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Repatriation of Sterling Debt

The war posed, on the one hand, the problem of conservation and effective utilisation of scarce dollar resources of the sterling area, of which India was a member; this called for an elaborate system of control, described in Chapter 12. On the other hand, the vast acquisition of sterling by the country during the war provided an opportunity for the repatriation of its sterling debt, the story of which is told in this chapter. Much initiative in this matter came from the Reserve Bank, which also implemented the numerous details of repatriation. There was almost complete identity of views between the Bank and the Government of India, but differences were encountered with the India Office, the British Treasury and the Bank of England, both on the principle of repatriation and its many details. Nevertheless, with dogged perseverance from the Indian side, it was possible to put through the operations in a remarkably successful manner.

It would be useful to give some information on the genesis and growth of India's sterling debt. Till the Mutiny of 1857 the sterling debt of the Government of India was insignificant, of the order of Rs. 4 crores only out of a total debt of about Rs. 56 crores. On account of the expenditure in connection with the Mutiny, the sterling debt went up to about Rs. 24 crores in 1860. From 1867 onwards there was a regular programme of borrowing in London for productive purposes, particularly irrigation and railways. By 1913, the sterling debt rose to Rs. 269 crores. There was a further increase in the debt during the inter-war years, on account of Government's assuming responsibility for the control and management of company-managed railways, the railway annuities and the war gift of £100 million to the U.K. As on March 31, 1937, the funded sterling debt stood at £357.3 million or the equivalent of Rs. 476 crores, as under:

Terminable Loans		*(£ million)*
India 5%	Stock 1942-47	9.48
" 41/2 %	" 1950-55	39.85
" 41/2%	" 1958-68	17.50
" 4%	" 1948-53	12.00
" 31/2%	" 1954-59	10.00
" 3%	" 1949-52	10.00
	Total	98.83

Non-terminable Loans

India 3 ½ %	Stock 1931 or after	88.67
" 3%	" 1948 or after	77 .02
" 31/2%	" 1926	11..54
	Total	177.23

Railway Debentures	24.66
Liability for British Government 5% War Loan 1929-47 taken over by India	16.72*
Railway Annuities	39.86
Grand Total	357.30

The repatriation of sterling debt began even before the war, that is to say, in the financial year 1937-38, on a very modest scale. However, it was only during the war years that repatriation was undertaken on a large scale; the major part of the debt was extinguished by the middle of 1943. Initially the repatriation was on a voluntary basis, but from early 1941 schemes of compulsory repatriation were brought into effect. Later, the Railway Annuities were also funded. Requisitioning of the Railway Debenture Stocks and liquidation of the Chatfield debt were other forms of sterling debt repatriation. By March 1946, sterling debt of the value of £ 323 million had been repatriated. The Bank and the Government of India were, however, unsuccessful, during the war years, in persuading the British authorities to acquiesce in the funding of the sterling pension liabilities.

Repatriation of sterling debt posed the problem of raising equivalent rupee funds. Since the sterling used for the repatriation of debt belonged

* Out of this, the liability for £ 1.25 million was assumed by the Government of Burma on separation. The actual total of outstanding sterling debt was therefore reduced to £ 356.05 million on April 1, 1937.

to the Reserve Bank, suitable arrangements had to be made to provide the Bank with alternative eligible rupee assets. The major part of the rupee finance for the first compulsory repatriation scheme was provided by the issue of rupee counterparts to the Bank and Government, roughly on a 50 -50 basis; Government paid for their share by drawing upon their cash balances, supplemented by temporary ways and means advances from the Reserve Bank. The counterparts held by the authorities were sold to the market gradually. Rupee finance for the second compulsory scheme was met by the issue of ad hoc Treasury bills to the Bank; with the intensification of the Government's loan programme and with the sale of counterparts later, these were mostly retired.

Initial Efforts: Open Market Purchases

The question of utilising the sterling balances of the Reserve Bank for repatriating the sterling debt had engaged the attention of Sir James Taylor right from March 1937. The level of sterling purchases of the Bank and the general economic and financial picture that was emerging in the early months of the year pointed to the accumulation of sterling assets in the Banking Department of the Bank to an extent that the Governor considered unnecessarily large. There were, in addition, the large hidden reserves in the form of gold, amounting approximately to Rs. 30 crores at the ruling market price, which would take the ratio of gold and sterling in the Issue Department to 75 per cent of the total notes issued. The Governor was averse to seeing this percentage rise above 60 in the following months; in March 1937, the ratio was 57 per cent. In his opinion, at least 10 per cent of the Issue Department's assets had to consist of internal securities, if the Bank were to have 'reasonable resources to control the internal market'. Assuming a continuation of India's export surplus on the existing scale, the Governor expected the Bank to be faced with surplus sterling of £5 to £10 million, after providing for any necessary expansion of the currency.

Writing to the Finance Member early in March 1937, the Governor stated that the situation was developing in a manner which required the serious consideration of Government. He pointed out that 'the nationalist school of thought' had its own suggestions to make for dealing with this problem. One suggestion (proposed to the Governor by Director Mr. B. M. Birla) was that the Bank should begin to buy gold. A second was to use the surplus for expansion, but the Governor did not favour it; he considered such a course inflationary! His solution was that Government should buy up their sterling debt, especially that maturing between 1948 and 1950. This he considered was 'the most effective way of building up the financial independence of the country'.The modus operandi envisaged first a reduction in the Government

balance by the equivalent of £5 million 'so as to necessitate Government obtaining it from the public by Treasury bills, with a view to the partial control of short money rates'; the Governor did not favour issue of ad hots to the Bank.

The Government of India were not enthusiastic about the proposals. They decided that the requirements of the situation would be met by the Bank selling to them its own holdings of the dated India sterling stock, for which the Bank had been in the market for some time. The Bank was to continue to pick up at its discretion any offers, however small, of these loans that came in the market -the loans were very tightly held -and to transfer them to the Government of India in convenient lots at periodical intervals. This was to be done in a manner suited to the Government's ways and means position, at the market price of the date of transfer with interest adjusted up to that date and at the rate of exchange for Government transactions of the day (later, the basis was changed to the price at which the Bank purchased the securities). While the Bank would effect the purchases through the Bank of England acting on its behalf, at the prevailing market prices in London, this was subject to the yield limits indicated by the Secretary of State which could be modified by the Government of India as circumstances dictated. It is interesting to know that Sir James Taylor opposed the criterion proposed by the Secretary of State requiring comparison of the yields on the India sterling stock with those of British securities; this, according to him, was of doubtful relevance, as the more important comparison would be with the yield on the Government of India's rupee securities of similar maturities. At that time, the average market prices of the sterling securities were appreciably below those of the corresponding rupee securities. The Government of India accepted Sir James's view. They also agreed to all the details of procedure drawn up by him to enable the Bank to operate in Indian Government securities in the London money market not merely as a buying agent but as a central bank, and having regard to the Government's ways and means position. The first sale of securities to the Government of India was effected on June 28, 1937. It was decided in September 1937 to cancel the securities already purchased by the Government and to have future instalments cancelled on purchase.

The Governor did not rest content with this procedure for repatriation since it was clear to him that with the small amounts of stocks that were available in the London market, there were no prospects of his being able to pick up more than about £ 1 million a year of securities for cancellation by the Government of India. He also anticipated that the Bank might be faced with ' embarrassing requests, not from India this time, but possibly from abroad, to build up gold reserves, which might not suit us '. He, therefore, proposed to Government

that the Bank should purchase the non-terminable 3 per cent and 3½ per cent sterling Stocks which had a free market and that the Government should cancel them in exchange for the same nominal value of the 3 per cent and the 3 ½ per cent Rupee Paper; the Bank would take these into its own portfolio in the first instance and sell as opportunity offered. This procedure would give the Bank a valuable weapon for controlling security prices in India because the 3½ per cent Paper was still the barometer of the gilt-edged market. Similar conversion terms for the fixed maturity loans were not then contemplated.

Neither the Secretary of State nor the Governor of the Bank of England lent the proposals his whole-hearted support. Both felt that the project should be limited to a sum of £ 5 million, further operations being left to be decided in the light of experience gained. Further, both the India Office and the Bank of England were again concerned lest the Reserve Bank should be saddled, 'contrary to sound central banking practice', with a large undisposable amount of irredeemable securities. As a safeguard, therefore, they suggested that the Bank's 'open position' should not at any time exceed £1 million. The U.K. authorities also felt that the correct formula would be to issue the rupee paper not for the face value of the sterling loan purchased but for the purchase price of the latter converted at the rate of exchange applicable to Government remittances on the date of cancellation, and taking into account the ruling market price of the corresponding rupee paper. The ' profit ' arising from the difference between the sterling and the rupee prices would then be reflected in the Government of India's debt position and not in a revenue receipt through the Bank's surplus as would be the case under the Reserve Bank's proposals. The Bank of England felt it even more prudent for the Bank to undertake the transactions as Government's agent, when it could be compensated for its services by a reasonable remuneration.

Since the whole object of the scheme was to bring the prices of sterling and rupee securities closer, Sir James felt that the procedure proposed by the Secretary of State for issue of rupee paper to the Bank was almost certain to land the Bank in losses. The limitation of £ 1 million on the Bank's open position was equally unacceptable to the Governor. In his words:

> I would certainly not be prepared on behalf of the Bank to make any promise restricting our freedom of action beyond the reasonable limits imposed by the second proviso to Section 17 (8) * of our Act which was arrived at after considerable discussion. Though naturally we do not contemplate working up to anything like these limits, we must reserve freedom of action.

* This proviso laid down the limits up to which Government securities of various maturities could be held in the Ranking Department.

The only solution Sir James could think of, short of dropping the scheme entirely, was for the Bank to do the business as Government's agent. As he confided to the Bank of England:

> the important thing is to get an early decision because in addition to other factors the passing of the Insurance Bill has led to a speculative rise in rupee gilt-edged with a consequent increase in the outflow of capital for investment in London. I am indifferent who gets the profits, or whether they are devoted to debt redemption or revenue, so long as I can get machinery into being to regulate these capital movements. I do not anticipate that I shall be able to do much but it seems to me that even a little is better than nothing. In India, also, the circumstances are not the same as in other countries. Elsewhere it might be arguable that it was immaterial whether external debt was redeemed through the central bank or directly by the investing public but in India it must be remembered that in many quarters the dogma that Indian exchange is too high and ought to be reduced by two pence has acquired an almost religious sanctity. Their devotion to this creed is not likely to be lessened if they stand a chance of gaining an additional 12 per cent by sending their money abroad.

The Government of India accepted Sir James's proposal that the Bank undertake the work as their agent on payment of commission. They did not also consider it worthwhile to argue with India Office about crediting the profits to revenue instead of taking them in reduction of debt. The arrangements were put into effect immediately, i.e., on October 18, 1937, when the Bank commenced transferring to Government from its own holdings of the 3 per cent and the 3½ per cent sterling Stock acquired by sporadic purchases in the London market.

The scheme was, however, halted in February 1938, on account of the weakening of the exchange and the fall in the sterling purchases of the Reserve Bank. Apparently the Governor regarded this as a temporary phenomenon; in fact, he had taken some measures, especially the levering up of short-term money rates, to improve the exchange position. Therefore, he continued to press Government for acceptance, at least in principle, of his original proposal that the Bank do the whole business as a principal rather than as the Government's agent, while still adhering to the principle laid down by the India Office regarding the appropriation of the ' profit ' arising out of the transactions. His proposals, Sir James argued further, would give the Bank the necessary freedom of action to conduct the operations (viz., the purchase of the sterling stocks in the London market, passing them on to Government for cancellation, and sale of the rupee securities in the Indian market) at its discretion; besides, with its general reserve and also provident and similar funds to invest, the Bank could, without any embarrassment, hold much more paper than Government could, whereas under the existing procedure Government could easily be

saddled with considerable quantities of rupee securities which was 'neither sound in theory nor convenient in practice'.

The Secretary of State was unconvinced by the Governor's arguments. He found it difficult to accept the view that it was 'sounder in theory or more convenient in practice' that the rupee securities should be held by the Bank rather than by Government. According to him, it was hardly an opportune time to resume the repatriation operations owing to the uncertain outlook as regards the trade balance and the lower level of gold exports, not to speak of the uncertainty of world political and economic conditions in general.

The Government of India agreed with the Governor in regard to the need for commencing the repatriation operations. However, in view of the falling off of the Bank's sterling purchases, the scheme was not revived during 1938. The total repatriation of debt in the financial year 1937-38 amounted to about £3 million or Rs. 4 crores, almost three-fourths comprising terminable loans. The cost of the terminable stock was met from the Government's resources. For the balance, rupee counterparts of the 3 per cent and 3 ½ per cent non-terminable Stocks were created for sale to the market. Besides, in the two years 1937-38 and 1938-39, payment of over £9 million was made towards the transfer of the Government's outstanding liability for the Family Pension Funds.

War-time Steps: Voluntary Repatriation

After the outbreak of war, sterling began to accumulate with the Reserve Bank in substantial amounts and it appeared desirable to resume the Bank's purchases in the London market for cancellation and issue of rupee securities there against. About the end of October 1939, India 3½ per cent sterling Stock 1931 or after was quoted at about £79 ½ against the quotation for the 3½ per cent Rupee Paper in India of about Rs. 86-8-0; thus the purchase of sterling stock in London and the creation of rupee paper for sale to the public in India was a profitable proposition for Government. Operations were, therefore, resumed about the end of October and the first cancellation was put through on November 15, 1939. As a result of the operations, the disparity between the price of the 3 ½ per cent India sterling Stock in London and the 3½ per cent Rupee Paper in India was reduced and it soon became apparent that if repatriation was to be effected on a substantial scale a more comprehensive scheme would have to be introduced. The Bank's external reserves had been built up to approximately 60 per cent of the note issue (excluding the hidden reserve in gold) and there was also a large sterling balance in the Banking Department; it was therefore felt safe to embark on repatriation on a larger scale.

The outline of the larger scheme was again the handiwork of Sir James. He considered that in any such scheme the basic principles to be followed should be that the scheme should be elastic and that the sterling loan cancelled should be replaced by a rupee loan of equal length as it would be inadvisable to pay off a long-term obligation and replace it by a short-term maturity, which might create an embarrassing position for Government later. His proposal contemplated the opening of rupee books by the Reserve Bank for each dated sterling loan and an offer to holders of the latter to have their holdings transferred to the rupee books on payment of a premium. This premium would be fixed from time to time by the Reserve Bank for each loan and it would be so graded as at times to give a reasonable profit to the transferor and at others to make the proposition less attractive. It was to be made quite clear that there would be no right of retransfer to sterling. He proposed further that the Bank might also purchase dated stocks direct for transfer to Government against creation of rupee securities which could be peddled out in the Indian market. While the Governor still preferred that the Bank should act as principal in these transactions, he did not press it for fear of delay in getting the scheme going. In any case, since the Bank held nearly £40 million sterling securities and Rs. 25 crores rupee securities as its working stock as at the end of 1939, the limitations of £1 million on the open position and £5 million on the total transactions prescribed earlier by the Secretary of State at the instance of the Bank of England had become pointless and needed to be scrapped straightaway.

In January 1940, the Government of India recommended to the India Office adoption of the proposals, which would result in extending the scheme of repatriation to all the India sterling stocks. The notification introducing the scheme was not issued until February 22, 1940 as there was a long three-way correspondence between the Secretary of State, the Government of India and the Reserve Bank. The delay was largely due to' the attitude of rather negative criticism' of the India Office, as Sir James Taylor put it. Many of the India Office's suggestions were not acceptable to the Bank, but it succeeded in bringing round the Secretary of State to its point of view. One suggestion of the India Office was the avoidance of an 'undue multiplicity of issues' and the offer of exchange facilities 'wherever practicable into a generic rupee security of similar maturities and same interest rate', e.g., 'sterling Stocks of 4½ per cent 1958-68, 3½ per cent 1954-59 and 3 per cent 1949-52 might possibly be related to rupee loans repayable 1955-60, 1947-50 and 1951 -54, respectively'.

Another suggestion made by the Secretary of State which did not find much favour with the Governor was that if the Bank's direct purchases in the market proved insufficient to cope with the sterling

accretions, the surplus sterling might be invested in United Kingdom securities of appropriate maturities with a view to utilising eventually their sale or maturity proceeds for repayment of India's sterling loans as they matured. This alternative could, the Secretary of State said, be considered in preference to compulsory acquisition or if the latter actually proved impracticable. While the Governor agreed that such a step would be preferable to one involving compulsory acquisition, he referred to a number of practical difficulties. Because of the five-year limit on the maturities of sterling securities held in the Issue Department which he 'would not like to see removed', and as the holding of sterling securities in the Banking Department would involve the payment of British income-tax which 'would take all the gilt off the ginger bread' the sterling investments would, Sir James reasoned, have- to be held by the Government of India and not the Bank.

The Secretary of State was also at long last agreeable to scrap the limits both on the open position and the total operations. Sir James had argued against the limits in severe terms, as 'an irritating reflection on our common-sense'.

The new scheme was announced in February 1940 and was made effective April 1, 1940. Under the scheme, which was also known as the Licence Scheme, since parties desirous of availing themselves of the scheme had to take out a licence from the Reserve Bank, rupee counterpart loans of identical maturity were created against the following sterling loans :

India	3%	Stock	1949-52
”	3½%	”	1954-59
”	4%	”	1948-53
”	4½ %	”	1950-55
”	4½ %	”	1958-68
”	5%	”	1942-47

The scheme did not, however, prove to be much of a success, partly because the sterling and rupee prices were in close approximation to each other and there was little or no inducement to convert sterling holdings into rupee loans and partly because of the delay and interruption to which communications between India and the U.K. were subject during the summer of 1940.

In 1939-40, total repatriation amounted to £17 million; rupee counterparts for the equivalent amount, namely, Rs. 22.79 crores, were created.

First Compulsory Scheme: February 1941

The Licence Scheme, while effecting repatriation of the sterling debt, had not assisted the other important object of utilization of the sterling

resources of the Bank. By November 1940, the Bank's sterling balances had increased substantially and the initiative for further action came from the India Office, although both the Government of India and more so the Reserve Bank had been keeping the position under continuous watch and had been contemplating large scale repatriation on lines similar to those then proposed by India Office. The India Office was prepared to urge the U.K. Treasury to requisition the holdings of dated sterling loans and sell them to the Government of India for cancellation. The rupee finance was to be provided by the issue of an equivalent amount of rupee securities, created ad hoc, to the Reserve Bank which could hold them in the Issue Department. For this purpose, India Office also felt that it would be appropriate to have the proviso to Section 33(3) of the Reserve Bank of India Act, imposing a ceiling* on the holdings of rupee securities in the Issue Department, amended.

Sir James recognised that the offer to requisition the India sterling securities would be 'a very welcome gesture by the British Government'. He proposed that the repatriation of the terminable debt should be done in three instalments, the earliest maturities being taken up first. At the prevailing market prices the cost of requisitioning the three lots was estimated roughly at -£ 24 million, £ 40 million and £ 26 million, respectively, or about Ego million in all, the face value of the total outstandings being &84 million. As regards finding the rupee finance, according to Sir James the basic principle was to avoid replacing long-term liabilities by short-term obligations. On that basis, the Bank was prepared to take up the whole of the first lot as rupee counterparts either in the Issue or in the Banking Department as suited it and the Government's ways and means programme. The Bank could then sell them out to the market as opportunity offered.

While the Government of India accepted Sir James's suggestions in toto, a number of problems were posed by India Office before it was convinced that it could approach the British Treasury and the Bank of England. As Sir James remarked, 'when the India Office start to elaborate side issues it is generally because something else is worrying them'! One important point was whether the entire terminable debt should be repatriated in one operation or whether it should be in three lots but with simultaneous notice for all the three. Sir James felt that a single operation of the magnitude involved might be too large even by the standards of the City of London; he also preferred giving separate notices for the three lots.

Another question was whether the requisitioning should not apply to residents of the U.K. only. Sir James had proposed and the Government of India had agreed that compulsion should apply to everybody;

* The ceiling was one-fourth of the total assets or KS. 50 crores, whichever was greater.

the India Office's suggestion to restrict the operations to holders resident in the U.K. would create difficulties for Indian holders who would be unable to sell their holdings to U.K. residents later. The final decision was in accordance with the proposals of Sir James and the Government of India.

As regards the restrictive provision concerning rupee securities in terms of Section 33(3) of the Reserve Bank Act, the position was that the first stage of the operations could be carried through under the existing limitation, but its retention would make the subsequent stages impracticable. Although Government initially thought that the limit (for the holding of rupee securities in the Issue Department) might be raised from 25 to 40 per cent or even 50 per cent, they later agreed with Sir James Taylor who considered it preferable to omit the proviso altogether. In the Governor's view, public objection to the abolition was also unlikely to be strong 'as its primary object, the development of a bill market, is obviously quite impracticable on the scale contemplated'. The Bank of England had, however, to be assured that the contemplated amendment retained 'adequate safeguards against unlimited use of the Issue Department' and did not give the Reserve Bank inflationary powers. Its fear of the likely undesirable consequences of the amendment also made it suggest revaluation of the Bank's gold which would extinguish some Rs. 40 crores of the repatriated debt and so avoid pro tanto creation of new rupee counterparts. This step was obviously out of question, for political reasons.

The Governor also put it to Government that the Silver Redemption Reserve might be abolished and its sterling assets of roughly Rs. 10 crores be used in buying the repatriated debt. This Reserve had been set up to enable the Government to pay the Bank for the rupee coin returnable in the event of Section 36(1) * of the Bank's Act becoming operative. The return of rupee coin was unlikely and, in any case, on the discharge of Government's sterling liabilities on the contemplated large scale, there would be no occasion for the Bank to desire payment for the rupees in sterling. The matter was taken up with India Office which, however, thought differently.

* Section 36(1) read: ' After the close of any financial year in which the minimum amount of rupee coin held in the assets, as shown in any of the weekly accounts of the Issue Department for that year prescribed under sub-section (1) of Section 53, is greater than fifty crores of rupees or one-sixth of the total amount of the assets as shown in that account, whichever may be the greater, the Bank may deliver to the Governor General in Council rupee coin up to the amount of such excess but not without his consent exceeding five crores of rupees, against payment of legal tender value in the form of bank notes, gold or securities:

Provided that if the Bank so desires and if the amount of gold coin, gold bullion and sterling securities in the assets does not at that time exceed one-half of the total assets, a proportion not exceeding two-fifths of such payment shall be in gold coin, gold bullion or such sterling securities as may be held as part of the assets under sub-section (6) of Section 33 '.

While discussions in respect of the various details of the scheme were going on, the Reserve Bank kept out of the market in London so as not to push prices up.

The Bank of England considered that from the technical point of view it could take up the entire terminable debt in one operation and the British Treasury agreed to the requisitioning of the dated India sterling stocks on the same understanding. The Governor was only too happy to accept this offer, as by this time the Bank had accumulated adequate sterling. Eventually the Bank of England was able to undertake the operation on the date originally contemplated, viz., February 7, 1941. Accordingly, on that day, a Securities (Restrictions and Returns) Order was issued by the U.K. Treasury under Regulation 1 (1) (a) and (b) of the Defence (Finance) Regulations, prohibiting market dealings in and calling for returns of holdings of the terminable India sterling stocks from residents of the U.K. Simultaneously, an Acquisition of Securities Order was issued, transferring these securities to the U.K. Treasury, at the prices (the day's quotations in London plus allowance for 2 ½ per cent interest) notified in the Order. On the following day, i.e., February 8, a vesting order was issued by the Government of India under the Defence of India Rules, transferring these securities held in India to themselves at the prices notified in the U.K. Order converted into rupees at 1S. 6d. Owners in India were given the option to receive payment in cash (in rupees only) or in rupee counterpart securities. Unlike in the case of the Licence Scheme of February 1940 for conversion of the sterling loans into rupee counterparts which was administered by the Bank's Bombay Office only, the facility was offered at both the Bombay and Calcutta Offices and no licence fee was charged; the object was to make the scheme as attractive as possible.

Residents and rulers of Indian States fell outside the purview of both the British and Indian Orders; it was decided that these persons should be given the option, as were other residents of the sterling area outside India and Burma, to surrender their holdings to the Bank of England against sterling, and if they so desired, to the Reserve Bank against rupees or rupee counterparts.

As agreed, the Government of India issued an Ordinance on February 8, 1941 deleting the proviso to Section 33(3) of the Reserve Bank of India Act. Two press communiques issued simultaneously explained the repatriation operation and the rationale of amendment of the Act.

Neither the Central Board nor its Committee was formally consulted during the discussions leading up to the decision to requisition compulsorily the outstanding terminable sterling debt. A last minute effort was made to keep the Board informed when, on February 5, 1941,

Sir James asked the Government if they could postpone the issue of the Ordinance amending Section 33(3) to the 13th so that he would have the opportunity of referring it to the Committee at its meeting on the 12th. However, Government issued the Ordinance on the 8th, as they wanted it to be out before the Assembly session began on the 11th. In these circumstances, the Governor had to meet the local Committee members at Calcutta to explain the scheme to them privately and convince them of its soundness, in advance of the meeting on the 12th, when he apprised the Committee officially of all the steps taken till then for the repatriation of the external debt. All the same, the Directors desired the Governor to bring it to the notice of Government that in their opinion the Committee ought to have been consulted before the Ordinance amending the Act was issued. They added that though this particular proviso was comparatively unimportant and that if they had been consulted they would have agreed, the principle was important as it might give rise to uneasiness that major alterations might be effected without reference to them. The matter was dropped on receipt of an apology from the Finance Member explaining that the situation was exceptional as 'the combined requirements of extreme urgency and the need for synchronisation with the action taken by His Majesty's Government made it impossible for Government to consult the Committee in this case' and that 'in the normal course of procedure Government would desire to consult the Committee or the Central Board before taking any action to amend the Reserve Bank of India Act'.

Rupee Finance for the Repatriation

As regards the local financing of the operation, rupee counterparts were to be issued for a nominal value equal to that of the sterling loans cancelled, in order to avoid any adjustments in respect of capital or interest in Government accounts. The manner in which the rupee counterparts were to be held involved a delicate balancing of principles and Sir James's knowledge and experience proved valuable in devising a flexible arrangement.

It was considered undesirable to replace a large block of funded debt by floating debt; it was, on the other hand, impracticable to raise the whole amount immediately by sale of counterparts to the public. It was thought best that out of about Rs. 120 crores estimated to be involved in the operation, some Rs. 50 to 60 crores of the counterparts be taken in the Bank's Issue Department to replace the sterling Treasury bills. The Government were to take on their own account as much as their ways and means position permitted, the Bank helping them by taking up intermediate Treasury bills in the Banking Department or

by giving them ways and means advances. Investment demand was to be met either out of Government's stocks or the Bank's, care being taken not to depress security prices. Government approved of the broad plan of distribution.

The total repatriation, till the end of March, under the scheme of February 8, was £ 60.05 million, including £ 6.03 million surrendered by residents in British India; the repatriation done through open market purchases and the Licence Scheme during the year 1940-41 amounted to £ 11 .24 million, making a total of £ 71 .29 million in all for that year. The total counterparts created amounted to Rs. 94.86 crores, of which Rs. 10.22 crores were issued to the public. The balance was taken up about equally by the Bank and the Government, the latter obtaining in March temporarily ways and means advances for Rs. 16 crores.

As the amounts of counterparts taken up by Government and the Reserve Bank aggregated over Rs. 80 crores and there was no possibility of the market being able to absorb this amount, steps were taken to cancel securities for Rs. 47.73 crores in the year 1941-42. Also, in order to reduce Government's liability for high interest bearing loans, an offer was made to the public in June 1941 to convert their holdings of 4 ½ per cent Loan 1950-55 and 4 ½ per cent Loan 1958-68 into 3 per cent Loan 1951-54 and 3 per cent Loan 1963-65, respectively, on terms corresponding to the prevailing market prices of these securities.

The repatriation operation formed the subject of a very heated debate in the November 1941 session of the Legislative Assembly on a resolution moved by Mr. Jamnadas Mehta, recommending that' in any fresh scheme of the repatriation of India's sterling debt, care should be taken to see that the cost of such repatriation on India's revenues is not unduly heavy as was the case with the last scheme '. The sting of the resolution was obviously in its tail! The mover charged Government with having incurred a loss of Rs. 35 crores on the whole transaction-Rs.15 crores (£ 11 million) in the discount allowed when the debt was incurred, Rs. 12 crores lost because advantage was not taken of the lower rate in 1939 and Rs. 8 crores lost because Government deliberately allowed the prices of the vested securities to rise by their open market purchases in London! There were other criticisms also against the operation and the rapid rate of accretion of the sterling balances. It was urged that the operation was undertaken more to help the British Government. A demand was made that the British Government should pay for their defence expenditure in India in rupees. The resolution was passed only after Mr. Mehta agreed to the deletion of the last few words referring to the cost of this operation as having been unduly high.

Second Compulsory Scheme: December 1941

The operations relating to the first compulsory repatriation scheme were virtually completed in the middle of June 1941, while open market purchases continued. The question of repatriation of the non-terminable sterling debt by one or more similar large scale operations had, however, come up for consideration much earlier. As on the previous occasions, action was initiated mainly by Sir James Taylor. He figured that, after earmarking an appropriate sum for currency expansion, sterling of the order of Rs. 200 crores would be available at the end of 1941; he considered that the most obvious use to which this large sum could be put was the repatriation of the non-terminable portion of India's sterling debt.

The non-terminable debt consisted of the 2 ½ per cent Stock 1926, the 3 per cent Stock 1948 or after and the 3 ½ per cent Stock 1931 or after, the face value and the market value of the outstanding portions of these loans aggregating £161 million (Rs. 215 crores) and £148 million (Rs.197 crores), respectively. There was, however, no information as to how much of this was held by residents in the U.K. and in India. The India Office estimated that the liability for repatriation of all these loans could be taken to be roughly Rs. 175 crores of which Rs. 85 crores could be held to consist of the 2 ½ per cent and 3 per cent Stocks. Although Sir James had put the total figure lower, at around Rs. 150 crores, he was not averse to accepting the India Office's estimate.

As the 3 ½ per cent Stock stood very nearly at par, the Governor felt that the British Treasury would be unwilling to acquire it compulsorily and would expect the Indian Government to redeem it after giving the requisite one year's notice. The loan could of course be called in during the notice period but Sir James was not very hopeful of such action being taken by the British Government. On the other hand, on notice of repayment being given for the 3 ½ per cent Stock, the prices of the 2 ½ per cent and 3 per cent Stocks would rise materially in view of a possible requisitioning or redemption sooner or later. If therefore any action was taken in regard to the 3 ½ per cent Loan, the Governor considered it desirable that the British Government should be asked to simultaneously exercise their requisitioning powers in respect of the other two loans. This meant a very large scale operation, as it would result in the clearing off of practically the whole of the external sterling debt. Balancing all the advantages and disadvantages of a combined operation, Sir James personally preferred that the 2 ½ per cent and 3 per cent Stocks should be requisitioned first and the 3 ½ per cent Stock left over till some time later. In this context, the Governor recommended also that the Bank's gold should be revalued so as to release equivalent sterling for the repatriation operation.

The Governor also considered other possible alternatives to repatriation of the sterling debt. In his opinion, one course was to lend sterling, free of interest, to the British Government up to £100 million, to be repaid within a year or so after the war. Another (which actually came from the Finance Member) was to request the British Government to take over the non-terminable liabilities and pay them off as and when it suited them, since compulsory acquisition of the non-terminable loans, which Government were free to redeem on a year's notice, might be the subject of still more unfavourable criticism in London business circles than in the case of the terminable stocks. Besides avoiding such criticism, the proposal had the theoretical justification that the liability in respect of India's sterling loans would be shared to a certain extent by the British Government, a position which was recognised by the India Office as early as January 1930.

While the first proposal appears to have been dropped at the Government of India's level, the second expedient, which was put to the Bank of England by Sir James Taylor himself (and later to India Office by Government), was found unacceptable 'partly because it would be most embarrassing to us as regards vesting by other Dominions and partly because of technical objections'.

The Government of India requested India Office early in April 1941 to sound the British Treasury as to whether it would be prepared to requisition the 2 ½ per cent and 3 per cent Stocks immediately as the prices of these loans were already rising. India Office did not consider the rate of accretion of sterling to the Reserve Bank such as to demand urgent action. The Treasury was consulted leisurely and a reply came only at the end of June 1941 that the proposals were unacceptable. It was considered dangerous to proceed on the assumption that the forecasts of sterling accruals would prove correct. The view was that there would not be any 'huge accumulations of surplus sterling'! The standard, the Secretary of State emphasised, should rather be a normal holding of at least 50 per cent in gold and sterling in the Issue Department, and in addition, 'a further appreciable margin of sterling in one Department or other' which would meet the requirements of large imports of essential raw materials, etc., when conditions permitted. The Secretary of State was also opposed to the use, for repatriation, of sterling released by the revaluation of gold; the position would be very different, he added, if the proposition was to release gold in excess of Rs. 44.4 crores at the new valuation and sell it for dollars, in which case, the resultant sterling accumulation would fully qualify for treatment as' surplus sterling' in connection with repatriation proposals!

Sir James Taylor found the Secretary of State's reply not unencouraging . In the interests of facilitating a speedy decision, he was

agreeable to adopting the formula prescribed by the Secretary of State for calculating the 'surplus' sterling available. He thought, however, that Government should seize this opportunity to return to the attack in regard to the Silver Redemption Reserve. 'Even if it is not to be abolished -for reasons which are far from convincing -there is no reason why the 10 crores which are locked up in a purposeless investment should not be regarded as part of the margin to be maintained'. As for the sequence of the operations, he stuck to his earlier view that the Stocks to be dealt with first should be those carrying the coupon rates of 2 ½ per cent and 3 per cent.

By the end of September 1941, the sterling assets of the Bank (in both the Banking and the Issue Departments) had risen to Rs. 200 crores. Rumours both in the U.K. and in India that a big programme of repatriation was again likely to be under way shortly had set the prices of the India sterling stocks rising. The Government of India continued to press the India Office to take up the matter with the Treasury early, but as usual, the Secretary of State desired to have a large amount of data in regard to the financing of the first scheme of compulsory repatriation before proceeding further. Both the Governor and the Government of India had to take pains to convince him that the prevailing opportunity for repatriation of India's sterling debt was too good to be missed.

The British Treasury's views were conveyed to the Government of India late in November 1941. The Treasury was unwilling to apply its requisitioning powers to the 2 ½ per cent and 3 per cent Stocks while there was outstanding and quoting near par the 3 ½ per cent Stock, which could be called for redemption in the normal way. The alternatives were, therefore, either to give the year's notice of redemption of the 3 ½ per cent Stock or wait till all the three could be tackled simultaneously. The Secretary of State personally preferred the latter alternative.

The Reserve Bank as well as the Government of India agreed that a combined operation was the best arrangement and considered that the Bank's existing sterling assets together with the outstanding forward market purchases were adequate to cover the repatriation requirements. The Government of India therefore urged the Secretary of State in the strongest possible terms to persuade the Treasury to agree to implementing the combined operation immediately. They cabled as follows on November 26, 1941:

> Opinion in India including Press is becoming increasingly critical of delay in effecting further stage of repatriation while prices continue to rise. In recent Assembly session resolution was passed that in any future scheme of repatriation care should be taken to see that cost was not unduly heavy. Debate was not without acrimony and charges were

> levelled that we were acting more in interests of foreign investor than of Indian tax naver. With a view to minimising ill effects of debate Resolution was accepted by Government in modified form omitting insinuation that last repatriation was unnecessarily expensive. Any material delay in respect of undated loans will put us in extremely embarrassing position. There is distinct possibility of Congress attending Budget session when fresh and still more virulent debate on repatriation must be expected. We regard it as most important that this should be avoided by fait accompli before beginning of session . . . . .
> In next Budget we shall have again to emphasise necessity of raising large rupee loans, main popular argument for which is repatriation, as means of financing war supply. If repatriation incomplete or capable of being represented as not having been carried out in manner reasonably favourable to India loan propaganda will suffer.

The Secretary of State's reply intimating the Treasury's agreement in principle to a combined operation was received about three weeks later. On December 23, 1941, the Treasury issued a vesting order, asking residents to surrender to it their holdings of the 2 ½ per cent and 3 per cent Stocks at prices (market quotations of the day plus interest) notified in the order. On December 24, an order was issued by the Government of India transferring to themselves the holdings of these Stocks by residents in India at prices equivalent to those in the U.K. order converted into rupees at 1S. 6d. At the same time, notice was given by the Secretary of State for the repayment of the 3 ½ per cent Stock on January 5, 1943. In the case of these operations no option was given for taking out counterparts as on account of the war situation in the East, Indian security prices were depressed as compared to the prices in the U.K. and it was thought that the response to any offer to give counterparts would be poor. It was arranged that the rupee finance would be provided by the issue of ad hoc Treasury bills to the Reserve Bank.

The operations were welcomed by both financial and political circles in India. In regard to this combined operation also, the Bank's Central Board was not consulted formally.

In terms of the second compulsory scheme, debt of the face value of £73.85 million was repatriated by the end of March 1942; the purchase value was £65.78 million or Rs. 87.71 crores. Sterling debt repatriated through open market purchases and the first compulsory scheme aggregated £25.19 million during 1941-42; in this connection, rupee counterparts for Rs. 33.58 crores were created.

In 1942-43, the repatriation operations covered the 3 ½ per cent Stock 1931 or after, the Railway Debenture Stocks and the Railway Annuities. The 3 ½ per cent Stock fell due for repayment on January 5, 1943. During the period from that date up to March 31, 1943, the total amount redeemed was £56.21 million including £2.37

million held in India. To finance this repayment operation, the Government created ad hoc Treasury bills for Rs. 72.2 crores in favour of the Issue Department of the Reserve Bank; the remaining amount was met from Government balances. Rupee counterparts of the face value of Rs. 67.63 crores were created in the form of extensions of the existing undated 3 ½ per cent Rupee Paper and were taken to the Government's Cash Balance Investment Account for gradual issue to the market through the Reserve Bank, as usual.

Funding of Railway Annuities

With the near completion of the repatriation of the sterling loans, dated and undated, the stage was set for the funding of the Railway Annuities and the requisitioning of the Railway Debenture Stocks. Action in these directions was accelerated by the keenness with which the Central Board of the Reserve Bank pursued the problem.

The total payments to be made under the Railway Annuities until their termination were estimated at £34.1 million. In September 1942 an arrangement was entered into by the Government of India with the British Government whereby for a payment of about £30 million by the Government of India, the British Government undertook to provide the annual sums required for payment to the annuitants until the termination of the Annuities. The arrangement was calculated to give the Government of India a return of about 2 ¼ per cent on their investment. The procedure was for the Indian Government to continue to pay the annuitants until maturity but the British Government were to find the finance for each instalment as and when it fell due, thus relieving India of any further payments on this account. Finance for this operation was provided in the first instance by ad Rot Treasury bills for Rs. 30 crores taken up in the Issue Department, the balance of Rs.10 crores being met by a ways and means advance. Rs. 15 crores of the ad hoc bills were subsequently cancelled from the proceeds of the 3 per cent Loan 1963-65, a special issue of which was made in October that year for the purpose.

Meanwhile, arrangements were in train for the requisitioning of Railway Debenture Stocks; as a matter of fact, from April 1942 onwards purchases of the Debenture Stocks were being made in the market as and when available. On January 15, 1943, the British Treasury issued a vesting order, requiring all residents of the U.K. to surrender to it their holdings of nine specified Railway Debenture Stocks, at prices fixed on the basis of the market quotations as on that date plus an allowance, by way of interest, for the delay in examining the documents surrendered for repayment. A similar order was issued by the Government of India the following day. The total nominal value

of the Debenture Stocks covered by these vesting orders was £20.2 million. At the same time, the requisite one year's notice was given for the redemption of the remaining three 3 ½ per cent Railway Debenture Stocks of which £11.2 million (nominal) was outstanding. The total face value of the Stocks acquired till the end of the financial year 1942-43 was £18.58 million, the rupee cost or purchase price being Rs. 24.51 crores. About half the rupee finance was found by the issue of ad hoc Treasury bills to the Reserve Bank, Rs. 5 crores by the issue of rupee coin to the Bank under Section 36 (2)* of the Reserve Bank of India Act, and the rest from Government balances.

Thus, in 1942-43, the repatriation was the largest, aggregating £119 million (purchase value Rs. 162 crores), inclusive of the open market purchases and the amounts surrendered under the earlier schemes.

During the year 1943-44, the various schemes of repatriation were nearly completed. The 3 ½ per cent Railway Debenture Stocks were redeemed on February 4, 1944 on the expiry of the notice period, the total amount paid being £8.9 million. Government also arranged to liquidate the Chatfield debt † of £8 .5 million arising from the pre-war scheme of modernisation of the Indian Army.

With the virtual completion of the several schemes of repatriation by 1943-44, the debt repaid during the next two years related merely to repayment of repatriated stocks not surrendered earlier. Stray lots amounting to £0 .41 million and £0.28 million (face value), respectively, were repatriated during the two years.

The stocks of railways owned and managed by private companies were also gradually acquired by the Government of India. The total cost of purchase of the various railways acquired during the war amounted to £30.7 million (Rs. 41 crores).

The amounts of sterling debt repatriated annually under the various schemes commencing from 1937-38 are given in the following table. It will be seen that out of a total debt of £323 million repatriated till the end of March 1946, about £53 million was accounted for by open market purchases. Against the repatriation cost totalling the equivalent of Rs.429 crores, Rs. 274 crores of rupee counterparts were initially created; of these, securities for about Rs. 50 crores were

* In terms of Section 36(2), the Government were to issue rupee coin to the Bank against payment if the Bank's holdings of such coin in the Issue Department fell below a prescribed figure.

† The Expert Committee on the Defence of India appointed in September 1938, with Lord Chatfield (Admiral of the Fleet) as Chairman, to make proposals for the reorganisation, expansion and modernisation of the Indian Army, submitted its report in January 1939. It postulated the acceptance by the Government of India of joint responsibility with the British Government for the external defence of India. The pre-war capital cost of implementation of the Chatfield Plan was estimated to be about £34 million, India's share being one-fourth of this amount.

REPATRIATION OF STERLING DEBT -FINANCIAL YEARS 1937-38 THROUGH 1945-46

	Face Value (£ million)	*Purchase value*		*Rupee Counter parts created (Rs. crores)*
		£ million	*Rs. crores*	
1937-38				
Open Market Purchases	2.99	3.04	4.05	1.12
1938-39	___	___	___	___
1939-40				
Open Market Purchases	17.09	16.34	22.05	22.79
1940-41				
Open Market Purchases	9.22	8.52	11.36	12.10
Licence Scheme of February 22, 1940	2.02	2.02	2.69	2.69
1st Compulsory Scheme of February 8, 1941	60.05	64.70	86.27	80.07
Total for the year	**71.29**	**75.24**	**100.32**	**94.86**
1941-42				
Open Market Purchases	12.11	12.36	16.48	16.14
1st Compulsory Scheme of February 8, 1941	13.08	14.14	18.85	17.44
2nd Compulsory Scheme of December 24,1941	73.85	65.78	87.71	___
Total for the year	**99.04**	**92.28**	**123.04**	**33.58**
1942-43				
Open Market Purchases	10.48	10.40	14.00	11.40
1st Compulsory Scheme of February 8, 1941	1.45	1.13	2.02	1.29
2nd Compulsory Scheme of December 24, 1941	5.22	4.31	6.12	2.30
Redemption of 3½ per cent sterling Stock 1931 or after	56.21	56.21	74.95	67.63*
Railway Debentures	18.58	18.38	24.51	___
Funding of Railway Annuities	27.06	30.05	40.07	___
Total for the year	**119.00**	**120.48**	**161.67**	**82.62**
1943-44				
Open Market Purchases	1.60	1.63	2.17	___
1st Compulsory Scheme of February 8, 1941	0.16	0.16	0.22	0.04
2nd Compulsory Scheme of December 24, 1941	0.32	0.28	0.37	30.38†
Redemption of 3½ per cent sterling Stock 1931 or after	0.71	0.71	0.94	8.00
Railway Debentures	1.33	1.29	1.72	___
Redemption of 3½ per cent Debenture Stocks of E.I., G.I.P. and B.B. & C.I. Railways	8.90	8.90	11.87	___
Total for the year	**13.02**	**12.97**	**17.29**	**38.42**

(Continued)

	Face Value (£ million)	Purchase value £ million	Purchase value Rs. crores	Rupee Counter parts created (Rs. crores)
1944-45				
1st Compulsory Scheme of February 8, 1941	0.09	0.09	0.12	0.02
2nd Compulsory Scheme of December 24, 1941	0.25	0.21	0.28	0.15
Redemption of 3½ per cent sterling Stock 1931 or after	0.03	0.03	0.04	__
Railway Debentures	0.04	0.04	0.05	__
Total for the year	**0.41**	**0.37**	**0.49**	**0.17**
1945-46				
1st Compulsory Scheme of February 8, 1941	0.15	0.16	0.21	0.01
2nd Compulsory Scheme of December 24, 1941	0.06	0.06	0.07	__
Redemption of 3½ per cent sterling Stock 1931 or after	0.06	0.06	0.08	__
Railway Debentures	0.01	0.01	0.01	__
Total for the year	**0.28**	**0.29**	**0.37**	**0.01**
Grand Total	**323.12**	**321.21**	**429.28**	**273.57**
Of which open Market Purchases	53.49	52.49	70.11	63.55

* Created against cancellation of £56.72 million of 3 ½ per cent sterling Stock 1931 or after.
†Includes counterparts for Rs. 30 crores created against cancellation of £26.25 million of 3 per cent sterling Stock 1948 or after during the period March 2 to June 16, 1942.

cancelled later, mostly in the year 1941-42. As at the end of March 1946, the total sterling debt of the Government of India was the equivalent of Rs. 38 crores only, as compared with Rs. 469 crores at the end of March 1939.

Funding of Pensionary Liabilities

One other direction in which the sterling balances could have been fruitfully employed but were not, owing partly to the inordinate administrative delays caused by the attitude of the India Office to view every suggestion that came from India with suspicion, was the funding of the pensionary, provident fund and other similar liabilities of the Government of India, expressed in sterling. Realising that this was a means of utilising a substantial sum of sterling, the Finance Member-this time the initiative came from him-raised the subject with the Governor in April 1942, by which time arrangements for repatriation of both the dated and undated India sterling stock had

been made. In the nature of things, the aggregate liability in respect of these items could not be quantified with any degree of accuracy, there being a number of imponderables. However, even if the liability was ascertainable on the most general terms, Sir James Taylor felt that it was desirable to fund it as it would absorb some of the sterling and secure a higher rate of interest than what the Bank would otherwise earn.

Several alternative methods of providing for the liability suggested themselves. The Government of India or the Reserve Bank could invest the required amount of sterling in suitable long-dated British Government securities (such investment by the Reserve Bank needed an amendment to the Act) or a once-and-for-all payment could be made to the British Government, who would make the necessary sterling available to the Government of India as and when required to meet the pension claims falling due. Sir James Taylor preferred the latter method, the arrangement taking the form of a loan by the Government of India to the Government of the U.K. He envisaged that the U.K. Government would constitute a fund with the amount and credit interest to it at an agreed rate. That fund would be calculated actuarially so as to give as accurate an estimate as possible of the amount which would be required at this rate of interest to amortise both the sterling pensions and repayment of the sterling portions of the provident funds. If at any time the relations between the two countries were politically determined, the fund would be made over to the British Government in exchange for a guarantee by them that they would take over the corresponding liabilities. The amount of the fund was to be revised actuarially every five years and the necessary adjustments made by payments by or refunds to the Government of India according as the valuation revealed that the fund was in deficit or had a surplus. In case the British Government were unwilling to finance the scheme directly in this manner, the Governor also thought that the Government of India would have to set aside a certain amount of sterling to be invested in longer dated British Government securities so as to form a nest-egg for such a fund. Assuming on a rough and ready basis of calculation that £75 million would be required for the operation, Sir James told Government in July 1942 that he would be prepared to provide them with the amount immediately.

The Finance Member discussed the proposals with India Office during his visit to the U.K. in August 1942. It was, however, not until the end of October that the Secretary of State sent a reply to say that the broad outlines of the scheme had to ‘go the rounds of about five other Departments here’ and that in the light of their comments, a revised scheme was prepared and was then ‘ undergoing

what I hope will be a final and expeditious circulation to the interested Departments'!

India Office was, however, in no hurry to discuss the matter with the Treasury. The proposals got bogged down in a lengthy triangular correspondence between New Delhi, London and Bombay, over various objections raised by India Office. The latter got Sir Sidney Turner, its Accountant General, to make a rough evaluation of the financial aspects of the scheme and arrived at a capital payment estimate of £150 million. Although this was considered by the Government of India to be a somewhat generous estimate, they had no mind to dispute it, particularly as the Reserve Bank saw no difficulty in releasing this amount by about the end of March 1943. The scheme contemplated an annual payment by the British Government of £6 million for 25 years tapering off gradually over the next 50 years, in return for a single capital payment by the Indian Government; the legal liability for the pensions was to continue to be that of the Indian Government.

The matter was mentioned in the Reserve Bank Board meeting of October 24, 1942. As Sir C. D. Deshmukh reported later, it ' failed to receive enthusiastic support, possibly as a result of a lack of a clear understanding of its implication'.* It would appear that the Government of India were keen to ensure that India Office recognised that the proposal was essentially theirs and not the Reserve Bank's ; for they made it clear to India Office that the suggestion for funding was discussed by the Bank Board 'purely informally and unofficially ' and that ' although general sense of meeting was clear, Board cannot be regarded as officially committed to recommendation since no resolution was passed or record of discussion entered in proceedings'.

The Government of India, relying on the Bank's expectations of the accruals of sterling, were keen to make the capital payment on April 1, 1943 and to have the Treasury's annuity payments commence on October 1 of the same year. One of the points raised by India Office was whether the Reserve Bank would be able to provide by the end of March 1943 the entire sterling required for the operation in one lump sum and still maintain its external reserves against note issue at 50 per cent plus a 'safe' margin of Rs. 12 crores. In fact, the Secretary of State propounded a new principle, viz., that as the note issue grew larger and larger in the war conditions then prevailing, each new increase should, in effect, have an increasingly higher proportional backing in the shape of external assets. The 40 per cent minimum fixed under the Act, he went on, had not at any time been thought of as the normal proportion to work to; the 50 per cent figure which had been generally accepted since the foundation of the Bank as a more appropriate ratio had been further modified in 1941 by

* Central Banking in India -A Retrospect.

the addition of a 'further appreciable margin' of sterling in one Department or the other.

Sir James Taylor had not been very enthusiastic even about the maintenance of the '50 per cent ratio plus a safe margin'. Hence he had based his calculations for the pensions funding scheme on the 40 per cent cover; in any case, he felt that the position would be speedily rectified by the continuing sterling accretions. He had, however, no objection to playing it safe, if the Secretary of State so wished, and accepting his proposal that two-thirds of the capital payment might be made immediately and the balance later, after three months or so.

In a letter which Deputy Governor Deshmukh wrote to the Finance Department on January 14, 1943, the Bank's objections to the Secretary of State's views on the need for a high sterling cover were stated elaborately, and as it appears in retrospect so validly, thus:

> It is necessary to remind ourselves that whereas in 1934 when the rupee was statutorily linked to the sterling the latter was a dominating currency in international money markets and India was a debtor to Britain to a very large extent, today sterling is not in its old pre-eminent position and a reversal has already occurred of the debtor-creditor relationship between Britain and India, with the prospect of the process continuing at least as long as the war lasts.
>
> We believe that at the back of the public criticism of India's growing sterling accretions and the concern expressed at their steady increase is the realization, whether it is expressed or implicit, that the international status of sterling is no longer what it used to be. It is this feeling that has obviously inspired the many non-official suggestions that in order to safeguard the solvency of its external assets India should endeavour to hold a larger proportion in either gold or dollars. Even from the historical point of view it is not so certain that theoretical opinion was unanimous that the principle of a percentage backing was suitable in all circumstances. There was the alternative theory that any such percentage should be subject to an overriding quantum limit in order that the size of the assets held in external currency should have some relation to the possible requirements of the country of that currency for correcting any temporary maladjustments. It could be argued, in other words, that some maximum limit, say, of £250 million, should be fixed for that proportion of external assets which is to be held in the form of sterling.
>
> Looking at the matter from another point of view, it will be easy to establish that the main demand on our sterling in the past has been for meeting the Home Charges on debt, pensionary and other establishment costs, and that neither the Currency Department nor its successor, Reserve Bank, has been called upon to sell exchange to anything like the same extent to make up shortages on private account. If that is so, then obviously with the almost spectacular diminution in the Home Charges that has taken place and is in progress the country need hold proportionately very much less sterling as part of its external assets against its foreign liabilities.

> As regards the nature of India's future foreign trade, it is not so certain either that in the post-war years it will run through channels requiring a large draught on its resources either in sterling or any other external assets. Very likely its internal trade will expand in the direction of making the country more and more self-contained, with the result that its requirements of external assets for the purposes of financing its foreign trade might not be on the scale which we were accustomed to see in the past. Thus from the point of view of the country's probable future trade needs it could be argued that there was no case for increasing our present statutory requirements, but rather for lowering them.
>
> In spite of the virtual extinction of Home Charges that has already occurred or is imminent, we have, however, no intention of raising the question of the reduction of the statutory percentage under present circumstances. With the way sterling is accruing as part of the war effort, it does not appear to be a practical issue. If, however, the theoretical question is raised of the desirability of our holding a larger percentage, we feel that we should set out the arguments to the contrary, particularly if our acquiescence was likely to be an impediment in finding sterling for any further funding operations that are regarded as otherwise fair and practicable.

The Bank's views were conveyed by the Government of India to the Secretary of State.

Another point raised by India Office was the question of the rate of interest to be applied for calculation of the capital payment. Since the Railway Annuities transaction had been effected at 2 ¼ per cent, it considered that it should be possible to arrange for 'something better' in this case, and sought the Government of India's agreement to negotiate with the Treasury (whose rigid attitude on the issue was well-known) for a rate not less than 2 ½ per cent. Both the Bank and the Government of India felt that there was a 'very good' case for 3 per cent, but not wishing to haggle, Government agreed to an 'absolute minimum of 2%'.

However, the U.K. Treasury made it known to the Secretary of State in February that while it was by no means unsympathetic, it would be averse to bringing the scheme into actual operation till several months later, possibly not before the next autumn, as it would otherwise come too closely on the heels of the disbursements for the 3 ½ per cent undated Stock and the vesting of the Railway Debentures. The Secretary of State tried to mollify the Government of India by suggesting that the delay would enable them 'to take credit twice over for scheme first by announcement in budget speech that it has been recommended to H.M.G. and later by announcing its inception'!

Further time was lost in the Finance Member's getting the Executive Council to agree to the scheme, as the Council linked the proposal with the one to set up a Development and Reconstruction Fund for post-war developmental purposes. Hopeful of getting the British Treasury's

agreement in principle to the scheme -the Secretary of State was already in informal consultation with the Treasury and its response was not unencouraging -the Finance Member mentioned it in his budget speech of February 1943; the idea met, however, with 'a somewhat cold reception'. In June 1943, after the approval of the Executive Council had been obtained to the broad outline of the scheme, the Secretary of State was authorised to put the proposals officially to the Treasury and to urge it to submit the scheme as early as possible to the Chancellor of the Exchequer for approval. The Secretary of State accordingly made a firm offer to the Treasury on the basis of interest at 3 per cent, the capital sum being payable on October 1, 1943 and the instalments commencing on April 1, 1944.

The postponement proposed in the date of capital payment disturbed Mr. Deshmukh (who had then assumed the Governor's powers) considerably. For one thing, there was already a lot of uninformed criticism in the country. The Indian commercial community opposed the scheme on the ground that it was less urgent than the acquisition of British investments. Even the amount of payment involved was being incorrectly reported in the press as being of the order of £240 million. For another, early implementation of the scheme would have helped the loan propaganda and also justified raising larger amounts by way of Treasury bills. It would also have been a great advantage to the Reserve Bank itself as it would have made possible an announcement at the annual general meeting that a further large lot of sterling had been put to good use. The Directors were beginning to express serious concern over the apparent inactivity of Government in the matter of considering their February 1943 resolution for valorisation of the sterling balances. There was, however, little that either Mr. Deshmukh or the Government of India could do.

The delay that had ensued between the Treasury's first unofficial acceptance of the scheme in principle in February and the time when the India Office could put the proposals to it officially after the Viceroy's Executive Council had given its approval had, in fact, hardened the attitude of the Treasury. The scheme was shelved indefinitely in February 1944 on the consideration that the proposals raised 'fundamental problems affecting not only India's balances but also the sterling obligations of the U.K. to other countries arising from the war'. It was only in July 1948, as part of the comprehensive agreement with the U.K. on the utilisation of the sterling balances, that the matter was finally solved through payment of £168 million for the purchase of annuities in respect of pensions payable to British nationals by the Government of India and the Provincial Governments,

Although what had been accomplished so far in the matter of debt repatriation made an impressive showing, the sterling used for

repatriation represented only about one-fourth of the sterling receipts of Rs. 1,649 crores from His Majesty's Government from September 1939 to March 1946. There were, besides, substantial sterling purchases by the Bank in excess of the other commitments. Thus, the sterling balances of the Reserve Bank, which stood at the equivalent of Rs. 70 crores on the eve of the war, had risen to Rs. 1,724 crores at the end of March 1946. So, the problem of sterling utilisation was still there!

The repatriation operations were summed up by the Finance Member in his speech on the budget for the year 1943-44, as follows:

> And thus India has completed the transition from a debtor to a creditor country and extinguished within the brief space of about three years accumulations over decades of its public indebtedness to the United Kingdom. Apart from the immediate exchange gain of a substantial relief from the necessity of finding sterling annually for the payment of interest charges, a great deal could be said on the implications of this remarkable change in India's status. To deal adequately with that theme and to attempt to prognosticate the role which India is destined to play in the post-war world, would carry me far beyond the limits of a budget speech.