 7.84 crores in 1948 - 49 - this was the first contraction in note circulation since 1937 - 38. In the year 1949 - 50, there was a further contraction of Rs 5.84 crores worth of notes or an average monthly decline of Rs 0.49 crores. Whereas in 1948 - 49, the monthly average decline was Rs 0.65 crores. But the anti-inflationary effect of such contraction of currency circulation was far outweighed by the inflationary effect of the increased money supply with the public during 1947 - 48 and 1949 - 50.

There was an improvement in the price situation

during the closing months of 1948 - 49. But it was short-lived and the price index recorded an almost continuous rise from April to October, 1949. The Economic Adviser's General Index which stood at 370.2 in March, 1949 touched 389.8 in September, 1949 which exceeded the post-decontrol peak level reached in July, 1948 and climbed to 393.3 in October, 1949. The following table gives an idea of price movements during the period.

<table>
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<th>Year and month</th>
<th>General Index</th>
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<tr>
<td>April, 1948</td>
<td>347.9</td>
<td>April, 1949</td>
<td>376.1</td>
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<tr>
<td>May,</td>
<td>367.2</td>
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<td>382.2</td>
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The Government was unable to check inflationary price situation in the past division period because of the following reasons:

1) War time increase in note circulation had been instrumental in swelling the stock of liquid money held by the people. The Government did nothing during the post-war or post independence period to relieve the people of such money. The Government had not frozen the money holdings of the people with the banks nor had it forced them to invest in savings certificates etc. It had demonetised notes above 100 denominations. But this was simply a conversion of high denomination notes into notes of smaller denomination.

2) With all tax and other incentives of the Government, production failed to make any upward movement because of the many drawbacks in the Indian economy. In India production is limited by the shortages of raw materials, small agricultural holdings, primitive method of cultivation etc. It is not possible to remove these handicaps within a short period of a few years.

3) The decontrol was most inappropriate and inopportune. The Government's views were vitiated on this issue on account of Gandhiji's dislike for controls.

4) Some other factors also favoured the thriving of inflation in India. Some of the best wheat and rice areas had gone to Pakistan. India lost the cotton area of Sind and jute area of Bengal. There were also crop failures in
some of these years.

INFLATION AND CHEAP MONEY POLICY

The cheap money policy, which was suitable for India during the years of war, was not in the interest of the country's economy during the post-war and post-independence periods. Sir C.B. Deshmukh, who was Governor of the Reserve Bank in the post-independence period was known for his views against cheap money policy. It was therefore quite proper for Sir Chintaman Deshmukh to think that under the circumstances prevailing in India, cheap money policy aggravated inflation. "Having considered all facts of the subject (cheap money policy) particularly in relation to this country, I was inclined to think that a consolidation of the progress already made towards cheap money was very essential before making any attempt further to cheapen money. It is being increasingly recognised that beyond a certain limit, cheap money not only ceases to be beneficial but in certain cases, for instance when inflation outrives the forces that engendered it, becomes positively harmful to the economy".¹

The consolidation measures spoken of by Shri C.B. Deshmukh included a reversal of the cheap money policy. There could be no immediate reversal of cheap money policy, because that would have given rise to chaos in Government security market.

¹ Speech delivered by Sir C.B. Deshmukh, Governor, Reserve Bank of India at the 13th Annual General Meeting of the Shareholders: Reserve Bank Bulletin, August, 1947.
It was therefore necessary to continue the cheap money policy for some time and simultaneously prepare ground for hardening money rates at the appropriate time in future. Sir B. Rama Rau explained as to why cheap money policy, though it helped inflation could not be abandoned in the immediate post-partition years. He said, "the policy (cheap money policy) could not however, be completely abandoned, because official support to gilt-edged market had become necessary in this country in order to prevent the disorder in the security market".  

There was an unloading of Government bonds by the scheduled banks, who found it more profitable to make investments in advances and loans to business and industry. As a matter of policy the Government had to support the prices of such securities from falling as it would have otherwise implied a rise in the discount rates on Government securities. The Reserve Bank which is entrusted with the task of supporting prices of Government securities had therefore to purchase such securities worth Rs.150 crores between 1948 to 1951. Ultimately as we shall discuss later on, there was a reversal of cheap money policy in November, 1951 when the bank rate was raised from 3 to 3½ per cent. This was the first change in the Bank Rate in fifteen years.

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The devaluation of the Indian Rupee in terms of dollar was made in consequence of the devaluation of the Sterling in terms of dollars. The Indian Rupee like all other currencies of the Sterling area is linked to Sterling. It was therefore very natural that the Indian Rupee as well as the other currencies of the Sterling area were devalued in terms of dollars, to the same extent the Sterling was devalued. We shall first study the reasons, which led to the devaluation of the Sterling value of the Sterling area, the British monetary authorities are to maintain the balance payments of the Sterling area, with countries outside it in balance. It is particularly so with the dollar area. As Britain provides for the foreign exchange needs of the Sterling Area countries any adverse balance of trade and payments of Britain or of other members of the Area with the Dollar area causes a drain on British gold and dollar reserves.

During the post-war years Britain faced serious difficulties of balance of payments with the Dollar Area. On account of the liquidation of her overseas investments for payment of war debts, a fall in the earning from her stepping services and a reduction of her income from merchandise trade, Britain's visible and invisible foreign earnings were considerably reduced. The net contribution made by interest and dividends from overseas investments towards meeting the cost
of commodity imports of U.K. had fallen from 21 per cent in 1938 to less than 4 per cent in 1948.

Balance of payments crisis was primarily responsible for the devaluation of the British pound in 1949. There were other factors also, which had influenced the British decision. The I.M.F. summarized all those factors which forced Britain to take such a decision in the following words: "There were the deterioration in terms of trade, the difficulties of recapturing an adequate share of dollar markets, its abnormal dependence on dollar imports, the persistence of inflationary pressure and the existence of large sterling balances".¹

Britain's payment crisis of 1949 was a direct outcome of American recession. In the U.S.A., a general decline in economic activity had started by the end of 1948. The index of industrial production had dropped by 10 percent in the middle of 1949. In June, 1949, there was a fall in non-agricultural employment by 2 millions more than what was in the previous year and civilian employment was reduced by 1.7 millions. With the decline in economic activity in U.S.A. in the first half of 1949, the balance of payments position of the Sterling Area with the Dollar Area considerably deteriorated. The exports of Sterling Area goods to U.S.A. fell

sharply. Many other countries outside the sterling area found their export earnings of dollars shrinking. The amount of U.S. imports which was 112 per cent of 1937 level in the last quarter of 1948 declined by 10 per cent in the second quarter of 1949. The average prices of imported articles which had remained stable in the last quarter 1948 and early 1949 began to decline in March, 1949. The value of U.S. exports remained stable though there was a fall in export prices. These changes in the foreign trade conditions of the U.S.A. aggravated the problem of world dollar shortage.

Although the total volume of U.K.'s imports in 1947 was only 76 per cent of that in 1938, the proportion of imports from the dollar area had risen to one-third of the total imports as compared to 23 per cent in 1938. Even after the imposition of severe restrictions on the imports from dollar area, the proportion of imports from the dollar area to the total imports remained unchanged in 1948. On the other hand the volume of U.K.'s exports to the dollar area had been declining.

In the first half of 1949, U.K.'s balance of payments with the world as a whole was favourable. But her balance of payment position with the dollar area had further deteriorated. In the first half of 1948 dollar deficit for the whole of the sterling area was worth £254 millions and in the second half it was worth £169 millions. It was estimated that in the first half of 1949, the deficit would be
of the order of £ 195 millions, but it actually turned out to be worth £ 44 millions more than the estimated amount.

There had been a substantial decline in gold and dollar reserves of the U.K. The drop was from £ 2,696 millions in December, 1946 to £ 1,856 millions at the end of 1948. In the second quarter of 1949, there was a fall of £ 93 millions in the receipts of the Sterling area from its exports to the U.S.A. as compared to the receipts in the first quarter and an increase of £ 35 millions in payments liabilities on account of imports. "The United Kingdom and the rest of the Sterling Area shared equally the reduction in receipts and the increase in payments". 1

The adverse balance of payments gave birth to a series of speculations against the Sterling. "Whenever confidence in the pound fell low, or the balance of payments became temporarily adverse, an exchange crisis was almost inescapable. A severe bout of this kind forced in 1949 a devaluation". 2

Two important factors led to a widespread speculative activity which went against the stability of the exchange value of the Sterling. In the U.S.A., the Sterling was available in the market at the rates much below the official


rate. This led the importers of wool and other raw materials in U.S.A. to believe that the Sterling is definitely over-valued and that the devaluation of Sterling was imminent. After the devaluation the imports were naturally expected to become much cheaper for them and therefore they refused their imports for the time being. On the other hand the Sterling Area importers of goods from Dollar Area apprehended the devaluation of the pound. They therefore thought that devaluation would mean a higher cost of their imports in case payments for them were delayed and eventually made after devaluation. Under such circumstances the importers in the Sterling Area made payments with the least possible delay for the imports they had already made and also made payments in advance for imports to be made in future. Importers to the United Kingdom who had contracted payment in Sterling sought to accelerate deliveries and to obtain payment as quickly as possible. In the three months from April to June, 1949, U.K.'s dollar and gold reserves fell by 14 per cent to £ 1,651 millions. Importers from U.K. sought to postpone their orders and deferred their payments in the expectation that Sterling would be available at a cheaper rate. On the other hand exporters of goods to U.S.A. tried to hold their dollar earnings and delay its repatriation on the expectation of a speculative gain.

In the eleven weeks from June 30 to September 18, Britain's reserves declined further by nearly 20 per cent to
\$1,340 millions. Devaluation was thus forced on Britain by a series of events which were more of speculative nature, rather than balance of payments deficits which sparked them. "Devaluation was thus seen to be an unavoidable step in order to end a situation in which difficulties were being intensified by the expectation of devaluation". 1

The United Kingdom therefore decided to devalue and approached the I.M.F. for its consent. The I.M.F. agreed to the British proposal for the devaluation of the pound by 30.5 per cent and on the 18th September, 1949, the exchange rate of the pound to the dollar was reduced from \$4.03 to a pound to \$2.80 to a pound.

"This (the devaluation of the pound) is an illustration of the serious influence which speculation can exert on the exchange position of a country, when its reserves are not adequate for dealing with the crisis". 2 Along with Britain all the Sterling Area currencies excepting Pakistani Rupee were also devalued. The currencies of Australia, Iceland, India, Iraq, South Africa, Burma, Ceylon, Ireland and New Zealand were devalued to the same extent as the devaluation of the Sterling. Pakistan maintained the pre-devaluation exchange value.

It is rather difficult to make a correct estimate of the contribution devaluation made to solve Britain's problems of adverse balance of payments, because the effects of short term capital movements cannot be disentangled from the slower movement of trade. Following quotation from the I.M.F. Annual Report for 1950 is noteworthy. The Report said, "Nevertheless, even with due allowances for the swing back of capital following devaluation, the progress made in reducing the dollar gap since September, 1949, is a hopeful sign. One indication of this progress is the recovery of the United Kingdom's gold and dollar reserves to £ 1,688 millions at the end of the year (1949), and to £ 2,422 millions at the end of June, 1950". 1

The devaluation of the Sterling had its repercussions on many other countries of the world, which were outside the Sterling area, but had very intimate relationship with it. The Egyptian pound was devalued to the same extent as the British pound. The exchange value (in terms of dollars) of the currencies of Denmark, Finland, Netherlands, Norway, Sweden and Jordan was reduced in the same proportion as the reduction in dollar rate of the Sterling. The I.M.F. also agreed to the new par values for its members outside the

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sterling Area, namely Belgium, Luxemborg and Canada. Before the end of September, 1949, with the consent of the Fund, France, Greece, Italy and Thailand also made adjustments in exchange rates. Others who made adjustments in their exchange rates were Afghanistan, Argentina, Israel, Portugal, Saudi Arabia and West Germany, all of whom were not members of the Fund.

THE DEVALUATION OF THE INDIAN RUPEE

Devaluation of the Indian Rupee was in the nature of a defensive measure. "He took this decision in the main as a defensive measure". The Indian Rupee was devalued at the same time and to the same extent as the devaluation of the British pound. The Dollar - Rupee exchange rate was changed from $1 = Rs.333 to $1 = Rs.476. The exchange value of the Rupee to the pound, however, remained unaltered at Re. 1 = £1 5s. 6d. There was a section of people in the country who thought that the exchange value of the rupee to pound should have been fixed at a lower level. It was said that, "The rupee has for some years been overvalued in terms of both the dollar and the sterling, while the sterling has been for a shorter period overvalued in terms of the dollar. There has thus been a theoretical case for devaluation of both the Sterling and the Rupee in

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terms of dollar and of the rupee in terms of the sterling".\(^1\)

The devaluation of the Indian Rupee was necessary in order to protect India's own interests in the Sterling Area. India is a member of the Sterling Area, and if the Indian Rupee was not devalued it would have become difficult for her to compete in the markets in the Sterling Area and outside it. As we could not leave the Sterling Area for the many benefits it offered to us, the devaluation of the Indian Rupee was a step in the right direction. The one great advantage that we enjoyed from our membership of the Sterling Area is our free access to the pool of 'Hard Currencies' including dollars maintained by Britain. In U.K., a pool is maintained, where U.S. dollars and other hard currencies earned by the Sterling Area are deposited. The hard currencies which include dollar are put at the disposal of such countries of the Sterling Area which have balance of payments deficits with the U.S.A. and other countries of the hard currency area. We again quote a few lines from the speech of Dr. Mathai, in Parliament, on devaluation of the Indian Rupee. He said, "It so happens that next to the U.K. we are the country which makes the biggest demand upon these central reserves. We are a net beneficiary. So long as there is a maladjustment in our monetary relations with hard currency countries, there is not

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1. Devaluation by L. Ghosh : Lecture delivered at a meeting of the Khajur Parisad, Calcutta on September 24, 1949, p. 11.
the slightest doubt that it is to our interest to remain in the Sterling Area". ¹

The devaluation of the Rupee was defended by J. Nehru in Parliament on two counts - (1) It would keep our capacity to compete with the goods of the other members of the Sterling Area undiminished; (2) It would also stimulate our capacity to export to the hard currency countries. ²

The opponents of devaluation opposed it on the following grounds - (i) It was felt that there was a shortage of goods for internal consumption and as such exports after devaluation could be expanded only by reducing rate of internal consumption. This would further stimulate the already existing inflation in the country; (ii) by reducing the prices of Indian goods - by means of devaluation - we cannot increase our sales abroad for there are many tariff barriers, exchange restrictions and other import restrictions in the importing countries; (iii) As a result of devaluation, the balance of payments position would deteriorate; (iv) Imports would be more costly.

Later events, amply proved that we had rightly

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1. Quoted by Dr. C.D. Deshmukh: Economic Developments in India, 1946 - 1956, pp. 64 and 65.

Pakistan which stuck to its old parity had to ultimately devalue after sometime when it faced severe adverse balance of trade and payments difficulties and the market value of the Pakistan Rupee had sagged. After devaluation by India the Pakistan Rupee's official value was to be about 100 Pak. Rupees = 120 Indian Rupees. But at the end of Indo-Pak trade agreement of early 1950, market rate had come down to 100 Pak rupees = 105 Indian Rupees.\(^1\)

In January 1950, the Indian Finance reported the market value of Pakistan 100 rupees = 95 Indian rupees. And thus we find that circumstances compelled Pakistan to devalue. Had we not devalued our currency, perhaps we would have faced a still worse situation. A section of the economists felt that the Indian rupee had been devalued more than what was necessary. They argued that the Indian Rupee should not have been devalued to the same extent as the devaluation of pound. Sir Stafford, who also was accused of having devalued the British pound more than what was necessary, gave the following arguments in favour of his action. He argued that a low parity was necessary in order to maintain a confidence in the pound and to ward off the feeling that it would be devalued again. It would make the position of the pound strong with a balance of payment surplus. "The parity

\(^1\) Indian Finance : March 24, 1950, World of Finance.
then chosen (\( £ 2.80 = £ 1 \)) may well have been - no doubt deliberately - too low in relation to comparative international costs, in order to instil sufficient overseas confidence in the pound".\(^1\) The same argument could be put-forth in support of the devaluation of Indian rupees.

Had we decided to devalue the Rupee to a lesser extent, people would have started apprehending another devaluation and thus confidence in the Indian Rupee would have been shaken. This situation would have caused a fall in our exports as people would have deferred import of Indian goods till the second devaluation that they would have apprehended. This would have ultimately culminated into serious balance of payments difficulties. Much of our accumulated Sterling balances would have been drained out, "the conservation of which was of great importance".\(^2\)

There was one more group of people who maintained that the Rupee should have been fixed at a lower parity with Sterling. Dr. A.K. Das Gupta writes, "I am one of those who hold the view that independently of Sterling, there was a strong case for devaluation of the Rupee and who believe that even in the face of the devalued Sterling, a slightly downward revision of the Rupee - Sterling rate is still called for".\(^3\) This was simply over enthusiasm for devaluation.

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2. Evolution of Central Banking in India by Sir B. Rama Rao, p. 44.
3. Dr. A.K. Das Gupta: War and Post-war Inflation in India, 1950, p. 52.
Fixing the sterling - Rupee rate at a lower level would have meant a further lowering of the Rupee - dollar cross rate. As we were importing huge quantity of food grains and other essential articles from the U.S.A., this would have caused serious balance of payments difficulties. With the limited items we had for exports a further lowering of the exchange rate of the rupee would have not brought any appreciable increase in our export earnings. With an improvement in our balance of trade following devaluation there was a futile campaign in 1951 for the revaluation of the Rupee to 1 S. 8 d. (one shilling eight pence).

After the rupee was devalued, it was feared that this may further strengthen the existing inflationary forces in the country. In anticipation of this, the Reserve Bank took certain advance monetary measures to conserve the country's foreign exchange resources and to curb any further price increases. Sir B. Rama Rau, who was then the Governor of the Reserve Bank made a personal appeal to the banks in the country to refrain from granting advances for hoarding and speculative purposes. In order to make his appeal effective, the Reserve Bank under the Banking Companies Act, asked the scheduled banks to notify daily any change in the line of credit extended and the margins given for all advances of Rupees one lakh and over.
THE NATIONALISATION OF THE RESERVE BANK OF INDIA, 1949

In the early post-war period, several European Central Banks including the Bank of England and Bank of France were nationalised. The Bank of England was nationalised in 1946. The object of the nationalisation of the Bank of England and that of the Reserve Bank of India was almost the same. Writing about the reasons for nationalisation, the Reserve Bank stated, "In view of the need for close integration between its policies (Reserve Bank's) and those of the Government, the question of state ownership of the Bank had been raised from time to time. It was only with the attainment of Independence, however, and in the changed climate of public opinion immediately thereafter that the decision was taken to nationalise the Bank". ¹

Writing about the nationalisation of the Bank of England, Prof. Bayers expressed similar views. He said that there should be an integration of the policy of any Central Bank and the broad economic policies of the Government. Nationalisation of the Bank of England brought such an integration of the policies of the two. The position of the Central Bank even after nationalisation, remains something different from a department of the government.

¹ Reserve Bank of India : Functions and Working, p. 3. A Reserve Bank of India Publication.
"It (the Bank of England after nationalisation) has the unique right to offer advice and to press such advice even to the point of nagging; but always of course subject to the supreme authority of the government". The purpose of nationalisation of the Bank of England was just to make out a written constitutional position of the Bank of England vis-a-vis the Government and make an integration of their policies. The position of one to the other was already fixed by conventions and also long before the Bank was nationalised the policies of the two were integrated. In the words of Prof. Sayers, "Treasury and Bank were already well used to working hand-in-glove before 1946, but only by clause 4 of the 1946 Act has the relationship acquired specific statutory authority".  

The Reserve Bank of India had similarly fully co-operated with the fiscal and monetary policies of the Government right from the time it was established. During the war years the Reserve Bank was virtually turned into a hand maid of the government by means of various ordinances of the Government of India. The statutory limitations on the working of the Reserve Bank in regard to note-issue and reserve were virtually erased out by such ordinances. The Exchange Control Act had made it the sole custodian of all

1. Prof. R. E. Sayers : Modern Banking, p. 65.
2. Ibid., p. 68.
the foreign exchange earned by the country. After we had joined the I.M.F. by the Act No.XXIII of 1947, the Central Government was authorised to determine the rate of exchange of the Rupee with other currencies — a privilege which was enjoyed by the Bank so far. "Such sub-servience of the Reserve Bank in the matter of exchange management and earlier experience of wartime, when the Reserve Bank of India, became for all practical purposes, a department of the government machinery and when irksome statutory restrictions in the Reserve Bank of India Act were brushed aside by suitable ordinances convinced anyone that its nationalisation may in effect mean only a change in level".  

The Bank was nationalised under the Reserve Bank of India (Transfer to Public Ownership) Act of 1948. The Government was desirous that the Bank should function as a state owned institution and the Act made a constitutional provision for this though by convention the Bank was already working as an organ of the Government. Commenting on the nationalisation of the Reserve Bank, the Bank’s annual Report of 1948–49 stated, "This would ensure a greater co-operation of the monetary, economic and financial policies of the Government and the Bank".  


1st January, 1949. The main provisions of the Act were as follows:

1) All shares of the Bank were transferred to the Government of India.

2) Compensation to the shareholders was paid at the rate of Rs.118 - 10 as. per share of Rs.100. Rs.18 - 10 as. was paid in cash and the balance of Rs.100 in long term bonds.

3) The Central Government is empowered to give, from time to time, such directions to the bank, as it may after consultation with the Governor of the Bank consider necessary in public interest.

The last mentioned provision of the Act is similar to the following provision in the Bank of England, Nationalisation Act of 1946. "The Treasury may from time to time give such directions to the Bank as after consultations with the Governor of the Bank they think necessary in public interest." 1

The framing of the Banking Companies Act of 1949 was a measure complementary to the nationalisation of the Reserve Bank of India. It gave the Bank wide powers to control the Banking companies and through them the credit market of the country. This Act authorised the Bank to prohibit banking companies generally or any banking company in particular from entering into any particular transaction or class of transactions or to issue a note of caution. The Bank is entitled

1. Prof. R.S. Sayers : Modern Banking, p. 68.
to inspect any bank.

These two Acts — Reserve Bank of India, Transfer to Public Ownership of 1948 and the Banking Companies Act of 1949 — gave the Central Government complete control over the monetary and fiscal policies of the country.

THE REALISATION OF OUR ACCUMULATED STERLING BALANCES

In a previous chapter we have already discussed in brief the amount and the process of accumulation of our Sterling balances. We now propose to deal with the release of the accumulated Sterling. At the end of the II World War, many Sterling Area countries had accumulated huge Sterling balances in the Bank of England. These accounts of such countries came into being because of the British war time expenditure, which was to be reimbursed to them by Britain, under various war time financial agreements. After the war was over, when the question of payment of these Sterling balances arose, the British opinion got itself divided into the following groups:

1) The repudiationist school

People belonging to this school of thought, were of the view that the war-time Sterling balances arising out of war expenditure should be declared null and void. This was particularly thought for India and Egypt, who they thought could gain independence after the war, because Britain had
fought such a costly war.

2) **Advocates of token payment**

The people who maintained such views, thought that it was perfectly moral for Britain to have repudiated such claims. But they said that for the sake of some practical considerations, Britain should pay a fraction of such balances as a token payment.

3) **The compromise school**

People belonging to this school of thought were in favour of Britain making a hard bargain with her sterling creditors and scale down her total payment liabilities to one-half or one-third of the total.

4) **The security school**

Another section of the people held the view that the amount of total payments that Britain may make to India need not be more than the total value of British financial interest in India.

In India also the people who expressed their views on our sterling balances, were divided into two groups.

1) **One group of people held the view that in lieu of our blocked sterling account, we must take all British assets in India – private and government.**

2) **The other section was of the view that we must convert all our sterling assets in other currencies because – (i) We**
were not likely to have any balance trade deficit with Britain in future; (ii) Rupee was directly linked to other currencies of the world after we had joined the IMF, and as such our relationship with sterling was not likely to be so close; (iii) Future British financial position in the world was not likely to be so predominant as it was in the pre 1939 period.

Under the various Sterling Agreements, our Blocked Sterling Account with Britain was settled. These agreements neither caused any scaling down in the amount nor could we get the full payments at once or convert them in other currencies immediately. The agreements were most graceful for both India and the U.K. and were based on mutual understanding and good will.

The first Indo-British Interim Agreement on Sterling Account was to be operative between July, 1947 to December, 1947. This agreement was concluded between the Government of U.K. one on the side and the Governments of India and Pakistan on the other side on August 14, 1947. By this agreement two accounts were opened – (1) Current Account – In this account India and Pakistan were provided with a working balance of £ 35 million with an undertaking that an additional sum of £ 30 million would be released within this period. One remarkable feature of the agreement was that no limitation was put on the convertibility of the pound into dollars.
This was done because India had a balance of more than Rs.100 crores with the Empire dollar pool. (ii) The rest of our Sterling balance was put into a blocked account.

The period of the working of first interim agreement was extended upto the 15th February, 1948. This was done because soon after the agreement was entered into, Britain imposed restrictions on the convertibility of Sterling into dollar because her holding of liquid dollar assets had come to a very low point. Indian Finance wrote, "Britain has done it due to economic and financial embarrassments." India had therefore to impose stringent restrictions on imports from dollar area. Britain was herself facing the shortage of capital goods and therefore orders placed with the U.K. for supply of goods - whose payments were to be made from the released Sterling balances under the interim agreement - were not followed by immediate deliveries. "The country was thus starved of imports" and the full value of the released Sterling could not be used.

The Finance Minister of India Mr. Chetty and that of Britain discussed about the release of India's Sterling Balances in mid-1948 in London. This resulted in the

1. Indian Finance : August 23, 1947, Crisis over convertibility.
2. Prof. C.N. Vakil : Economic Consequences of Divided India, p. 449.
Financial Agreement of the 9th July, 1948, which was to remain in force up to the 30th June, 1951. At the time when we were negotiating for the release of our Sterling Balances, doubts were again expressed by a section of the people in India, that they were likely to be scaled down. But Mr. Chetty gave an emphatic assurance that this would not happen. He said, "If they try (i.e., if Britain tries to scale down our Sterling Balances) we can take over British assets in India".¹

There were three main objectives of the negotiations: (i) to determine the value of the stores and installations taken over from the British Government by the Government of India in April, 1947; (ii) to capitalise the pensions payable to the British nationals who had served in India; and (iii) finally to obtain a release of further amount of Sterling and arrange for the multilateral convertibility of a part of it.

The negotiations relating to pensions and the purchase of stores and installations were taken up by the Indian Government jointly with the Government of Pakistan. A price of £ 100 million was agreed upon for the stores and installations, whose book value was estimated to be £ 375 millions. To provide funds for meeting the annual liabilities regarding payment of pensions, the Government of India agreed to

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¹ Quoted by, Indian Finance, August 2, 1948, p. 372.
purchase from the Government of U.K., two sixty years tapering annuities by paying capital sums of £ 147.6 million and £ 20.5 million in respect of pensions payable by the Government of India and the Provincial Governments respectively. An amount of £ 80 million was released from Blocked Account i.e. Account No. II to Account No. I of the Reserve Bank for a period of three years ending the 30th June, 1951.

It was found that we had on June, 1948, an unspent balance of £ 80 millions in our current account No. I. This was allowed to be added to the further amount of £ 80 millions now released making a total of £ 160 millions to be released during the three year period of the agreement.

In the first year of the working of the Agreement, India could draw an amount of £ 15 million in hard currency from Britain in addition to her current earning of the same and her purchase from the I.M.F. The amount of Sterling releases to be multilaterally convertible during first and second year was left to be determined later on by agreements and negotiations. Lastly, under the Agreement, an amount of £ 55 million was fixed as due to India from the United Kingdom in final settlement of all matters arising out of Defence Expenditure plan.

Excepting the communists of India, who condemned the Sterling Agreement in a booklet entitled 'Sterling Agreement in the face of realities', it was hailed by all section of
the Indian people. It was too much for us to expect an immediate release of the whole sterling balance and conversion of the released sterling into other currencies, because Britain was not in a position to permit us to do so. The agreement arrived at was reasonable. Hailing the agreement the Indian Finance wrote, "Considering the heat engendered by the controversy over sterling balances in the past two years, the case with which a settlement for a period of three years has been arrived at should be welcome by all". 1

We have already noted that the financial agreement of July, 1948 was tenable for three years and at the time of the Agreement we had an unspent sterling balance of £ 80 millions in Account No. 1. It was therefore agreed that this amount would be released during the year ending June, 1949 and £ 40 million during each subsequent years ending June, 1950 and June, 1951. But as a result of heavy imports, there was a considerable depletion in our balances in Account No. 1. The need to curtail our imports was apparent in the first quarter of 1949, whereas it was also realised that this reduction in imports was against India's interest and was likely to affect the British exporters. The United Kingdom Government therefore, agreed to permit advance transfer of releases of subsequent periods.

An Indian delegation went to England in June - July,

1. Indian Finance : July 17, 1948, A Calm after a storm.
1949, to make fresh negotiations about Sterling releases, as it was thought that the Sterling release agreed upon in mid-1948 was not likely to be sufficient to meet India's needs. As a result of the negotiations, the British Government agreed to release an additional amount of £ 51 million over and above the amount agreed to in mid-1948 agreement. An amount of £ 50 million was to be released to meet the liabilities incurred under old Open General Licence II, prior to its cancellation in May, 1949. The annual releases for each of the two years ending June, 1950 and June, 1951 were raised to £ 50 millions. The Sterling releases were liberal and Britain showed sufficient consideration for our needs by promptly entering this fresh agreement. "Releases by agreement were liberal, in fact, as to put a severe strain on the British economy - and when allowable releases were overdrawn, as by India in 1948 - 49, a new, more liberal agreement was promptly negotiated". ¹

After the term of the Financial Agreement of 1948, was to expire on July 1, 1951, a fresh agreement was negotiated. This agreement extended the period of Sterling releases up to June 1957. Thus under the new agreement releases of Sterling Balances were settled for a period of another six years. The main provisions of the agreement were as follows:

1) A sum of £ 310 million was to be transferred from Blocked Account No. II to Account No. I — Current Account. This sum was to be retained with the Reserve Bank against Currency Issued and was not to be drawn unless there was an emergency. And even when there was an emergency, it could be withdrawn only with the permission of the Government of the United Kingdom.

2) Upto £ 350 million per year could be released and transferred from Account No. II to Account No. I from July, 1951 to June, 1957.

3) Any amount that could not be drawn out of £ 350 million released in one year could be carried forward and added to the release in the next year.

4) In case of necessity an additional sum upto £ 5 million could also be drawn in a year, and the sum was to be deducted from the next year's release. In case the Government of India expected that the excess amount required was to exceed £ 5 million in any year, it could obtain release of the same with the consent of the Government of the U.K. subject to the same condition of adjustment against next year's release.

5) Any balance left over in Account No. II at the expiry of agreement, i.e., on 1st July, 1957 was to be automatically transferred to Account No. I.

The utilisation of the released Sterling balances was slow. The amount of Sterling that was released in Account
No. I, up to June, 1951, was not fully used and on July 1, 1951, the amount of un-utilised Sterling balance was £ 9 crores. On the 3rd July, 1953, the released Sterling in Account No. I of India was £ 712 crores i.e., £ 53,36,80,000 out of which an amount of £ 5,06,20,000 remained un-utilised.

INFLATION AFTER DEVALUATION

The anti-inflationary measures taken after the reimpo-
sition of control in 1948 were not of much avail. We have already marked that prices started moving upward after some decline and the rise was quite obvious at the end of the first quarter of 1949. Dr. Mathai confessed that the procurement prices of food grains in 1949 were higher than those in 1947 by 25 to 50 per cent. The Index of prices of industrial raw materials had already crossed 450 mark in December, 1948. During the Budget discussion on the 11th March, 1949, the Minister for commerce, Dr. K.C. Neogy said, "Inflation has further added to our difficulties. Buyers in the foreign markets are already showing considerable resistance to the high prices being charged for our exports".¹

We have already studied that the Indian Rupee was devalued along with the devaluation of Sterling in September, 1949. It was feared that this was likely to lead to an

¹. Quoted by Dr. C.D. Deshmukh : Economic Developments in India, 1946 - 1956, p. 62.
increase of the Rupee prices of certain export goods, whose supply was considerably inelastic. This may, it was further apprehended, give windfall profits to the people who were the exporters of such goods and may consequently act against the anti-inflationary policy of the Government. The Government therefore, contemplated some measures to relieve the people of a part of such profits. In pursuance of such a policy, the Government issued an Ordinance on the 22nd September, 1949, which empowered the Government to impose export duties on vegetable oils, oil seeds, vanaspati, shellac, steel and tobacco and increase the existing export duties on raw jute and jute manufactures.

This was followed by an eight point programme of the Government announced by the Finance Minister in the Parliament on the 5th October, 1949. It aimed broadly at holding the price line and conserving the country's foreign exchange resources. The eight points were as follows:

1) Formulation of the future pattern of trade so as to reduce expenditure of foreign exchange to a minimum having regard to the essential requirements of the country.

2) Employment of India's bargaining power for the purpose of bringing down to reasonable levels the prices of industrial materials imported from countries whose currencies had appreciated due to our devaluation.

3) Prevention of speculative price increases by various
legislative and administrative measures along with a strict regulation of credit facilities.

4) Imposition of custom duties consistently with the principle of non-discrimination on articles exported to hard currency areas, so as to ensure a maximum amount of foreign exchange for the country and also to ensure that the advantages of devaluation were distributed amongst the foreign importers, the Indian manufacturers and Indian Exchequer.

5) To take action to further the rate of investment which generally follows any devaluation of currency.

6) Extension of facilities for voluntary settlement of taxes in respect of war profit to assesses whose cases were not referred to the Income-tax Investigation Commission.

7) Introduction of economy measures for securing an aggregate reduction of ₹40 crores in Government expenditure in 1959-50 and of thrice that amount in the year 1950-51, and

8) Reduction of 10 per cent in the retail prices of essential commodities, manufactured goods and food grains.

On the 28th October, the Government announced a reduction by 3 to 15 per cent in food grain prices.

After an initial decline of money supply with the public in 1948-49 and 1949-50, to the tune of ₹43.3 crores and ₹18.4 crores respectively, there was again a pronounced increase of ₹99.2 crores in money supply in
1950 - 51. Of this rupees 83.7 crores or 84 per cent was held as currency by the public and the balance of 15.5 crores in the form of deposit with bank.

During 1950 - 51 a significant source of monetary expansion was the substantial payments surplus which was reflected in a net accrual of sterling worth 37.6 crores to the Reserve Bank of India. In the year 1949 - 50, when money supply had fallen by 18.4 crores, the Reserve Bank's holdings of foreign assets had shown a net decline of 73.4 crores. It is noteworthy that in contrast to the year 1949 - 50, there were no addition to money supply in 1950 - 51 on account of Government's cash balances, which in fact went up by 32.8 crores as against all of 54.7 crores in 1949 - 50.

"Devaluation was not followed by any great upsurge in price level", as was apprehended by some people. In November, 1949, the Economic Adviser's General Index declined by about 3 points to 390.2 and by about 9 points in December, 1949 to 381.3. The main reason for this fall was a fall in food grain prices and also that of manufactured articles. The controlled prices of food grains and certain essential commodities namely cloth and yarn, sugar, steel and pig iron went down during this period.

1. Dr. D. Bright Singh: Inflationary Price Trends in India since 1939, p. 263.
The downward trend in prices was short-lived and it was reversed in January, 1950 and the improvement of November and December, 1949, was practically lost by March, 1950. The general index moved up from 381.3 in December, 1949 to 392.4 in March, 1950. The prices gathered further upward momentum during the next year i.e., in 1950 - 51. The rise was particularly steep during the later part of the year. Price rise was accelerated by the outbreak of the Korean war. Prices tended to be steady between September and December, 1950, but thereafter they again started rising continuously and reached the peak of 438.6 in March, 1951. Thus there was a rise of 11.8 per cent in 1950 - 51 as against a rise of 6.0 per cent in 1949 - 50.

Korean War

The outbreak of the Korean war gave rise to a sudden spurt to speculative activity. The Economic Adviser's General index rose by about 10 points from 395.6 in June to 405.2 in July, 1950. To meet this situation the government again announced an eight point programme, outlining the major economic and financial policy of the government. The programme's aim was, 'to hold the price line and to ensure through increased production, economies and large supplies that the inflationary pressure did not go out of hand. In pursuance of these objectives, steps were taken to relax import control and prevent the hoarding of food grains.

These measures bore fruits and there was a general steadiness in prices in October and in November there was a decline. The general index which was at 412.5 in September fell to 410.9 in November. But prices thereafter resumed the upward trend after the Chinese entered into the Korean War and as already stated before, the index reached the peak figure of 438.6 in March, 1951. "The prolongation of the war in Korea, rising import prices, heavy export commitments and higher prices granted to a number of controlled commodities... contributed to the upward trend in prices". This may also be attributed to the decontrol of prices of raw jute and jute manufactured on the 9th March, 1951.

THE DEMONITISATION OF HYDERABAD CURRENCY

During the British rule in India, Hyderabad was the only native state which was permitted to issue its own currency consisting of notes and coins. This had given the Nizam a very attractive source of income. With the accession of the Hyderabad State to Indian Union, Indian notes and coins were declared legal tender money in Hyderabad from January 26, 1950. The Hyderabad currency known as Hali Siaca also continued to be legal tender and arrangements were made for its conversion into Indian notes and coins at the rate of

After we had joined the Fund and through it had established direct relationship with the various important currencies of the world, it was not possible for us to maintain the Rupee - Sterling relationship in the old form.

Sections 40 and 41 of the Reserve Bank of India Act, 1934 made it obligatory for the Bank to convert Rupee in Sterling and vice - versa at a fixed rate. After we became a member of the I.M.F., these sections were replaced by the following provision in the Act. "The Bank shall sell to or buy from any authorised person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi or Madras or at such of its branches as the Central Government may by order determine, foreign exchange at such rates of exchange and on such conditions as the Central Government may from time to time by general or specific order determine, having regard, so far as the rates of exchange are concerned to its obligations to the International Monetary Fund".  

After we had joined the Fund - a world monetary union - it became difficult for us to decide whether we should still remain in the Sterling Block, a regional currency group. There was a section of opinion in India which strongly advocated that we should sever our relations with the Sterling Block.

Dr. Gyan Chand was one of those who held such opinion. Grounds

The Indian coinage Act of 1906 was made applicable to the Hyderabad State with effect from April 1, 1951.

The Government of India allowed sufficient time for the conversion of Hyderabad currency notes into Indian currency. The conversion was allowed upto March 31, 1953. In March, 1953, the Union Parliament passed the Hyderabad Paper Currency Act, 1953, which repealed the Hyderabad Currency Act, in terms of which Hyderabad Government issued Hali Siocca.

Provision was, however, made for these notes to continue as legal tender for a period not exceeding two years from the commencement of the Act in order to avoid inconvenience to the public. The Act also laid down that Hali coins and one rupee notes would remain legal tender for a further period upto March 31, 1955.

On January 26, 1950 when the Indian currency was introduced in Hyderabad, the total circulation of Hali currency amounted to Rs. 48 crores Hali (or Rs. 41 crores Indian). The Government of India further extended the period of conversion of Hali currency into Indian currency for one more year i.e., upto the 31st March, 1956.

Writing about the replacement of Hyderabad currency by the Indian currency, the Indian Finance remarked, "Any new comer to the State in the old days was exposed to the agonising prospect of the loss of a considerable part of his money
through the mysterious play of exchange rates between two currencies (Indian and Hyderabad). The rates fluctuated every day and even in each city. ¹ The unification of the currency system of Hyderabad with the Indian Union automatically solved this problem of fluctuating exchange rates of the Hyderabad currency to the Indian currency.

REPLACEMENT OF FRENCH INDIAN CURRENCY BY INDIAN CURRENCY

From November 1, 1954, the provisions of the Indian coinage Act 1936, the Reserve Bank of India Act 1934 and the Currency Ordinance of 1940 were extended to the French establishments in India, consequent on the merger of these establishments with the Indian Union. Accordingly, Indian currency became legal tender in the French establishments, but French currency in circulation on the eve of the merger (October 31, 1954) was to continue to be legal tender up to April 30, 1955. Meanwhile, arrangements were made with the State Bank of India to provide facilities at their Condicherry Pay Office for exchange, at par, of French currency into Indian currency.

Although the French currency ceased to be legal tender on April 30, 1955, the facilities for its exchange into Indian currency were made available to the public up to October 15, 1955.

The total value of Indian currency issued in exchange for French currency amounted to 37 lakhs.

THE POST-PARTITION BALANCE OF TRADE AND PAYMENTS

Data regarding India's balance of payments used to be compiled even before the Second World War for the use of the League of Nations. But the statistics then published were not very accurate and they gave only a rough estimate of the balance of payments position of India and showed the general trend. The Reserve Bank of India writes, "They were incomplete in that a large part of the invisible transactions remained unrecorded, and the compilation lacked certain essentials of a modern balance of payments accounts". Considerable progress regarding the balance of payments data has since been made. India now as a member country of the I.M.F. follows the method of compilation formulated by the I.M.F. The I.M.F. publishes data regarding annual balance of payments of about 75 countries.

The systematic compilation of India's balance of payments figures started in 1948 and these figures have been published in a comprehensive form in the Reserve Bank of India's publication entitled "India's Balance of Payments...".

1948 - 49 to 1961 - 62". Strictly speaking balance of payments data for 1946 and 1947 is not comparable with the data for the subsequent years as this data covers the whole of the undivided India. Even up to 1951, the data regarding transactions between India and Pakistan were excluded from accounting.

Between 1939 and 1945, India had a favourable balance of trade on government as well as private accounts for the following two reasons: (i) severe restrictions were imposed on our imports from abroad; (ii) the recoverable war time expenditure incurred on behalf of U.K. for Allied war efforts in India and abroad. The result was accumulation of huge sterling balance with Britain at the end of the war. Since the outbreak of the war to the end of the financial year 1945 - 46, India's recoverable war expenditure amounted to £1,740 crores. A considerable portion of our sterling earnings through favourable balance of trade and payments was utilised for the repatriation of sterling debts. The total value of such debts repatriated during the war amounted to £425 crores.

Immediately after the war India's balance of payments position became adverse on account of the following reasons. During the war period our imports were severely curtailed and many of the demands of the people remained unsatisfied. The industries were worked to their full capacity, but there were no replacements. At the end of the war when we had
a huge Sterling balance, there was nothing to be worried about excessive imports, limited exports and an adverse balance of payments for some years. There was an alarming increase in prices in the country, which required to be curbed.

For all these reasons, India at the end of the war had a reasonable need to import more than what she could export. She had nothing to worry about the imports from soft currency areas because she had accumulated Sterling balances. She could equally import more than her exports for sometime from the hard currency area as she had accumulated Dollar balance worth £115 crores with the Empire Dollar pool.

The Government, therefore, permitted liberal import of the commodities the import of which in its opinion could check the inflationary rise in prices. Import of commodities essential for industrial development was also generously permitted. For the first time large scale food imports were made in the country. Writing about this turn in our foreign trade position, Prof. Vakil said, "The era of favourable trade balance was over, and there followed a series of years of continuous trade deficits financed by release of Sterling by United Kingdom. The foreign exchange difficulties of Britain prevented India from utilising her Sterling balances according to her wishes". 1

1. Prof. C.N. Vakil: Economic Consequences of Divided India, p. 448.
In the beginning of the financial year 1947 - 48, drastic restrictions on imports were imposed, particularly on those from the hard currency areas. The measure was particularly aimed at preventing any large scale deficit of hard currency. It was also aimed at preventing continuous balance of payments deficits. It was anticipated that India's food imports would be prolonged, whereas we were not very sure about the time and amount of our sterling releases. Under such circumstances, a reversal of the liberal import policy was quite natural. The accumulated sterling balance needed to be preserved for the import of capital goods.

There was a fall in the sterling reserves of the Banking Department of the Reserve Bank from Rs. 516.54 crores on September 27, 1946 to Rs. 412.44 crores on July 11, 1947. There was a section of people who did not favour the reversal of the policy of liberal imports. For example the Indian Finance wrote, "Having regard to the total of our foreign exchange resources which even at the present day amount to over Rs. 1,500 crores, there is no need to be nervous about the consequences of these developments".  

There was a overall balance of trade deficit in 1947 - 48 to the extent of Rs. 37.58 crores. The deficit was mainly confined to medium currency areas - which included

1. Indian Finance : July 19, 1947, Import Control and after.
Switzerland and Sweden - and hard currency areas. Deficit with the former currency area was of ₹8.50 crores and with the latter of ₹40.78 crores. Out of a deficit of ₹40.78 crores of hard currencies, the deficit with the Dollar countries amounted to ₹38.34 crores. In his budget speech of the year, the Finance Minister expressed his anxiety for the situation. The drain of our foreign exchange reserve was very heavy during the years 1945 to 1947.

In the year 1948 - 49, controls on imports from hard currency areas were further tightened and were confined to the most essential goods which were not obtainable elsewhere. These measures were taken in view of the possible increase in deficit of hard currency because of food imports.

After the Indo - U.K. financial agreement of July, 1948 was signed, imports from soft currency areas were liberalised. This could also be possible on account of our easy soft currency reserve position, as a result of effective import control policy adopted in 1947 - 48. Two Open General Licences Nos. XI and XII were introduced in July, 1948 covering soft and medium currency areas.

In order to meet the increasing deficit of hard currency - a currency whose stock in our reserve was very limited - the Government of India made all possible efforts to push up our exports. "The need for maximising hard currency earnings was of paramount importance", said the

Reserve Bank of India. The serious fall in India's hard currency earnings became a matter of considerable anxiety in the second quarter of 1948 - 49 and the Government appointed the Export Advisory Council.

The Council suggested the removal of export duty on certain commodities exported to the hard currency areas, to grant special incentive to the exporters to hard currency countries and to place certain items under Open General Licence. Writing about the problem of our adverse balance of trade with the hard currency areas, the Eastern Economist commented, "The problem of hard currency although forms only a part of the currency problem, is almost more difficult than the whole. For in making sterling payments, we happen to have our reserves in the No. 1 Account which enable us to live on sterling somewhat beyond our means. In hard currency we have no reserves, and indeed at present have obligations to return to the International Monetary Fund loans which we have already received". 1

In 1948 - 49, the attempts to increase our exports to the dollar area did not succeed due to a temporary recession in the U.S.A. and the U.S. consumers' postponing their purchases. The imports in 1948 - 49, reached a high figure

of Rs. 514 crores due to the policy of Liberal Open General Licence to check inflation. In 1948 - 49 besides a deficit of Rs. 252 crores in current account, our balance of payments on capital account was also adverse so that the drain on our foreign exchange reserve was heavy. The loss of foreign exchange due to adverse balance of trade on both the accounts amounted to Rs. 338 crores. There was also a sizeable outflow of capital on official and private accounts.

Our deficit of hard currency in the current account amounted to Rs. 49.5 crores in the first half of 1949 as against Rs. 10.4 crores and Rs. 32.3 crores in the first and second halves of 1948. Following devaluation in 1949 exports rose sharply from Rs. 106.8 crores in the third quarter of the year to Rs. 175.2 crores in the last quarter. This coupled with reduced imports led to a surplus of Rs. 8.6 crores for the second half of the year.

The hard currency deficit of Rs. 81.8 crores for the year ending June, 1949 was financed in the following way, (i) we got $ 60 million from the Central Reserve of the Sterling Area; (ii) we were further permitted to overdraw from this central pool an amount of $ 84 million; (iii) we purchased $ 56 million from the I.M.F. against Rupee payments and (iv) we got dollars from the balance of India's supply mission.

India's balance of foreign trade on current account
for the year 1949 - 50 can be divided into three distinct phases. During the first phase which lasted up to May, 1949, imports rose to Rs. 60 crores per month as against Rs. 38 crores per month during the same period in 1948. Total exports for May, 1949 declined to Rs. 26 crores as against Rs. 40 crores per month during the first six months of 1948 - 49. During the second phase which lasted till there was devaluation imports were held in check, while exports began to show an upward trend. In the last phase, which lasted from the time of devaluation to the end of the year, exports showed continuous rise. This was due to the devaluation of the Rupee. As against a deficit of Rs. 175.9 crores in the first nine months of the year 1949 the last quarter showed a surplus of Rs. 29.4 crores, the increase in exports due to devaluation rather than decreased imports were responsible for this surplus.

The spectacular effect of devaluation was very short lived. In the first quarter of 1950 - 51 there was a surplus of Rs. 23.9 crores due to restricted imports and increase in exports. But the position deteriorated in the second quarter when there was a deficit of Rs. 15.9 crores. "To a large extent devaluation had spent its force quickly, because India had no large surpluses to export, which itself was due partly to the difficulties of getting capital goods and partly to the non-devaluation of Pakistan". 1

1. Dr. L. Bhisham Singh : Inflationary trends in India since 1939, p. 176.
The Korean war which broke out in June, 1950 again stimulated our exports and enabled India to enjoy a favourable balance of trade and payments. The third quarter of the year saw the initial effects of rearmament and stock-piling in U.S.A. and Europe. The total value of our exports, which in the second quarter of the year had fallen to ₹112.5 crores reached nearly the level of previous quarters, and were ₹128.1 crores. But it was in the fourth quarter of the year that the full impact of the rearmament and stock-piling demands were felt on our balance of payments; exports in this quarter attained an unprecedented level of ₹170 crores. Total imports in the last two quarters of the year were ₹5 crores more than those in the first half.

The payments position with the hard currency area changed from one of deficit of ₹55 crores in 1949 to a surplus of ₹29 crores in 1950. This surplus was possible because of the Korean war and the changed international economic situation.

India had a remarkably favourable balance of payment with the Sterling Area in 1950. In 1949, India had a deficit of ₹46.00 crores with this area, which turned into a surplus of ₹59.7 crores in 1950.

The adverse balance with the 'other areas' in 1950 amounted to ₹27.1 crores as against ₹70.3 crores in 1949.
This reduction in deficit became possible more due to a fall in imports and not through increased exports. Exports to these areas could not increase because India had not much to export to these areas.