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The Bank And The Partition

The partition of India into the new Dominions of India and Pakistan, in 1947, posed several delicate problems. The Bank was an adviser to a departmental committee set up by the Interim Government to reach agreement on several issues relating to currency and coinage arrangements, management of exchange and public debt, transfer of the Bank's staff and property, and division of the Bank's profits, assets and liabilities. The Bank endeavoured to fulfil this role efficiently and impartially. Under the arrangements agreed upon, the Bank was to be the currency authority in Pakistan and banker to the Central and Provincial Governments in Pakistan till the end of September 1948. It was also required to manage Pakistan's exchange control and public debt till the end of March 1948.

The Bank was confronted with some unusually difficult problems during the period when it was the common central bank for the two Dominions. Despite its best efforts at impartiality, the Bank incurred the displeasure of the Pakistan authorities who complained that the attitude adopted by the Bank was 'not in keeping with its duty as the banker of the Pakistan Government and its currency authority'. The result was that the Bank ceased to function as the central bank for Pakistan three months earlier than the scheduled date, i.e., as from July 1, 1948. The biggest hurdle was the division of the assets and liabilities of the Bank, and even to this day some differences on this issue have remained unresolved.

The partition and the widespread disturbances which followed it had an adverse impact, though temporarily, on banks operating in the border Provinces; the Bank rendered timely assistance to the banks to avoid damage to the banking structure. Developments in this sphere are narrated in Chapter 22.

Another development with regard to the Bank's responsibilities outside the country was that with effect from April 1, 1947, the Bank's central banking functions in Burma ceased in terms of the notice which the Burma Government gave on October1, 1946, for the termination of Part II of the India and Burma (Burma Monetary Arrangements) Order, 1937.

Consequent on attainment of Independence and the accession of the princely State of Hyderabad to the Indian Union on January 26, 1950, the Indian currency assumed legal tender character in the Hyderabad State as from that date; the Hali Sicca rupee ceased to be legal tender effective April 1, 1955.

THE PARTITION

Following the acceptance in principle of partition of the country by the major political parties in India, a special committee of the Cabinet was set up by the Interim Government 'to examine the administrative consequences of partition and to take necessary steps for the transfer of power to the two Dominions'. The Committee was replaced, from July 1, 1947, by the Partition Council, which had the Governor General as its Chairman and two representatives each of the Indian National Congress and the Muslim League as its members. The Cabinet Committee and later the Partition Council worked through a Steering Committee comprising two officers, viz., Mr. H. M. Pate1 and Mr. Mohamad Ali. Ten Expert Committees were appointed to deal with matters connected with partition; the Bank was concerned with Expert Committee No. V (i) *. The Committee was required (i) to make recommendations regarding currency and coinage arrangements for the two Governments, (ii) to formulate proposals for the division of the assets and liabilities of the Reserve Bank and the organisational consequences of partition in respect of 'its administrative machinery, (iii) to make recommendations regarding exchange control for the two States and (iv) to report on the position of the two States in regard to the membership of the International Monetary Fund and the International Bank for Reconstruction and Development.

PARTITION ARRANGEMENTS

The Committee faced no easy task. It was required within about a month's time to complete the study of the several complex problems involved and as far as possible reach agreements. The Committee was to be assisted by the Finance Department and the Reserve Bank, who

* The members were (1) Ghulam Mohammad, (2) Zahid Hussain, (3) K. G. Ambegaokar, (4) Sanjiva Row, (5) I. Qureshi, (6) M. V. Rangachari
Secretaries: H. S. Negi and AnwarAli.

were to prepare material on each term of reference, to enable it to reach decisions. The Bank proved equal to the occasion; the preparation of notes dealing with the various aspects of the problems connected with the partition of India, insofar as they concerned the Bank, had indeed been taken up in the Bank long before a formal request to that effect came from the Government. Two notes, in particular, deserve mention, viz., one dealing with currency and coinage arrangements, division of assets and liabilities and of profits of the Bank, transfer of staff and of movable and immovable property, administration of public debt, etc., prepared by Mr. N. D. Nangia, the Deputy Chief Accountant, and the other on the impact of partition on India's position in the I.M.F. and the I.B.R.D., prepared by Mr. Ram Nath, the Secretary. All notes, excepting a technical one, were signed by the departmental officers; in one of his letters the Governor explained 'this was done advisedly in order not to commit even the executive, much less, the Committee or the Board'.

Bank as an Adviser to the Committee

The Governor persuaded both the sides to agree that the Reserve Bank 'should be consulted only in an advisory and not in a partisan capacity'. He suggested also that it would be convenient if the Committee came to Bombay for consultations, so that all the executives and important Directors of the Committee of the Central Board would be available for consultations. This, however, did not suit one of the members on the Committee, and the Bank was requested to send its experts to Delhi. As the Committee was only a departmental one (with two non-official advisers on the Pakistan side), a delegation comprising the two Deputy Governors (Messrs Trevor and Mehkri) and the Secretary to the Central Board was considered sufficient.

The delegation was in Delhi from July 6 to July 12, 1947, and attended the two full meetings of the Expert Committee held on July 8 and 11. While the Expert Committee succeeded in reaching agreement on several matters, there were quite a number of issues on which the two groups of members were sharply divided; these had to be referred to the Steering Committee.

At this stage, it would be useful to indicate the role of the Bank's Central Board in the consideration of the various matters relating to the partition arrangements. As regards placing matters before the Board, the Governor took the view that the Board should come in only at the level of the Partition Council, i.e., it would be sufficient if a report of all that happened before the Expert Committee was made to the Board for its consideration and approval before the Expert Committee actually submitted its report. Hence, on his return from Delhi in the last week of June after discussing the preliminaries of the procedure and composition of the Expert Committee, and the role to be assigned to the Reserve Bank, the Governor included in the agenda for the July 21 meeting of the Central Board the subject ‘ Consequences of Partition ‘. The Governor also arranged to circulate a copy each of the notes forwarded to the Finance Department amongst the Directors on the Committee of the Central Board early in July, immediately after they were sent to Delhi, and to the other Directors in the second week of July. The report of the delegation on the discussions with the Expert Committee and a few notes prepared in the Bank after the delegation’s return from Delhi were also forwarded to the Directors. At the weekly meeting of the Committee of the Central Board, held just prior to the Central Board meeting, the Governor also placed a matter that had been subject to much controversy, namely expansion of currency against ad hots (this is referred to in detail in a later paragraph).

The Board, in its resolution passed at the July 21 meeting, generally approved the advice tendered to the Expert Committee, ‘as set forth in the Notes submitted to the Central Board ‘, subject to a slight modification mentioned below. The resolution stated:

> adequate legislative safeguards shall be introduced by the Government of Pakistan as well as the Government of the Union of India to provide that such overprinted Bank Notes* shall be payable on demand (1) only at the offices of the Reserve Bank of India situated in Pakistan, and not at offices of the Bank situated in the Indian Union, during the period the Bank manages the currency of Pakistan, as agents for the Government of Pakistan or otherwise, and (2) only by the Government of Pakistan thereafter.

It may not be out of place to mention here a small incident as a sidelight on the interest which the Directors took in the affairs of the Bank, and the strong view they held that the Board should be consulted before views on important matters on behalf of the Reserve Bank were expressed. One of the Directors, it appears, remarked, two days after the Central Board meeting, that is on July 23, that the question of seeking confirmation by the Board of the advice tendered by the delegation to the Expert Committee occurred to the executive only on receipt of complaints from Directors. The Governor, in a written reply, objected to this remark very strongly, and to convince the Director that his belief about the chronology of events was wrong, he presented the facts to him with dates. The Governor explained also why he thought it fit to bring in the Board only at the level of the Partition Council, and observed that the formal and final advice was to be that of the Board contained in its resolution passed

* These refer to Pakistan overprinted notes.

on July 21, 1947. While acknowledging this communication from the Governor, the Director made no reference to his earlier remark that the matter was referred to the Board only on receipt of a complaint, but stated in general terms that the Board or the Committee could not have any useful function, if views on important matters were expressed without its previous consultation and consent. According to him, this particular matter was so important and of such far reaching consequence that the Board should have been consulted before any views were expressed to the Expert Committee.

In anticipation of the possibility of the matter being raised again at the August meeting of the Board, at the Governor's instance, the Finance Department sent a telegram to the Governor on August 2, explaining that he could not have put any matter before the Committee earlier than he did, and expressing their regret that misunderstanding had been created. The Director concerned also wrote to the Governor that it was never his intention to allege that the Governor submitted the matter to the Board only on complaints but that if he had used inadvertently words which created such an impression, he was sorry for it.

Report of the Expert Committee

The Expert Committee submitted its main report on July 28 and a supplementary report on August 5. The supplementary report related to the treatment of the sterling assets held by the Bank. Though the Committee did not succeed in reaching agreement on all issues, it was creditable that it completed the discussions on all relevant matters speedily, thus simplifying considerably the Steering Committee's work. The following paragraphs deal with the more important issues concerning the Bank in respect of which the Expert Committee reached unanimous decisions.

(1) It was agreed that the existing currency and coinage would remain common to both the territories up to March 31, 1948. The subsequent six months, April-September 1948, would be a transitional period, during which only Pakistan overprinted notes would be issued in Pakistan areas but India notes already in circulation in Pakistan would continue to remain legal tender in Pakistan. The minting of Pakistan new design coins would start from March 1, 1948 or possibly earlier, and these would be issued in Pakistan from April 1, 1948 up to the extent available; any excess demand in Pakistan for coins would be met by India coins.

The Reserve Bank was to be the currency authority for both the countries during the period the currency remained common and also during the transitional period, April-September 1948. This was subject to agreement being reached on points 1 to 4, mentioned on page

544. The Committee suggested that a legal provision should be made to the effect that overprinted Pakistan notes and Pakistan coins would be received by the Reserve Bank only at its offices in Pakistan and that the Bank was not liable to receive them at its offices in India. This suggestion was in pursuance of the recommendation made by the Central Board of the Reserve Bank in its resolution passed on July 21, referred to earlier.

Agreement was also reached that from October 1, 1948, the Reserve Bank would cease to be the currency authority for Pakistan. Also, from that date, India notes would cease to be legal tender in Pakistan; however, the Pakistan currency authority and Treasuries might accept them for encashment for a further period of say three months*. The liability in respect of overprinted Pakistan notes would be taken over by the Pakistan currency authority; the Reserve Bank would have no liability in respect of these notes after September 30, 1948. These recommendations of the Committee were broadly in line with the suggestions contained in the note forwarded by the Bank.

(2) The Pakistan Government proposed to have their own separate Public Debt Office and run their exchange control from April 1, 1948. In respect of other matters like remittance facilities within each Dominion, control over banks and maintenance of Government account, it was agreed that no change was to be made so long as the Bank remained the common currency authority.

(3) The Muslim members wanted the Bank to open a branch at Dacca and the Bank agreed to do so as soon as necessary arrangements could be made regarding office accommodation and staff.

4) The Bank was agreeable to transfer all its moveable and immoveable property situated in Pakistan to the new Pakistan currency authority, at its book value, on October 1, 1948.

Regarding staff, the Bank undertook to make recruitment for the new currency authority in Pakistan. In respect of the existing staff, the Bank stated that while Muslim employees having their places of domicile in Pakistan areas would, of course, have to go over to those areas, the transfer of Muslim employees having their domicile in India and of non-Muslim staff serving in the Pakistan areas would be on a voluntary basis. Further, the Bank agreed to make available to the Pakistan Government, on deputation basis, any further staff required by them. The Bank's proposals were considered suitable by the Committee.

(5) The Committee suggested the adaptation of the Reserve Bank Act to include Pakistan territories for the period the Bank acted as a

* A different length of time was mentioned elsewhere in the report. While discussing division of assets and liabilities, the non-Muslim members recommended a six-month period for retirement of India notes, while the Muslim members considered even this inadequate.

central bank for Pakistan to enable the Bank's shareholders in Pakistan to continue as such. It was agreed that the adaptation would cease to have effect from October 1, 1948; thereafter, only residents in India would be qualified to be shareholders, those in Pakistan ceasing to exercise the rights of a shareholder, otherwise than for the purpose of sale of the shares. The shares would have to be transferred to residents in India gradually by private sales; the same procedure had been adopted in respect of Burma.

(6) It was agreed that the profits of the Bank should be shared between India and Pakistan in the ratio of Pakistan overprinted notes in circulation on September 30, 1948, plus India notes returning from circulation in Pakistan from October 1, 1948 to March 31, 1949, or any extended date agreed upon, to total notes in circulation in India and Pakistan on September 30, 1948.

(7) The Bank was of the view that a thorough system of control of exchange transactions between the two countries was extremely difficult and administratively expensive in view of the extensive land frontiers and the absence of natural boundaries. It was also considered doubtful whether the banking system would be capable of shouldering the burden. As the Muslim members desired to introduce exchange control from April 1, 1948, and considered that the customs cordon essential for this purpose could be established by that date, the Bank agreed to give assistance to Pakistan for setting up the administrative machinery in this behalf. It suggested that an officer of the Pakistan Government might be deputed to the Bank to undertake a detailed study of its methods and procedures. Also, as the Bank would be functioning in Pakistan up to September 30, 1948, it undertook to work out, in consultation with the Pakistan Government, the consequent changes to be effected and volunteered to provide the necessary administrative staff at the Bank's Karachi office, strengthened, if necessary, by transfers from other centres.

The Expert Committee was not in a position to make specific recommendations regarding allocation of foreign exchange for use in each territory up to March 31, 1948, and suggested that the two Governments should arrange for consultations and arrive at some agreement. However, it was decided that the foreign exchange allocated to Pakistan would be administered by the Reserve Bank according to the directions of the Pakistan Government till March 31, 1948. The Committee considered it desirable that both the Governments should follow a uniform policy in respect of all matters connected with foreign exchange during the transitional period up to March 31, 1948 and should co-ordinate their policies even thereafter, particularly during the period the Bank was to be the common currency authority. This was in line with the recommendation made by the Deputy Governor, Mr. Trevor, in a memorandum (dated July 15, 1947) which was forwarded to the Committee. The Deputy Governor had observed that there were strong grounds for advocating continuance of the existing system even after introduction of a separate currency for Pakistan. However, as that was not considered to be suitable, he strongly recommended that a system of exchange control should be devised which while maintaining separate controls might so dovetail their activities so as to function for the mutual advantage of both the territories.

Main Points of Disagreement

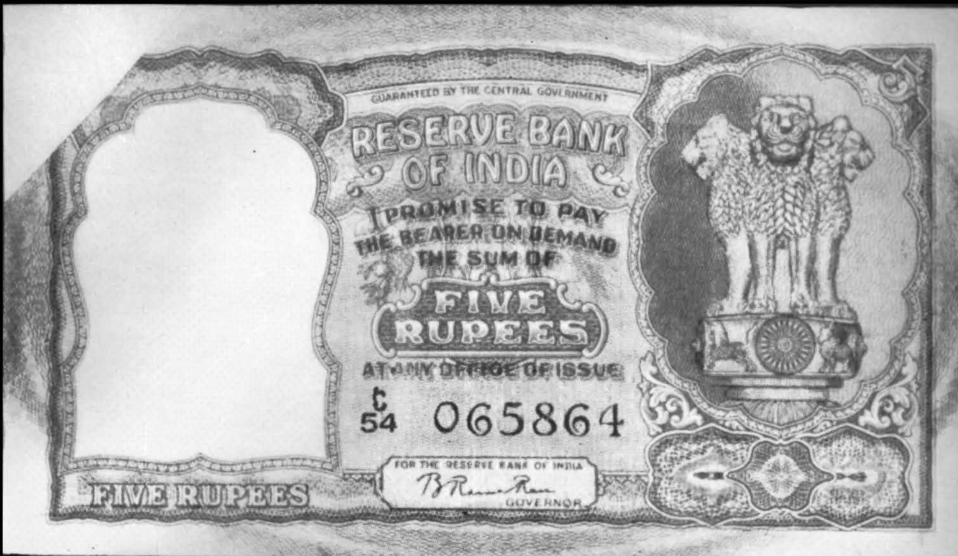
There were several issues -very vital in fact -on which the two sides had serious differences. The more important of these were:

(1) The Muslim members demanded that the Pakistan Government should appoint a Deputy Governor of the Reserve Bank. This was not acceptable to the non-Muslim members, whose argument was that Governors and Deputy Governors did not represent any Government as such and were responsible to the Central Board and that a Deputy Governor could not act on behalf of the Pakistan Government. The Bank was in complete agreement with the non-Muslim members.

(2) The Muslim members claimed that the Pakistan Government should directly nominate two out of the four nominated Directors on the Central Board, of whom one should. be a member of the Committee of the Central Board. The non-Muslims had no objection to a convention being established that the Government of India would accept the nominations of the Pakistan Government, but they did not agree to the Act being amended for the purpose.

(3) The Muslim members desired that (a) in matters concerning Pakistan, the Bank should consult the Pakistan Government, (b) in matters concerning both India and Pakistan the Bank should consult both the Governments, and (c) differences, if any, between the two Governments, should be left to be resolved through the normal diplomatic channels. The non-Muslim members agreed to (a) and (b), but in respect of (c), they wished to add that, if the, matter could not be resolved in the manner suggested, the final decision should rest with the Government of India.

(4) The Muslim members desired that a provision should be made in the Reserve Bank of India Act for expansion of currency required by Pakistan Government against that Government’s securities. This was a very important issue and needs to be dealt with at some length, especially since it was specifically referred to the Committee of the Central Board. The non-Muslim members did not agree to these proposals, but the Reserve Bank representatives did not see any


GUARANTEED BY THE CENTRAL GOVERNMENT
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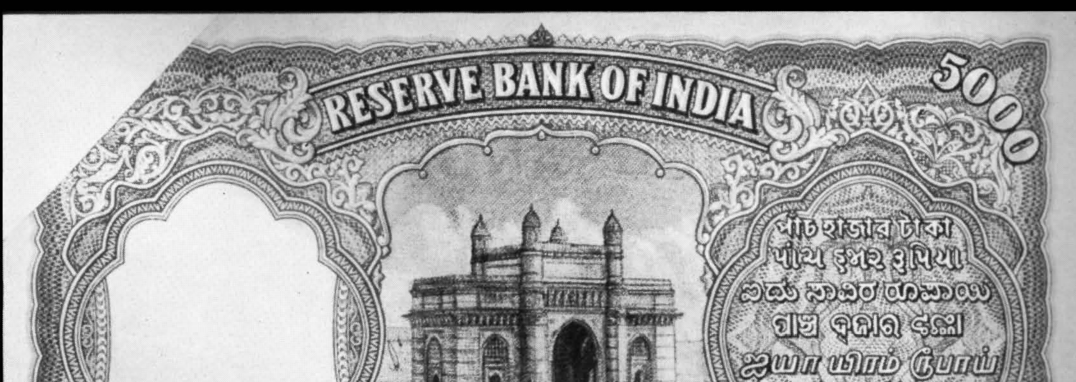
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5000
GATEWAY OF INDIA BOMBAY
RESERVE BANK OF INDIA
FIVE THOUSAND RUPEES
पांच हज़ार रुपया

Staff* housing *colony* at *Byculla, *Bombay.*

objection provided (a) a total limit was fixed for both the Dominions, and (b) Pakistan agreed that on the handing over of the assets against Pakistan note issue, such ad hots would be deducted first before proceeding to a pro rata allocation of the remaining assets. The Governor shared this view, but at the same time he considered that the matter was too important for the executive to take a decision on their own, and a brief memorandum by the Governor together with a note prepared by the Deputy Governor, Mr. Trevor, was submitted to the Committee of the Central Board, at its meeting on July 16, 1947 for its consideration.

In his note Mr. Trevor stated that though normally the Reserve Bank's temporary accommodation would take the form of ways and means advance, it might not entirely meet the requirements of the Pakistan Government. On the other hand, recourse to accommodation against ad hots should only be made as a last resort. The Deputy Governor submitted some proposals aimed at avoiding, or at any rate restricting, unnecessary expansion. These were:

> (a) As a part of the settlement, a proportion of Government's cash balance sufficient to meet the Pakistan Government's reasonable cash requirements during the period the currency of the two Dominions was jointly managed by the Reserve Bank, should be transferred to that Government;
> (b) cash requirements of the Pakistan Government not covered by the cash balance thus transferred and by their revenue receipts would be met from ways and means advances from the Bank as long as there were sufficient notes in the Banking Department of the Bank; a special rate of interest of ½ per cent would be charged on such advances; and
> (c) only when the cash balance of the Pakistan Government augmented as above was exhausted and the Reserve Bank was unable to provide finance from its Banking Department, should currency be expanded against ad hots, the issue of which would be subject to two conditions, viz., (i) limits would have to be fixed up to which ad hots would be accepted by the Bank and (ii) the Pakistan Government would have to undertake to redeem the full amount of advances or ad hots at the time of the division of assets and liabilities on September 30, 1948.

On the assumption that, as in the past few years, the Bank's holdings of rupee securities in the Issue Department would remain in the neighbourhood of Rs. 60 crores for some years, the Deputy Governor considered a limit of Rs. 20 crores for creation of ad hots by the Pakistan Government as reasonable. Though it was unlikely that India would require to expand currency against ad hots during that period, the Deputy Governor suggested a limit of Rs. 40 crores for such expansion.

The stipulation regarding the redemption of ad hots by Pakistan at the time of division of assets and liabilities, on September 30, 1948, meant that Pakistan's ways and means advances or ad hoes would be set off against the note liability taken over by Pakistan and only in respect of the balance of the note liability the other assets in the Issue Department would be shared pro rata.

The Committee of the Central Board, at its July 16, 1947 meeting, passed the following resolution:

> That Government of India be advised of the Committee's view that in order to avoid the dangers to both Dominions inherent in any unnecessary expansion of currency, the portion of the Cash Balance to be handed over to Pakistan should be sufficient to meet their normal requirements during the period of joint management of the currency and that as long as notes held in the Banking Department are sufficient for the purpose the Pakistan Government's further requirements should be met by ways and means advances at a special rate of ½ of one per cent; only when these sources are exhausted should recourse be had to expansion of currency subject to an overall limit.

The Muslim members accepted all the proposals of the Bank excepting the limit of Rs. 20 crores for issue of ad hots. They feared that such a limit would put them in a difficult situation if unforeseen developments necessitated a larger amount. Also, since the Act did not prescribe any limit, India would be free to expand currency against its ad hots, and it was unfair they argued, to impose any restriction on similar action by Pakistan. The non-Muslim members, on the other hand, considered the limit on total expansion against ad hots an essential condition, and suggested a limit of Rs. 40 crores for India and Rs.10 crores for Pakistan.

(5) The Muslim members wanted to leave it open to the Pakistan Government to entrust the administration of their currency to the Reserve Bank for a further period after September 30, 1948, on an agency basis. The Deputy Governor considered this practicable if the Act was amended but the non-Muslim members regarded such an arrangement as inappropriate.

(6) In respect of the Issue Department, the only point of agreement was that the Pakistan Government should take over from the Reserve Bank, on October 1, 1948, the liability in respect of all the Pakistan overprinted notes of the Reserve Bank issued up to that date; against this currency liability, there was to be provisional allocation of assets to the Pakistan Government on September 30, 1948, in the ratio in which the various assets were held in the Issue Department on that day. With regard to India notes in circulation in Pakistan areas, the liability for which also was required to be assumed by Pakistan, there was disagreement between the non-Muslim and Muslim members

concerning the time that should be allowed for the final allocation of the assets to be made over to Pakistan against these India notes. The non-Muslim members considered that this should be done on March 31, 1949, and should be equivalent to overprinted notes taken over by the Pakistan Government on September 30, 1948 and India notes returned from circulation in Pakistan between October 1, 1948 and March 31, 1949; the Muslim members considered that this period was not adequate and desired to have a provision leaving it open to the Pakistan Government to extend the date. The non-Muslim members argued that since the notice regarding the demonetisation of India notes would have been given on April 1, 1948, a period of one year was more than sufficient for the withdrawal of India notes. India notes coming into the hands of the Pakistan Government after March 31, 1949 could be exchanged, they observed, in the normal manner as foreign exchange. The Bank's representatives were in agreement with the non-Muslim members.

(7) It was agreed that so far as the cash balances of the Pakistan Government and the deposits of Pakistan scheduled banks were concerned, the Reserve Bank would 'discharge its obligations in cash in the normal manner'. What this 'normal manner' meant was not indicated. The non-Muslim members wanted the surplus assets of the Bank including the Reserve Fund to be shared on the basis of note ratio, after deducting from the value of such surplus assets on September 30, 1948 two items, namely, (i) sums payable in respect of the current financial year till that day to Government and the shareholders and (ii) Burma's share which had not been determined till then. The Muslim members, on the other hand, were of the view that the Reserve Fund, which had been contributed by Government, should be allocated in the same manner as the uncovered debt of the then Central Government.

(8) The non-Muslim members observed that the Dominion of India would be 'the international personality of present India', and would therefore continue to remain a member of the I.M.F. and the I.B.R.D. Consequently, Pakistan should apply for membership of these institutions; India should sponsor the membership and give all assistance to enable Pakistan to secure it. The Muslim members held that both India and Pakistan were successor Governments and both should jointly approach the institutions for membership and division of the existing quota. The non-Muslim members argued that it was for the I.M.F. and the World Bank to decide whether India continued to retain the membership and whether its quota should be reduced and that it was not for India to take the initiative.

The issue had been considered in the Bank by Mr. Ram Nath, Secretary to the Central Board. In a note submitted to the Expert

Committee, Mr. Ram Nath observed that the more appropriate course would be to ask for a separate quota for Pakistan, as gold payment in that case would be only 10 per cent of the official holdings of gold and dollars in terms of Section 3(b) (ii) of Article III of the Fund's Articles of Agreement. If, on the other hand, an increase was asked for in India's quota and the increased amount thereafter divided between the two countries, then 25 per cent of the increase in quota would have to be paid in gold in terms of the Fund's Articles, and consequently a smaller amount of gold and dollars would be available for distribution between the two territories. The note suggested a figure of $100 million for Pakistan's quota in the Fund.

Supplementary Report on Sterling Balances

The Supplementary Report on division of sterling balances submitted by the Expert Committee on August 5 was in the nature of separate memoranda embodying the views of the Muslim and the non-Muslim members of the Committee.

The Muslim members contended that sterling securities were really in the nature of loans advanced by the Government of India to the British Government to facilitate their war expenditure, and involved heavy sacrifices for the masses. In view of this, the most equitable basis for dividing sterling balances, they contended, would be with reference to the sacrifice made by the people. According to them, the average per capita income of Pakistan areas as a whole was 32 per cent lower than that of the Indian Union. Therefore, Pakistan should get, they argued, a share in the sterling balances determined on the basis of population plus 32 per cent; this worked out to 30.5 per cent of the total sterling balances. Also, in their view, it was not necessary to keep large sterling reserves in the Issue Department. They suggested that it was enough if the total of gold and sterling was kept at 40 per cent of the note issue and that the rest should be treated as an asset of the Government. However, they should not be distributed as the other assets of the Government, but should be divided on the basis suggested by them (that is, population plus 32 per cent). In the Reserve Bank's books, such sterling securities transferred should be replaced by ad hoc securities of the Government of India, and the share of India and Pakistan in those securities should be on the same basis as in respect of sterling securities. In respect of sterling in the Banking Department, they suggested that after keeping an amount equivalent to Rs. 50 to 60 crores, the rest should be treated in the same way as sterling in the Issue Department.

The views of the non-Muslim members were substantially the same as Mr. Ram Nath's. In a note which he prepared after attending the

Expert Committee meetings, Mr. Ram Nath observed that the sacrifices which resulted in the accumulation of sterling had their counterpart in the amount of notes and bank deposits held by the public in various parts of the country. The division of sterling must therefore follow the territorial location of the liabilities it was intended to safeguard. Mr. Ram Nath also pointed out that Government had no prior claim on the sterling balances. Any such claim, in his view, would correspondingly prejudice the convertible of the rupees in the hands of the public. Also, if such a course was adopted, the note pointed out, the Government would be acquiring sterling against their I.O.U .s, without being required to raise necessary funds through taxation or borrowing. Pakistan's share of sterling in the Issue Department should be entirely on the basis of the amount of notes in circulation in that Dominion. For apportionment of sterling in the Banking Department, the only practicable method, Mr. Ram Nath observed, would be 'according to the respective proportions of bank deposits in the two territories including their share of the cash balance of Government '.

Steering Committee

The Steering Committee reached conclusions expeditiously. These were approved by the Partition Council and were embodied in the Pakistan (Monetary System and Reserve Bank) Order, 1947, issued on August 14, 1947. The Order did not refer to some important matters on which agreement was reached by the Steering Committee; a few of these may be mentioned first, since agreement on these was a prior condition for the issue of the Order.

(I) It was agreed that the appointment of a Deputy Governor by the Pakistan Government would not be appropriate; there would be no objection to the appointment by the Pakistan Government of an Officer on Special Duty for maintaining contact with the Reserve Bank.

(2) The Government of India should agree to take two nominees of the Pakistan Government on the Central Board of the Reserve Bank; it was not considered necessary to amend the Reserve Bank of India Act for the purpose.

(3) The Committee recognised that it was not in the interest of both the countries to encourage unnecessary currency expansion against cad hots and considered an overall limit of Rs. 60 crores -Rs. 20 crores for Pakistan and Rs. 40 crores for India-reasonable, provided the proposals put forward by the Bank were adhered to. It was further provided that in the event of an unforeseen contingency, the Pakistan Government would have the right to ask the Government of India for a further expansion up to Rs. 10 crores if the latter agreed to it and also did not want to utilise substantially their limit of Rs. 40

crores; the limits proposed were to apply, the Committee stated, until Pakistan issued her own notes, i.e., April 1, 1948. The fixation of this date required confirmation by the Reserve Bank. The Bank did not, however, agree with this date and observed:

> As our objections to the issue of ad hots were based on financial considerations, viz., to prevent unnecessary inflation of currency in either of the Dominions, we fail to see why the Steering Committee should have interpreted our propoals to mean that the restrictions were to apply only up to the 31st March 1948 . . . . . the limits should therefore apply for so long as the Reserve Bank continues to be the Central Bank of Pakistan, and is entrusted with the management of currency of that Dominion.

Pakistan (Monetary System and Reserve Bank) Order, 1947

The main provisions of the Pakistan (Monetary System and Reserve Bank) Order, 1947, are explained below.

Banker to Government: The Bank was to continue to function as banker to the Central and Provincial Governments in Pakistan up to September 30, 1948. However, after March 31, 1948, it was not to be entrusted with the management of public debt, issue of new loans and exchange control operations.

Currency and Coinage: The Bank was to have .the sole right to issue notes in Pakistan up to September 30, 1948. While India notes were to continue to remain legal tender in Pakistan up to September 30, 1948, the Order provided for the issue by the Bank, from April 1, 1948, of notes in Pakistan, carrying the inscription ‘Government of Pakistan’ in English and Urdu. The Government of India were not liable to pay the value of any notes so inscribed; the Bank’s liability in respect of such notes was to cease on September 30, 1948.

The Order did not specify the date on which the Government of Pakistan would issue their coins, but it provided that if any Pakistan coins had been issued, the Bank was not to issue India coins in Pakistan after March 31, 1948, except to the extent that Pakistan coins were not available in sufficient quantities. India one rupee notes were not to be legal tender in Pakistan after September 30, 1948; these were to be withdrawn in order to allocate the liability between the two Governments.

Management of Foreign Exchange: Up to March 31, 1948, the Bank was to sell to or buy from any authorised person in Pakistan, on demand, foreign exchange at such rates and on such conditions as the Government of Pakistan would determine from time to time, in consultation with the Government of India.

Control of Scheduled Banks: The Government of Pakistan were empowered to declare as Pakistan scheduled banks, any bank which fulfilled certain requirements and which did not fall under the jurisdiction of the Government of India, The Reserve Bank was to have the same control over Pakistan scheduled banks as it had over scheduled banks in India; the Banking Companies (Restriction of Branches) Act, 1946, and the Banking Companies (Inspection) Ordinance, 1946, were to be applicable to the whole of Pakistan up to September 30, 1948. The Bank could call upon any Pakistan provincial co-operative bank, with which it had transactions under Section 17 of the Reserve Bank Act, to furnish weekly returns.

Adaptation of the Reserve Bank Act: The Order listed the amendments to be effected in the Reserve Bank Act to enable the Bank to carry out its functions in relation to Pakistan.

Remittance Facilities : The Bank was required to provide up to March 31, 1948 remittances at par between its offices in Pakistan and such offices in India, as might be prescribed by the Bank, in such amounts and subject only to such rate or rates of commission as might be approved by both the Governments.

Division of Bank's Profits: Since the Reserve Bank's profits mainly represented the return on assets held in its Issue Department against note issue, the formula for the allocation of profits of the Bank was based on the relative share of each in the total value of notes in circulation in the two territories. Pakistan's share in the Bank's profits was to be in the same proportion as that of the total value of overprinted Pakistan notes in circulation in Pakistan on September 30, 1948, plus the total value of India notes returned from circulation in Pakistan between October 1, 1948, and March 31, 1949, to the total value of notes in circulation in India and Pakistan on September 30, 1948. However, if a unanimous declaration was made by or on the authority of the two Governments that on or around January 1, 1949, India notes returned from circulation in Pakistan in considerable quantities, then India notes returning up to September 30, 1949 were to be taken for the purposes of this Section as well as for the purposes of division of assets of the Issue Department, referred to below.

Division of Assets of the Issue deportment: The basic principle observed in the division of the Bank's assets derived from the fact that in the case of every financial institution assets match liabilities. The transfer of assets had therefore necessarily to be balanced by a transfer of equivalent liabilities. Since the assets of the Issue Department were held against liability for note issue, the extent of assets transferred to Pakistan was equivalent to the note issue liability assumed by Pakistan. Thus, the Order provided for the transfer to the Government of Pakistan from the Issue Department of the Bank, as soon after September 30, 1948 as practicable, assets equivalent in value to the total liability in respect of Pakistan overprinted notes outstanding on that day. India notes in circulation in Pakistan on September 30, 1948 were to be accepted by the Government of Pakistan at par up to March 31, 1949, or if the two Governments considered it necessary, up to September 30, 1949, and assets from the Issue Department equivalent in value to such India notes retired were to be transferred to the Pakistan Government on demand. The Bank's holdings of Pakistan's rupee securities and advances, if any, taken by the Pakistan Government from the Bank were to be first set off against the liability for Pakistan notes and India notes returned from circulation in Pakistan and only in respect of the balance, the other assets of the Issue Department, consisting of gold, sterling securities*, India rupee coin, Pakistan rupee coin and Government of India securities, were to be transferred in the proportions in which they were held in the Issue Department on September 30, 1948. Pakistan rupee coins remaining with the Bank after the division of assets were to be made over to the Government of India for disposal otherwise than as coin.

Reserve Fund: The amount of Reserve Fund to be distributed between the two Governments was to be that which would have accrued to the Government of India in terms of Section 57† of the Reserve Bank of India Act, if the Bank were placed in liquidation in the prescribed manner. Of this amount, Pakistan's share was to be the same fraction as the fraction of the uncovered debt of the Government of India for which the Pakistan Government became liable on August 15, 1947. This was so because the Reserve Fund of Rs. 5 crores transferred to the Bank on its inception in the form of Government paper was included in the total debt of the Government of India.

Other Surplus Assets: The 'other surplus assets' of the Bank were to be divided between the two Governments in the ratio of their respective shares of assets of the Issue Department. Amount due to Pakistan was to be credited as a capital payment in reduction of the debt, if any, due by that Government to the Government of India.

Bank's Property in Pakistan : The Order required the Government of Pakistan to take over, if the Bank so desired, at book value all or any of the property held by the Bank in Pakistan for the purpose of carrying on its business.

Imperial Bank: The Imperial Bank was to act as the Reserve Bank's agents in Pakistan up to September 30, 1948.

Status of the Bank in Pakistan: The Reserve Bank Act was to 'cease to be part of the law of Pakistan', and the status of the Bank in Pakistan was to be 'that of a corporation existing only by virtue of the law of India and capable of suing and being sued as such in Pakistan'.

* The division of sterling assets in the Issue Department on the basis of note ratio was only provisional, pending the Partition Council's decision on sharing of sterling assets of the Bank.

† Section 57 provided for the distribution of the Reserve Fund and surplus assets between the Central Government and the shareholders in the proportion of 75: 25, in the event of the liquidation of the Bank.

Significant Omissions: As mentioned already, the sharing of sterling assets in the Issue Department in the ratio of note circulation, provided in the Order, was only provisional, pending decision by the Partition Council. The Order did not make any reference to the division of sterling assets of the Banking Department, as the Partition Council had to take a decision on that issue too.

Another significant omission related to the fixation of limits on holdings of Government of India securities and Pakistan Government securities in the Issue Department. The draft Order, which was discussed at a joint meeting of the representatives of the two Governments held on August 13 and 14, 1947, did contain a provision to the effect that the Government of India rupee securities in the Issue Department should not exceed by over Rs. 40 crores the amount held on August 15, 1947, while the amount held in Pakistan Government securities should not exceed Rs. 20 crores. Later, however, there were differences between the Muslim and the non-Muslim members regarding the interpretation of this clause and so this matter did not figure in the Order.

Partition Council's Decisions

The question of division of sterling assets, which had caused the biggest headache to the two parties, was at last resolved by the Partition Council on December 1, 1947. The Partition Council announced two other decisions also on the same day; these related to (i) limits on expansion of currency against ad hots after March 31, 1948 and (ii) clarification in respect of payment for I.M.F. quotas.

Sterling Assets of the Reserve Bank : In addition to the sterling which was to be transferred to Pakistan in terms of the Pakistan (Monetary System and Reserve Bank) Order, 1947, Pakistan was to be entitled to an amount of sterling calculated as under : From the total of the sterling assets in the Issue and Banking Departments as on September 30, 1948, the lump sum payable to the British Government on account of capitalisation of pensionary liability, military stores and fixed assets, as on April 1,1947, in India, etc., would be deducted. Of the balance, an amount in sterling, which taken together with the entire amount of gold held in the Issue Department would constitute 70 per cent of the liabilities of the Issue Department, was to be allocated to Pakistan in the proportion of note liability; let us say this amount was the equivalent of Rs. A crore. Of the remainder, 17 ½ per cent was to be allocated to Pakistan (let us say Rs. B crores). The difference between the total amount of sterling thus worked out (i.e., Rs. A + B crores) and the amount Pakistan was to receive as her share of the sterling assets of the Issue Department in terms of the

Pakistan Monetary Order was to be the additional sterling to be made available to Pakistan. India was to sell to Pakistan this amount of additional sterling for Indian rupees on .demand being made by Pakistan up to December 31, 1967.

The two Dominions were to negotiate separately with the British Government for releases of sterling beyond January 1, 1948. The Reserve Bank was to open a separate account or accounts with the Bank of England, and transfer to it/them from its No. 2 Account a sum equivalent to the release made by the British Government to Pakistan and also the amount fixed as Pakistan's working balance. Pakistan's exchange operations were to be conducted through those accounts.

It was also agreed that from January 1948 each Dominion would retain separately its foreign exchange earnings, foreign exchange expenditure being debited against respective earnings. There was to be no exchange control between the two Dominions up to March 31, 1948.

Expansion of Currency Against Ad Hocs: As regards expansion of currency against ad hocs, the decision reached by the Partition Council was:

> It was agreed that Pakistan would seek the Reserve Bank's view on the abolition or the stepping up of the limit for expansion of currency against Pakistan ad hots after 31-3-r 948. Pakistan would also consult the Bank about their desire that they should not be required to take ways and means advances before resorting to expansion of currency in the case of need. India would not object to any arrangement in respect of these matters that the Bank may agree to, having regard to the interests of both the Dominions.

The Council's decision thus related to the position after March 31, 1948. For the period up to March 31, it will be recalled that the Steering Committee had recommended, and the Partition Council had approved, a limit of Rs. 40 crores for India and Rs. 20 crores for Pakistan; the latter figure could be increased to Rs. 30 crores with the Government of India's consent. However, the entire clause imposing the limits was deleted from the draft Pakistan (Monetary System and Reserve Bank) Order, 1947. The position whether the Bank could expand currency against ad hocs till March 31, 1948, thus remained ambiguous.

Quota in the I.M.F.: The Partition Council's decision was in the nature of clarification of the recommendations made by the Steering Committee in August 1947†; it provided that India should give to Pakistan in gold and in U.S. dollars or other acceptable foreign

† The Steering Committee had merely stated 'when Pakistan becomes a member of International Monetary Fund and the International Bank, the Dominion of India will make available to Pakistan its ascertained share of the gold and dollar assets or equivalent value thereof in the form of dollars or any other foreign exchange acceptable to the Fund and the Bank'.

exchange, an amount equal to 17 ½ per cent of what undivided India had paid by way of subscription to the Fund and the World Bank. However, gold payment by India was not to exceed what Pakistan would actually be required to pay to the I.M.F.

Cash Balances: A few days later, an agreement was also reached in respect of distribution of cash balances. The Government of India's cash balances at the time of the partition were a little under Rs. 400 crores, inclusive of the securities held in the Cash Balance Investment Account. Of these, Pakistan's share was fixed at Rs. 75 crores; this was inclusive of Rs. 20 crores made available to Pakistan as a working balance on August 15, 1947.

FUNCTIONING OF THE BANK AS CENTRAL BANK OF PAKISTAN

The Bank set out promptly to fulfil its role as the central banking authority for Pakistan scrupulously in accordance with the provisions of the law. But before long, the Bank's relations with Pakistan turned out to be far from smooth.

Staff and Board Arrangements

The reallocation of the Bank's staff between its offices in India and Pakistan did not present any serious problem. In line with the arrangements made by the Partition Office in respect of Government employees, the Bank afforded all its employees in July 1947 an opportunity (through a questionnaire) to select the areas in which they desired to serve. The employees were given appropriate assurances regarding the continuance of their existing terms and conditions of service. The inter-Dominion transfers of staff were more or less completed by May 1948. Arrangements were also concurrently made to engage and train new staff to man the Bank's offices in Pakistan in replacement of the non-Muslim staff who were evacuated from that Dominion as also to meet the requirements of those offices for additional staff. Another measure taken to ease the acute staff position of these offices, at the special request of the Pakistan Government, was the further opportunity given in June 1948 to those of the Muslim staff who had finally opted for India to alter their option in favour of Pakistan if they wished to do so.

As regards the Central Board, according to the Partition Council's decision, the Government of India had to appoint two nominees of the Government of Pakistan to two of the four seats on the Board reserved for nominated Directors. The Pakistan Government desired that Sir

Syed Maratib Ali, a nominated Director on the Board, continue as one of their nominees; as regards their second nominee, they proposed the name of Mr. St. John Turner, an official of the Bank of England who had been brought over to assist their Finance Ministry in matters relating to banking, etc. The proposal regarding Sir Syed Maratib Ali was accepted by the Government of India. As for Mr. Turner's nomination, the Government of India's view was that on account of his being on deputation with the Pakistan Government, he was in effect an official of that Government and was therefore precluded from being nominated, by virtue of the provisions of Section 10(1) (a) of the Reserve Bank of India Act as amended by Section 1 (4) in Part III of the Pakistan (Monetary System and Reserve Bank) Order, 1947. Even if his temporary appointment with the Pakistan Government were ignored, his nomination would still infringe Section 10(1) (d) of the Act which disqualified employees or officers of any bank. The Government of India apprised the Pakistan Government of the difficulty. Later, on January 12, 1948, in the vacancy caused by the resignation of Sir Arthur Bruce, they nominated Mr. Nazir Ahmed Khan, an advocate of Lahore, as proposed by the Pakistan Government. However, as Mr. Khan continued to be a Member of the Pakistan Constituent Assembly after his nomination as Director -this fact does not appear to have been within the knowledge of the Government of India at the time of his nomination -the nomination became void on March 12, 1948, in terms of Section 11 (5) of the Act; Mr. Khan formally tendered his resignation from the Directorship with effect from March 11.

Pakistan's Request for an Advance and Transfer of Cash Balances

The Bank's functioning as banker to the Pakistan Government was smooth in the first four-and-a-half months, but in early January 1948 serious trouble arose on two very important issues raised by the Pakistan Government. The two issues were: (i) grant of accommodation to the Pakistan Government and (ii) transfer of Rs. 55 crores of cash from the Government of India's cash balances with the Bank to Pakistan Government's account. The final outcome was the earlier termination of the Bank's role as currency authority and central bank in Pakistan.

Even before the Pakistan Government approached the Bank in regard to the above matters, exchange of views had taken place between the Governor and the Government of India. Following press reports regarding the Government of India's decision not to implement the financial settlement with Pakistan, especially that regarding the cash payment, in view of the deadlock over Kashmir, the Governor sent a telegram to the Finance Secretary of the Government of India on December 24, 1947, saying that having regard to the large volume of Indian currency held in the currency chests in Pakistan area, and the temptation for that Government to draw on them for want of funds, it would be wise to start paying them the remainder of the cash balance agreed to in lots of say Rs. 3 crores a week. Governor prefaced his telegram by saying:

> While recognising decision influenced by political considerations, I feel it is my duty to draw attention to considerations of currency which may not appear clearly to Government.

Sir Purshotamdas Thakurdas, whom Governor consulted, concurred with him. The Finance Secretary's reply was that Government did not propose to release any part of the cash balance for the present and 'as regards the request by Pakistan to Reserve Bank of India for accommodation, it is obvious for Bank to decide and Government do not wish to be party to it'.

Meanwhile, the Bank received a request dated December 25, 1947 from the Pakistan Government for an advance of Rs. IO crores against ad hoc securities; the Pakistan Government hoped to repay the advance out of the cash balance of Rs. 55 crores yet to be released. The Bank offered to consider their request as one for a ways and means advance at the special rate of ½ per cent indicated by it earlier, to which the Pakistan Government agreed. Accordingly, in exercise of the discretion vested in the Executive and as an interim measure, the Bank credited the Pakistan Government's account with Rs. 5 crores. The Governor then called for certain information from the Pakistan Finance Ministry to enable the Bank to come to a decision regarding the granting of the balance of Rs. 5 crores after a reference to the Committee of the Central Board. The Governor was, however, anxious that the Pakistan Government should not misconstrue the Bank's action as treating them differently from the undivided Government of India. In his letter to the Pakistan Finance Secretary, the Governor explained that there were definite limits on ways and means advances to Provincial Governments; in respect of the Central Government, though no such limit was fixed, advances to the Central Government had not been in excess of Rs. 20 crores. The consideration influencing the Bank in granting such advances to the Central and Provincial Governments was the same, the Governor pointed out, namely, there should be a fair chance of repayment of the advance within three months. Further, while the Bank had a fair idea of the budgetary position of the Indian Government, it had no idea at all of the budgetary position of Pakistan to determine whether any accommodation to them would be a sound banking proposition.

As regards the Pakistan Government's expectation to repay the advance out of the cash balance, the Governor remarked that the payment appeared to be very uncertain in the light of pronouncements made on both sides and that unless the Bank had a firm statement from the Government of India indicating the date by which, or the rate at which, the amount would be paid to Pakistan, the Bank could not take it into account for purposes of determining accommodation to Pakistan. The Governor concluded that there was no prospect of the Bank's considering anything beyond Rs. 10 crores as the permissible limit for Pakistan. The Governor also drew the Pakistan Government's attention to the fact that in the absence of an agreement between the two countries on the amount of ad hoc treasury bills Pakistan could issue, no provision had been made in the Reserve Bank of India Act for holding such bills of the Pakistan Government in the Issue Department.

The Governor's explanation was not acceptable to the Pakistan Government; they were of the view that to restrict ways and means advance to Pakistan Government to Rs. 5 crores would be' in direct conflict with and in violation of' the undertakings given by the Bank at the time of partition. As regards the Governor's statement that ways and means advances subsequently converted into ad hoc Treasury bills would not be available for transfer to the Issue Department, Pakistan's Finance Secretary remarked:

> since these ad hocs have in any case to be set off first against the India notes returned by the Government of Pakistan at the time of the division of assets of the Bank on 1-10-1948, it is hardly necessary that the treasury bills should necessarily be transferred to the Issue Department of the Bank from its Banking Department. Even under the Act as it stands, therefore, there is nothing to prevent the Reserve Bank providing accommodation to the Government of Pakistan against its ad hoc treasury bills. In the circumstances, we cannot recognise any validity in the objection raised.

The Finance Secretary went to the length of suggesting that the Bank was departing from fair dealing at the interference of the Indian Government. To quote:

> The Pakistan Government find it difficult to believe that a responsible institution like the Reserve Bank would wish to risk its reputation for fair dealing were it not for the interference of the India Government who are determined to strangle Pakistan financially and economically. In the circumstances the straightforward course for the Reserve Bank would be to inform the Government of Pakistan that it finds itself unable to continue as its Banker and currency authority, and to effect a division of the assets of the Bank forthwith.

In a separate memorandum, the Finance Secretary demanded that the Bank should transfer Rs. 55 crores of cash balance to the account of the Pakistan Government; otherwise, the Bank should not allow the

Government of India to operate their account without the Pakistan Government's consent. 'We hereby demand that the Reserve Bank should treat both Dominions on an equal footing in this respect', the memorandum concluded.

The Governor emphatically repudiated the charge that the Bank was departing from fair dealing with Pakistan due to the 'interference' of the Government of India. Informing the Pakistan Finance Secretary that the Committee of the Central Board had decided (on January 7, 1948) to grant a further advance of Rs. 5 crores to the Pakistan Government, the Governor added that in view of the 'gravity' of the issues raised by Pakistan, he would leave the question of any further accommodation to them to be decided by the Central Board at its emergency meeting on January 14. The Governor referred to the Finance Department's telegram of August 14, 1947, asking the Bank to transfer Rs. 20 crores to Pakistan and the balance to the Indian Dominion as opening balance on the 15th, and pointed out that the Bank saw no justification for imposing an embargo on operation by the Government of India on their account with the Bank. Further, the Bank had not received any documents regarding the reported financial settlement between the two countries. The Governor, therefore, requested both the Governments to furnish him with relevant documents to enable him to consider the question.

Emergency meetings of the Central Board were convened on January 14 and 15, 1948. After the discussions, at the meeting on the 15th, Mr. Nazir Ahmed Khan proposed and Sir Syed Maratib Ali seconded resolutions providing that (i) the due share of Pakistan Government in the cash balances having been determined at Rs. 75 crores, a sum of Rs. 55 crores should be credited to the Pakistan Government account in addition to Rs 20 crores already so credited; (ii) in regard to ways and means, the Bank should abide by the decision of the Partition Council which was on the basis of advice tendered by the Bank, viz., ways and means advances would be given to Pakistan without any limit so long as notes were available in the Banking Department of the Bank; and (iii) there should be no limit in respect of expansion of currency against Pakistan Government securities after March 31, 1948, when Pakistan notes would begin to be issued and expansion would be effected through Pakistan notes.

The resolutions were put to vote and lost, the voting being nine against and two in favour, with one abstention.

Thereafter, Mr. C. R. Srinivasan proposed and Mr. Ramanathan Chettiar seconded the following resolutions:

> (1) Resolved that (i) in view of the fact that the Reserve Bank is not concerned with the allocation of cash balances between the two Governments for which it acts as Banker, that it maintains two accounts only

> one in the name of the Pakistan Government and the other in the name of Government of India, and that it can transfer funds from one account to the other only on the instructions of the Government from whose account funds are to be transferred, the Reserve Bank is unable to comply with the request of the Pakistan Government to transfer Rs. 55 crores from the Government of India without requisite authority from the latter;
>
> (ii) nor is the Reserve Bank able to accept the contention of the Pakistan Government that the Reserve Bank shall not permit the Indian Government to operate against the cash balances without the consent of the Pakistan Government in the event of such a transfer not being made.
>
> (2) Resolved that the Reserve Bank never contemplated, and is unable to accept the position that ways and means advances should be made to unlimited amount and the views of the Partition Council incorrectly put cannot bind the freedom and discretion of the Reserve Bank to take note of relevant factors in deciding the limit of such advances.
>
> (3) Resolved that expansion of currency against Pakistan ad hoc treasury bills is not permissible under the Reserve Bank Act and the Board is unable to accept the responsibility for such expansion or advise such a course, and that in regard to expansion of Pakistan Government overprinted currency against their ad hoc treasury bills and the position of the Reserve Bank under the Pakistan Monetary Order, the possibility of advancing the dates mentioned in Sections 4 and 5 of Part II of the Pakistan (Monetary System and Reserve Bank) Order, 1947, be considered in consultation with the two Governments and a report made to the Board at their next meeting.

The resolutions were carried by ten votes to two.

The Government's stand on the cash balance issue was explained by the Deputy Prime Minister, Sardar Vallabhbhai Patel at a press conference held in New Delhi on January 12, 1948. Sardar Pate1 said that soon after the informal and provisional agreement on cash balances had been reached, he had made it quite clear to the Pakistan authorities that the Government of India 'would not regard the settlement of these issues as final until agreement had been reached on all outstanding issues'. He added, 'I made it quite clear then that we would not agree to any payment until the Kashmir affair had been settled'. According to him, the Pakistani authorities did not raise any objection then. It was only on December 22, 1947, at the time of the final talks on the Kashmir issue, that the Pakistan Prime Minister objected to the treatment of the financial issues and the Kashmir question together and demanded immediate transfer of Rs. 55 crores to their account. The Government of India's reply was that they stood by the agreement but that in view of the hostile attitude of the Pakistan Government regarding Kashmir, the payment would have to be postponed in accordance with their stand throughout the negotiation.

However, Mahatma Gandhi was very unhappy about this matter. His view was that the balances must be released to Pakistan. In this connection, he even undertook a fast. In the circumstances, the Government of India reviewed the matter and on January 15, 1948 announced their decision to implement immediately the agreement in regard to cash balances, by way of 'Government's contribution, to the best of their ability, to the non-violent and noble effort made by Gandhiji, in accordance with the glorious traditions of this great country, for peace and goodwill'. Prime Minister Nehru made it clear that the decision 'does not mean any change in our unanimous view about the strength and validity of the Government's position as set out in various statements made by distinguished colleagues of mine. Nor do we accept the facts or arguments advanced in the latest statement of the Finance Minister of Pakistan'.

Loan Floatations

In September 1947, Deputy Governor Mr. Trevor received a letter from Pakistan's Joint Finance Secretary stating that the Finance Minister was considering the issue of 3 per cent bearer bonds repayable not earlier than 1977. The Joint Finance Secretary wanted to know the prospects for the issue and the earliest date by which the bonds could be issued. The Deputy Governor was very much against issue of bearer bonds in Pakistan for a number of reasons, which he listed in his letter. In his words, 'its introduction by Pakistan at this stage would be a retrograde step, against which I would strongly recommend'. Mr. Trevor also pointed out that the conditions in the money market were very unstable and that he could not offer any encouragement for the successful floatation of a loan. He suggested that the question might preferably be deferred till April next year, by which time the Bank would be in a position to tender advice regarding the terms and the nature of the loan to be issued by the Pakistan Government. Mr. Trevor also suggested that the scrips issued should be in the same form as the current loans of the Government of India, viz., Government Promissory Notes and Stock Certificates. The Bank's advice was heeded and no issue was made in 1947.

In January 1948, however, a few days after the cash balance transfer episode, the Bank was informed by Pakistan's Finance Secretary of his Government's decision to float simultaneously three loans, short, medium and long. The Bank was asked to make necessary arrangements to receive subscriptions for these at its offices and at the offices of the Imperial Bank of India in India, in addition to receiving such subscriptions at the Bank's and Imperial Bank's offices in Pakistan and at Treasuries in Pakistan. The Bank was also asked to make arrangements at its and Imperial Bank's branches in Pakistan and Treasuries in Pakistan for issue of 1½ per cent tax-free Bearer Bonds, which the

Pakistan Government proposed to issue. The Finance Secretary further enquired whether the Bank would be prepared to take over from the Government of Pakistan at current market rates, Government of India securities, which they proposed to acquire from Provincial Governments, semi-Government bodies and institutions in Pakistan, in lieu of their own securities.

After reference to the Committee of the Central Board, Mr. Trevor Wormed the Pakistan Government that

(i) the Bank would have to ascertain from the Government of India whether they were agreeable to the Pakistan Government competing with them in the Indian money market, and

(ii) the Bank would have to consider whether the purchase of Government of India securities from Pakistan would suit its investment portfolio and whether or not expansion of currency would be involved. The Government of India would also be consulted as the arrangement involved a serious inflationary potential.

Mr. Trevor considered that the conditions in the securities market were far from favourable from the point of view of a new floatation, and repeated his earlier advice that issue of loans should be deferred for another two to three months.

The idea of raising funds in India was dropped by the Pakistan Government but they went ahead with other arrangements relating to the floatation; four loans, namely, (i) 2 ¾ per cent Loan 1953-54, (ii) 3 per cent Loan 1960, (iii) 3 per cent Loan 1968, and (iv) 1½ per cent Income-Tax Free Bearer Bonds 1958, were issued in mid-February 1948. Total subscriptions received till March 31, 1948 in respect of the four issues, which were on tap, aggregated about Rs. 32 crores.

TERMINATION OF BANK'S ROLE IN PAKISTAN

The termination of the arrangements for the Bank's role as Pakistan's central bank may now be mentioned briefly. Relations between the Pakistan authorities and the Bank were strained because of the events mentioned earlier. In the circumstances, the Governor declined two invitations extended to him by the Pakistan Finance Minister to visit Karachi, and offered to depute a Deputy Governor, Mr. Trevor or Mr. Mehkri, instead. In his telegram of January 31, 1948, declining the visit to Karachi, the Governor observed:

> I am not prepared to risk lack of consideration and courtesy which wholly unwarranted accusation lead me to fear.

When the Pakistan Finance Secretary brought to the Governor's notice that the Pakistan Government deplored the attitude taken by him and took exception to it, the Governor sharply retorted:

> you could not deplore my attitude more than I deplore your Government's action in dragging Reserve Bank unnecessarily into a public controversy. The Bank has always recognised its responsibility to your Government and discharged it to the best of its ability.

The Governor had another complaint against the Pakistan Government. In a memorandum to the Committee of the Central Board prepared in some other connection, he referred to the difficulties the Bank experienced owing to the Pakistan Government's refusal to allow the Bank necessary facilities for redistributing India notes held in the currency chests in Pakistan and which were surplus, considering the requirements of that Dominion till March 31, 1948; from April 1, 1948, Pakistan overprinted notes were to be issued in Pakistan. A protest was lodged on January 14, 1948, and in early February 1948 the Governor deputed Mr. McCallum, the Manager of the Bombay Office of the Bank, to Karachi for settling the issue. The question of destruction and removal of surplus India notes from Pakistan was discussed and a phased programme of destruction, removal and cancellation of India notes was worked out, subject to confirmation by the Reserve Bank.

Following exploratory talks at New Delhi between the Governor and Mr. Zahid Hussain, High Commissioner for Pakistan in India and later the first Governor of Pakistan's central bank, the Pakistan Government sent, in February 1948, a communication to the Bank to say that it had been agreed that Pakistan should take over the responsibility for currency and banking arrangements in Pakistan, effective April 1, 1948, and that Indian currency notes in the chests located in Pakistan would be returned to the Bank before that date. The removal and destruction of notes would be so arranged as to leave, in currency chests in Pakistan, Indian currency notes equivalent to Pakistan's credit balance with the Bank. The Bank's Board, which considered the matter on February 24, 1948, had no objection to Pakistan's assuming responsibility for its currency and banking arrangements from April 1, 1948, provided the agreement between Pakistan and the Reserve Bank regarding withdrawal and/or destruction of notes in chests located in Pakistan was carried out 'both in letter and spirit', and provided appropriate amendments were made to the Pakistan (Monetary System and Reserve Bank) Order, 1947, and other relevant agreements between the Governments of India and Pakistan in consultation with the Reserve Bank.

Tripartite talks were accordingly held between the representatives of the Governments of India and Pakistan and the Reserve Bank in

Bombay between March 10 and March 13, 1948, and later continued at Delhi. During the talks, the Government of Pakistan withdrew their original proposal to terminate the Monetary Arrangements on March 31, 1948; it was agreed that the termination should be effective three months later, viz., on June 30, 1948, or three months earlier than the original date of September 30, 1948; an agreement was signed on March 31, 1948. The decisions reached were embodied in the Pakistan Monetary System and Reserve Bank (Amendment) Order, 1948, issued on the same day. The main provisions of the Order are given below.

Pakistan Monetary System and Reserve Bank (Amendment) Order, 1948

Division of Issue Department's Assets: Pakistan's share in the Issue Department assets was to be equivalent to the value of Pakistan notes outstanding on June 30, 1948, plus the total value of India notes which were legal tender in Pakistan on June 30, 1948, or in respect of which the rights of encashment in Pakistan existed on that date, and which were retired thereafter and delivered by the Government of Pakistan to the Reserve Bank till the end of June 1949.

Allocation of Sterling and Rupee Securities: The basis for the division of sterling assets laid down in the Amendment Order was, on the whole, favourable to Pakistan; her share worked out higher than what she would have got under the earlier arrangement. It will be recalled that the Pakistan (Monetary System and Reserve Bank) Order of August 1947 had provided for distribution of each item of the Issue Department's assets, including sterling, in the ratio of notes in circulation in the two Dominions. In addition to the sterling thus transferred to Pakistan, the Partition Council's decision of December 1, 1947 required India to sell to Pakistan on demand, for Indian rupees, an additional amount of sterling until December 31, 1967; this additional amount was to be worked out according to a formula laid down by the Council (see page 553). The relevant provisions in the Amendment Order differed from the arrangement described earlier in two important respects, viz.,

(i) The sterling assets of the Issue Department were to be distributed in the proportion of note issue only after certain deductions were made there from, and

(ii) Pakistan was to be paid wholly in sterling in respect of cash balances of the Central and Provincial Governments of Pakistan with the Bank to the extent Pakistan currency in the Banking Department was inadequate. Any amount that banks in Pakistan might require the Reserve Bank to transfer out of their deposits with the Bank to the Government of Pakistan was also to be paid in sterling, if the transfer was made after June 30, 1948.

While Pakistan was thus to receive sterling in full, subject to minor adjustments, for its cash balances and deposits of banks in Pakistan with the Reserve Bank, India was compensated by providing that her No.1 Account with the Bank of England* was to be kept intact and was not to be available for distribution between the two countries. The sterling holdings of the Banking Department were not adequate to meet payments to be made to Pakistan Central and Provincial Governments in respect of their cash balances, amounts that banks in Pakistan might require the Reserve Bank to transfer to the Pakistan Government, and payment to be made to the British Government in respect of pensionary liability, defence stores, etc., and also to keep intact an amount equivalent to the balance at the credit of the Bank's No.1 Account. The Order therefore provided that for determining Pakistan's share of sterling securities in the Issue Department, under sub-section (3) of Section 4 (Part IV) of the Pakistan (Monetary System and Reserve Bank) Order, 1947, the amount of sterling securities held in that Department on June 30, 1948 was to be deemed to, be reduced by an amount by which sterling held in the Banking Department of the Bank fell short of the aggregate of the various claims. These were:

(i) payments to be made in sterling to the U.K. Government in pursuance of any agreement that might be reached regarding the final settlement of the sterling balances;
(ii) the amount standing to the credit of the Government of Pakistan and the Provincial Governments in Pakistan to the extent they were payable in sterling;
(iii) the amounts that banks in Pakistan might require the Reserve Bank to transfer out of their deposits with it to the Government of Pakistan ; and
(iv) the amount of the balance at the credit of the Bank's Account No.1 with the Bank of England.

The Order provided that to the extent sterling securities in the Issue Department were deemed to be reduced rupee securities in that Department should be deemed to be increased for purposes of distribution.

Return of Notes, Coins in Chests: The Government of Pakistan were required to return, as expeditiously as possible, to the Bank at its offices in India all India notes, India rupee coin and Pakistan rupee coin held in the currency chests of the Bank in Pakistan on June 30, 1948, and no such notes or coins were to be put into circulation from those currency chests in Pakistan after that day.

Transfer of Assets: The Bank was required to transfer from its Issue Department to the Government of Pakistan, as soon after June 30,

* No.1 Account was for current transactions and No.2 Account for capital transactions.

1948, as practicable, assets of a total value equivalent to the total liability in respect of Pakistan notes outstanding on that day. India notes which might be legal tender in Pakistan on June 30, 1948, or in respect of which the rights of encashment in Pakistan existed on that date, were to be accepted by the Government of Pakistan at par until June 30, 1949. On the delivery of such notes to the Bank from time to time in instalments of not less than Rs. 5 crores each, assets of equivalent value were to be transferred from the Issue Department to the Government of Pakistan. The Order, however, provided that no assets of the Issue Department of the Bank were to be transferred to the Government of Pakistan, until that Government returned to the Reserve Bank, India notes and India and Pakistan rupee coins held in the currency chests in Pakistan on June 30, 1948, at least to the extent the value of these notes and coins exceeded the value of Pakistan notes in circulation on June 30, 1948. The Bank was entitled to withhold from the value of all or any of the assets to be transferred to the Government of Pakistan from the Issue Department of the Bank an amount equal to the value of India notes and coins which were, for the time being, held in Pakistan.

Exchange Control: There was to be no exchange control between India and Pakistan till June 30, 1948, nor were any restrictions to be placed on the transfer of funds or securities from one Dominion to the other, whether on current or capital account.

Bank's Offices in Pakistan

Earlier, at the urgent request of the Government of Pakistan, an office of the Bank was opened at Dacca with effect from February 9, 1948, to undertake the supply of fresh notes to and the removal of soiled notes from the currency chests located in East Pakistan. From the same date, the office also accepted deposits from banks and afforded exchange and remittance facilities to the public. A branch of the Exchange Control Department was opened at Dacca on March 19, 1948. As it was necessary that before the monetary arrangements with Pakistan were actually terminated the office assumed its full responsibilities, it was converted into a full-fledged branch of the Issue Department with an independent circle of issue on April 1, 1948. Thus, from the above date, the office began to discharge the full issue and banking functions, except the conduct of Government business which continued with the Imperial Bank branch at that centre.

With a view to assisting the Pakistan Government in taking over the management of the existing public debt of the Provincial Governments in Pakistan in terms of the Pakistan (Monetary System and Reserve Bank) Order, 1947, new Public Debt Offices were established at all of the Bank's offices in Pakistan; the one at Dacca started functioning on February 21, 1948, while those at Karachi and Lahore were opened on March 1 and March 8, 1948, respectively. These offices were also to undertake the issue and management of any new loans of the Pakistan Government. Securities Departments were also organised at all these offices. A wing of the Central Accounts Section, which maintained the principal accounts of the various Governments and cleared inter-Government adjustments, was transferred to Karachi to form the nucleus of a similar organisation for Pakistan.

Distribution of the Bank's Assets

As already mentioned, in terms of the Pakistan Monetary System and Reserve Bank (Amendment) Order, 1948, the Bank ceased to function as central bank for Pakistan from July 1, 1948, its functions being taken over by the newly established State Bank of Pakistan. The remittance facilities existing between the two Dominions were withdrawn. The Bank's offices at Karachi, Lahore and Dacca were also taken over by the State Bank of Pakistan.

The transfer, to the State Bank of Pakistan, of its share of the assets and liabilities of the Banking Department of the Bank was a relatively simple affair. The Bank advised the Bank of England to transfer, as on July 1, 1948 (though the transfers were actually made between July 2 and 5), to the State Bank of Pakistan No. 1 and 2 Accounts in all £75.56 million (equivalent to Rs. 100. 74 crores), the amount being arrived at as follows:

	(Rs. crores)
Deposits of the Central Government of Pakistan	69.27
Deposits of the Provincial Governments in Pakistan ..	5.66
Deposits of banks	25.65
Transfer made at the instance of the Federal Reserve Bank of New York	1.50
Miscellaneous	-0.33
	101.74
Less amount retained as opening balance of State Bank of Pakistan Account at Calcutta	1.00
	100.74

The transfer of the assets of the Issue Department, on the other hand, turned out to be a difficult task. To start with, the Bank was required to make, as explained earlier, a notional reduction in sterling assets and corresponding increase in rupee securities as held on June 30, 1948, to arrive at the divisible volume of sterling assets and rupee securities.

For this purpose, a notional figure of Rs. 450 crores was taken as the payment to be made to the British Government; the actual figure turned out to be Rs. 325 crores, and corresponding adjustments in each Dominion's share of sterling and rupee securities were made later. Pakistan became entitled to a larger release of sterling assets, against return of equivalent rupee securities which it had received earlier.

As against the total assets in the Issue Department on June 30, 1948 of Rs. 1,351 crores, assets earmarked for Pakistan came to Rs. 133 crores, in respect of Rs. 51.57 crores of Pakistan inscribed notes and Rs.82 crores of India notes returned from circulation after June 30, 1948. Thus Pakistan's share in each asset of the Issue Department worked out to 9.900795 per cent. The actual assets released (and taken delivery of) amounted to Rs. 127 representing mainly the value of rupee coins held in Pakistan. The itemwise distribution was as under:

(Rs. crores)

	Total Assets As on June 30,1948	Pakistan's Share Earmarked	Realsed and taken delivery of
Gold	44.41	4.40	4.21
Sterling Securities	1,135.33 (1,027.61)	101.74	97.33
Rupee Coin-----			
India	40.19	3.98	3.50
Pakistan	3.32	0.33	0.31
Rupee Securites	127.84 (235.56)	23.32	22.31
Total	1,351.09	133.77	127.67

Figures in brackets represent the effect of the final adjustment ,in terms of the Pakistan Monetary System of Reserve Bank(Amendment) Order,1948.

The transfer of the assets was mostly effected between September 1948 and March

Difficulties arose in respect of India notes transferred to Pakistan after June 30, 1948. It was estimated at the time of the partition that total note circulation in Pakistan would be Rs.120 to Rs. 130 crores. Inscribed Pakistan notes on June 30, 1948 were of the value of Rs. 51.57 crores, Therefore, on the basis of the above estimate, about Rs. 80 crores of India notes were due to return from circulation after June 30, 1948. As against this, the actual value of India notes delivered to the Reserve Bank by the State Bank of Pakistan in the first six months July-December 1948 came to as much as Rs. 103 crores, while even thereafter, the weekly remittances continued to be sizeable. Investigations revealed that a fair percentage of remittances received from Pakistan contained notes issued in India after March 31, 1948. Enquiries instituted by the Bank also revealed that substantial quantities of India notes did pass over to Pakistan, the main leakage having occurred on the eastern border. The transfer was mainly for payment of goods, e.g., jute, purchased from Pakistan. The results of the investigations were conveyed by the Bank to the Government of India in February 1949.

In early March 1949, the matter was taken up by the Government of India with the Government of Pakistan. In a letter dated March 3, 1949, to the Pakistan Government, they observed that it had been clearly established that the remittance of India notes the Bank received from the State Bank of Pakistan included both notes issued in India after March 31, 1948, i.e., after India notes ceased to be issued in Pakistan by the currency authority and also notes issued in India for the first time after June 30, 1948. Also, the Pakistan Government had kept alive the legal tender character of such notes by providing facilities for their encashment, which encouraged import of India notes into Pakistan. Continuing, the Government of India observed that in their view the agreement had been 'totally vitiated' and that the matter required 'to be examined afresh in order that the object of the agreement, namely, to determine the proper shares of India and Pakistan in the assets of the Issue Department of the Reserve Bank on the basis of note circulation in the two Dominions on the 30th June 1948 may be fulfilled.' They suggested that the matter should be considered at a meeting of the representatives of the two Governments and of the Reserve Bank and the State Bank of Pakistan at an early date about March 21, 1949.

The Government of India also informed the Bank that 'the intention is that pending negotiations with the Pakistan Government further releases to them should be withheld'. With a view to restricting further transfers of India notes, the Reserve Bank of India issued a notification on March 4, 1949, prohibiting the export to Pakistan of currency notes of the Government of India and the Reserve Bank of India notes; bona fide travellers to Pakistan were, however, permitted to carry amounts not exceeding Rs.50 in all. On the same day, a notification banning the import into India of India one rupee notes from Pakistan was issued by the Government of India.

The Pakistan Government strongly protested against Government's instructions to the Reserve Bank not to transfer, until further notice, assets against India notes returned by the State Bank of Pakistan. The Government of India's reply was that notes tendered to the Reserve Bank included notes which were not in circulation in Pakistan on June 30, 1948, and therefore it was not possible for the Reserve Bank to continue to make payment.

A meeting of the representatives of India and Pakistan was held in Bombay on April 6 and 7, 1949, to discuss this matter. The representatives of India explained that Pakistan was entitled to a share in the assets only in respect of notes which were in circulation and legal tender in Pakistan on June 30, 1948 and which the State Bank of Pakistan could encash and deliver to the Reserve Bank by June 30, 1949. Pakistan's representatives contended that the movement of notes across the border was inherent in the agreement and this was supported by the subsequent agreement (Payments Agreement) which did not place restrictions on the exports of currency notes from one Dominion to the other. The Indian representatives pointed out that the restrictions had not been imposed on transfers of currency to save harassment to travellers. The meeting did not lead to any agreement.

The matter was again considered at a conference held at New Delhi on July 29 and 30, 1949, to discuss mainly extension of the Payments Agreement. Pakistan's representatives observed that they were entitled to a share of Rs. 176 crores of the assets and if it was a question of a small adjustment they would agree to it. The representative of the Reserve Bank pointed out that according to the West Bengal Government's estimate, India notes of the value of Rs. 55 crores had been transferred to East Bengal after June 30, 1948 in payment of goods and services, while there was evidence that notes of the value of a few crores of rupees had been transferred to West Pakistan from the Hyderabad State. However, he said he would be satisfied if the estimate of the Bank's Research Department in respect of the notes transferred, namely Rs. 44 crores, was accepted and an adjustment made. The subject was discussed again in 1950 but no progress was made and the position remains the same today.

While the amount of India notes returned from Pakistan and qualifying for a share in the Bank's assets was the major issue involving protracted correspondence between the two Governments and the two central banks, there were other points of disagreement too, including the payment of interest and discount on the securities transferred to Pakistan and division of the Reserve Bank's profits and surplus assets. As regards interest and discount on securities, for instance, the Reserve Bank allowed the State Bank of Pakistan interest from July 1, 1948 on that portion of the interest bearing assets which was earmarked on June 30, 1948 against Pakistan note circulation. But the Pakistan State Bank claimed such interest and discount as from July 1, 1948, even in respect of securities transferred to it against delivery of India notes retired from circulation in Pakistan after June 30, 1948. The Reserve Bank's argument was that interest on securities held as cover against notes in circulation must obviously accrue to the Reserve Bank, since the Bank was liable for the notes. Under the Reserve Bank Act, the liability for India notes collected by Pakistan after June 30, 1948 was not terminated until the notes were actually delivered to the Reserve Bank and the notes removed from its circulation account under the provisions of that Act. The question remains unresolved to this day.

Bank and Indo-Pakistan Payments Agreement

During the course of the tripartite talks between the Governments of India and Pakistan and the Reserve Bank held in Bombay in March 1948 to modify the monetary arrangements between India and Pakistan, it was agreed that exchange control and also restrictions on transfer of funds or securities between the two countries should be avoided and that instead a payments agreement should be entered into. Initially, the agreement was to be for a period of one year, the main feature being that each country should hold the other's currency up to a certain amount. Such an agreement was entered into on June 30, 1948, that is, just on the eve of the Bank's withdrawal from Pakistan, and was to be effective July 1, 1948.

The Agreement provided for the official rate of exchange between the India rupee and the Pakistan rupee to be at par; it was not to be altered by either Government 'except after due notice and mutual consultation'. There was to be no exchange control between the two countries and no restrictions were to be placed on the transfer, on current or capital account, of funds or securities from one country to the other, particularly on transfer of evacuee funds in private hands. In respect of evacuee funds in the hands of Custodians of Evacuee Property, the Agreement provided for mutual consultations between the central banks of the two countries, so as to ensure that such transfers were effected without undue strain on the country's exchange resources. The Agreement left both the Governments free to impose restrictions on transfer of gold and silver, subject to such exemptions as might be agreed upon by the two Governments in respect of evacuee property.

Under the Agreement, the two central banks, acting as agents of their respective Governments, were required to sell to each other their own currency to the extent of Rs.15 crores against the currency of the other country; sale beyond this limit and up to a maximum of £7.5 million was to be against sterling to be credited to the selling Bank's No.1 Account with the Bank of England, while further sales were to be against sterling to be credited to the selling Bank's No. 2 Account with the Bank of England. Each Bank had the right to sell to the other Bank, at any time, against all or part of its own currency held by that Bank, that Bank's currency or sterling from its No.1 Account with the Bank of England. It was also provided that in the event of devaluation, the holdings of the depreciated currency held by the other central bank would be revalued on the basis of the new parity and the account of the central bank incurring a loss as a result of such revaluation would be written up by the credit of additional India rupees or Pakistan rupees, as the case might be. The Agreement provided that the two central banks would collaborate to maintain the India and Pakistan rupees at parity and to that end they were to take steps to enforce the use of the official rate as the basis of all transactions.

A couple of days before the Agreement was signed, the Bank issued a press release stating that from July 1, 1948 its offices at Bombay, Calcutta, Delhi, Madras and Cawnpore would buy from and sell to, scheduled banks in India, Pakistan rupees at India rupees 99 31/32* buying and 100 l/32 selling. The corresponding rates at which scheduled banks were to buy from or sell to the public amounts over Rs. 5,000 were not to be lower than India rupees 99 15/16 for buying and higher than India rupees 100 1/16 for selling.

Initially, such purchase and sale transactions by the Bank were restricted to scheduled banks, but from August 21, 1948, they were extended to the public too, the rates being 99 15/16 buying and 100 1/16 selling. The State Bank of Pakistan, on the other hand, had authorised its offices from July 1, 1948 to purchase from and sell to the public direct in addition to scheduled banks.

Discussions between the two countries on the question of continuance, or otherwise, of the Payments Agreement were held in June 1949 at which the Bank was also represented. It was decided to extend the principal Agreement for a further period up to June 30, 1950, subject to certain modifications. The supplementary agreement was signed on September 10, 1949, but within a few days, on account of the devaluation of the Indian rupee and the non-devaluation of the Pakistan rupee, the Payments Agreement between the two countries became inoperative. The subsequent developments are reviewed in the section on exchange relations with Pakistan, in Chapter 20.

TERMINATION OF MONETARY ARRANGEMENTS WITH BURMA

Even before the partition of India, that is to say, with effect from April 1, 1947, the Reserve Bank of India ceased to be Burma’s central bank; this did not, however, create any serious difficulties, unlike in the case

* With a view to discouraging large import of Pakistan notes into India, the rate of discount was raised in February 1949 to eight annas per cent with a minimum of four annas except in cases where notes were tendered by Government Departments or refugee organisations.

of the cessation of the central banking functions for Pakistan. The Government of Burma gave notice, effective October 1, 1946, determining the operation of the provisions of Part II of the India and Burma (Burma Monetary Arrangements) Order, 1937. The notice meant that the arrangements which were put into force on the political separation of Burma in 1937, and under which India and Burma continued to share a common currency and banking system under the aegis of the Reserve Bank of India, would cease from April 1, 1947, on the expiry of six months from the date on which the notice came into effect.

Amendment of the Burma Monetary Arrangements Order, 1937

The Government of Burma returned to their headquarters in Rangoon in October 1945 but they did not take over the financial responsibility from the British Military Administration (B.M.A.) until February 1, 1946. On that date, the responsibility for currency and coinage in Burma was also transferred by the B.M.A. to the Government of Burma. Thus, the Bank's responsibility for currency in Burma, which had ceased in June 1942, was not restored to it even after the return of the civil Government to Burma. The Bank's Agreement with the B.M.A. lapsed on February 1, 1946, but the Bank continued as banker to the Government of Burma and as its agent in currency matters. The Burma Monetary Arrangements Order of March 18, 1937 was amended on June 4, 1946 by an Order in Council [The India and Burma (Burma Monetary Arrangements) Amendment Order, 1946] to regularise with retrospective effect the position regarding the Bank's limited functions in Burma. In terms of the Amendment Order, during the period commencing with October 16, 1945 and ending on such a date not later than September 30, 1946 as the Governor of Burma might determine, the provisions of the 1937 Order in regard to the Bank's functions of note issue in Burma, issue of India rupee coin in exchange for legal tender notes and of such notes against legal tender coin (including India subsidiary coin) in Burma and control of Burma scheduled banks were to cease to be operative. In other words, the Bank's functions were limited to those of being banker to the Government of Burma, purchase and sale of sterling and provision of remittances between India and Burma. Through the facilities for the free exchange of Burma and British India currency through the Reserve Bank, the currencies of India and Burma continued to be linked together as before the war. The Amendment Order also provided for the transfer of the liability for Burma notes issued prior to May 1, 1945 (excluding notes of Rs. 1,000 and Rs.10,000 denominations which had ceased to be legal tender in terms of the

Proclamation issued by the B.M.A. in May 1945) from the Government of India to the Government of Burma along with payment of equivalent sterling as cover; thus, the manner of payment was different from that prescribed in the 1937 Order for transfer of assets of the Issue Department. The transfer took place on June 5, 1946; with the payment of the sterling equivalent of Rs.10.08 crores, representing the balance of Burma notes in circulation.

The Currency Notes Act, 1946 (Burma Act No. XXV of 1946), which was passed on July 6, 1946 but was deemed to have come into force with effect from October 16, 1945, vested the sole right for issue and management of currency and bank notes in Burma in the Governor of Burma; in exercise of this right, he could issue B.M.A. overprinted India notes. This Act also regularised the position with regard to the transfer of the liability for the notes already issued by the B.M.A. to the Burma Government. In terms of this Act, Burma notes issued by the Reserve Bank (other than those of Rs. 1,000 and Rs. 10,000 denominations) and India notes continued to be legal tender in Burma.

In respect of the Bank's role as banker to the Government of Burma, as mentioned in Chapter 9, there had been no interruption to this function even when that Government moved to India during the war. In March 1946 it was decided not to insist on their maintaining the customary minimum balance with the Bank, as the maintenance of a balance in Burma notes with the Bank would only have resulted in swelling the sterile balance of these notes with the Bank; instead, a suggestion was made that for the period from February 1, 1946, until such time as the permanent currency and financial system of Burma had been decided upon, the Government of Burma should compensate the Bank for its services on the same basis as the B.M.A. did previously, viz., the actual expenditure incurred on maintaining its office in Burma plus 12½ per cent of its establishment charges. This was accepted by the Burma Government.

Severance of the Currency Link

In June 1946, the Government of Burma decided in principle to sever the currency link with India and to establish an independent currency to be managed by a Currency Board situated in London. However, as the earliest date by which the Currency Board could begin to operate was April 1, 1947, the Burma Government enquired of the Bank whether the existing arrangements in regard to its functions in Burma could be allowed to continue for a further six months after September 30, 1946. Also, as it was not considered possible for Burma to design and provide entirely new notes and coin by April 1, 1947, they desired that the Burma Currency Board be permitted to use India coin and

Reserve Bank notes with an overprinted inscription 'Burma Currency Board -Legal Tender in Burma only'. The Bank agreed to the joint monetary arrangements being continued until March 31, 1947. The Bank had no objection also to the use of its notes by the Board provided the Government of Burma and the British Government joined to indemnify it against all liability on any such notes issued in Burma. In other words, as in the case of the overprinted B.M.A. notes, the Reserve Bank would have no liability for these notes, although its name appeared on them. The Burma Monetary Arrangements Order was thereafter amended in August 1946 by a further Order in Council, [The India and Burma (Burma Monetary Arrangements) (Second Amendment) Order 1946] with a view to enabling the termination of the joint monetary arrangements with India on six months' notice. This notice was served on the Government of India by the Burma Government to run from October 1, 1946; and after its expiry, that is to say, on April 1, 1947, the currency system of Burma was delinked from that of India.† The Bank also ceased to be banker to the Government of Burma with effect from that date

Disposal of Surplus Burma Notes

Paragraph six of the India and Burma (Burma Monetary Arrangements) Amendment Order, 1946, had made it obligatory on the part of the Burma Government to sell to or purchase from the Reserve Bank currency which was legal tender in Burma, in such amounts as the Bank might require or offer as the case might be, against payment by or to the Bank of the purchase price in India rupees or, if mutually agreed, in sterling. For the purpose of this provision, the Burma rupee and the Indian rupee were deemed to be at par.

It was mentioned that when responsibility for the coinage and currency in Burma was transferred to the Military Administration and later to the Government of Burma, the currency link between India and Burma continued; in other words, the responsibility of the Reserve Bank for maintaining exchange rates between Burma and India and Burma and London remained unaffected as the provisions in the Burma Monetary Arrangements Order and the Reserve Bank Act [Section 41(A)] to sell remittances at specified rates were not repealed. As a result of the war, the Government of Burma were faced with large budgetary deficits. As Burma had no regular money market on which the Government could draw, they had to adopt the somewhat unorthodox

† The new Burma currency was to be the Burma rupee, and it was to have a direct link with sterling and not via the Indian rupee. Issue of B.M.A. overprinted India notes was discontinued from April 1, 1947, and for a period of one year from that date, the Burma Currency Board issued its own overprinted India notes, with the Reserve Bank's concurrence.

method of financing their deficits by the issue of fresh notes convertible only with the aid of the Reserve Bank into means useful for obtaining supplies of goods and services. As the Bank was under a statutory obligation to exchange Burma currency into Indian rupees and sterling, the result was a heavy accumulation of Burma and B.M.A. notes with the Bank. In effect, India was being called upon to meet a large portion of the external obligations of the Burma Government. The Burma Government were not in a position to implement their undertaking in paragraph 6 of the Amendment Order of June 1946 and take over the Burma rupees which the Bank found surplus to its requirements. The Bank took up the matter with the Government of Burma several times from March 1946 onwards but they took no steps to rectify their cash position and take over the Bank's surplus stock. Early in December 1946, the balance of these notes with the Bank stood at over Rs. 19 crores, the amount being actually in the nature of an interest free advance to the Burma Government.

At the request of Director Mr. C. R. Srinivasan, the Central Board was apprised of these and the other developments with regard to Burma at its meeting held on December 9, 1946. On a review of the facts, the Board resolved 'that the attention of the Government of India be drawn to the unsatisfactory state of the monetary connection between India and Burma. The Board are convinced that it would be against the interests of the Reserve Bank to allow further amounts of Burma and B.M.A. notes to accumulate with the Bank after the 1st January 1947 in the existing manner'. The Board was also against the Bank's accepting sterling instead of Indian rupees for any amounts of Burma and B.M.A. notes held by it if offered by the Government of Burma, in view of the Bank's already heavy holdings of that currency.

The Board's views were conveyed the Government of India on December 17, 1946. The Government were informed that on a further effort being made the Government of Burma had actually expressed their inability to liquidate their liability to the Bank unless they were granted a loan by the Government of India and that they had already approached the latter for such a loan. The Bank added that it was requesting the Government of Burma to pay, on the surplus notes, interest at the rate of 2 per cent which was the prevailing rate charged on ways and means advances to Government. If the Government of Burma were, for any reason, unable to meet the Bank's claim forthwith, the Bank proposed that the Government of India might consider adjusting the amount due to the Bank on this account in the settlement which would be made between the two Governments under Part IV of the Burma Monetary Arrangements Order, 1937; this Part detailed the manner of computation of Burma's share in the Bank's profits, its surplus assets (including the Reserve Fund), the Government of

India's silver stocks, etc., during the currency of the Order and after its expiration. No progress towards a settlement was, however, possible owing to the Government of Burma's other domestic preoccupations as well as several complications in connection with the question of the settlement of Burma's pre-war debt to India and the adjustments under Part IV of the Order of 1937.

The Government of Burma were, in the meantime, in urgent need of at least a part of the Burma and B.M.A. notes in the Bank's own holdings to meet certain large payments, as owing to shipping and other difficulties, the stocks of fresh Burma notes with the Rangoon Office could not be replenished in time. Early in March 1947, they requested the Bank to release the whole or at least Rs. 10 crores worth of Burma notes out of its holdings immediately, without prejudice to the Bank's right to claim settlement of the whole amount in sterling or in Indian rupees at a future date. The Government of India were, on the other hand, unable to take a decision on the question of accepting sterling from, or sanction of a rupee loan to, the Burma Government until the final result of the negotiations with the British Government on the utilisation of the sterling balances was known and the desirability or otherwise of acquiring further sterling from Burma in exchange for the notes could be assessed.

The Bank agreed to grant ways and means advances to the Burma Government at its Rangoon Office to enable them to tide over their acute temporary difficulty. It did not, however, consider this a suitable remedy; nor could it hand over the notes to the Burma Government, as desired by that Government, without receipt of equivalent assets. Therefore the Bank suggested to the Government of India that the best solution would be for them to take over the Bank's entire surplus holdings of Burma notes as on March 31, 1947, and any ways and means advances granted by it to the Burma Government in this connection, against payment in cash or securities and to make available to the Burma Government their immediate requirements of notes pending the completion of the loan negotiations or a decision to accept sterling.

With a view to easing the Burma Government's difficulties and at the same time wishing not to saddle the Bank with further sterling, the Government of India agreed to the Bank's handing over Rs. 10 crores of Burma notes to the Burma Government in exchange for sterling as a temporary measure on the 'clear understanding' that if the rupee loan was granted, the Burma Government would repurchase the whole of this sterling from them against Indian rupees if they so desired. Subsequently, on March 28, 1947, a meeting was held in New Delhi between the representatives of the two Governments when the Government of Burma desired that the Bank should accept sterling for the rest of its stock of Burma and B.M.A. notes and also waive completely its claim for interest at 2 per cent. Taking all considerations into account, the Government of India thought it best to accept Burma's offer to pay in sterling; they were also agreeable to reduce the interest rate to ¾ per cent which was the prevailing Treasury bill tap rate of the Government of Burma, but not to waive the claim altogether. An agreement was reached between the two Governments on this basis. The Bank was thus credited by the Government of Burma with £14.68 million (excluding £7.5 million received earlier) being the sterling equivalent of Rs. 29.58 crores of Burma and B.M.A. notes held by it; besides, interest of Rs. 13.87 lakhs was received in rupees.

Withdrawal of the Bank from Burma

The Bank's office in Rangoon formally ceased to function from April 1, 1947. To enable the Bank to wind up its affairs in Burma, the Reserve Bank of India (Amendment) Act, 1947, was passed on March 17, 1947, providing for the deletion of all references to Burma in the Reserve Bank of India Act, 1934; it came into force on April 1, 1947. The Amendment Act repealed all the emergency Ordinances promulgated in 1942 to deal with the situation that arose on the occupation of Burma by the Japanese and the one issued in 1945 to enable the Bank to act as banker to the B.M.A. The Bank's properties in Rangoon were transferred to the Government of Burma at an agreed price as provided in Part IV of the Burma Order of 1937. Such of the staff of the Rangoon Office as desired to stay on in Burma were taken over by the Burma Currency Board and the Government of Burma. The remaining staff were absorbed by the Bank in its Indian offices. The existing remittance facilities between India and Burma under the Scheme introduced in October 1 1940 were also withdrawn from April1.

The Reserve Bank of India (Amendment) Act, 1947, provided also for the winding up of the Rangoon share register. There were, however, only 8,525 shares on that register on March 28, 1947 as against the 30,000 shares originally allotted to it. On and after April 1, 1947, the shareholders on the Rangoon register, excluding those residing in the Andaman and Nicobar Islands whose names were to be transferred to the Calcutta share register, ceased to be qualified to be shareholders of the Bank. As mentioned in Chapter 17, the elective Director's seat for the Rangoon area was allotted to the Madras area.

It may also be mentioned here that the Bank's claim on the Government of Burma for an amount of Rs. 12.85 lakhs was eventually dropped. The amount comprised the Bank's cash balances at its Rangoon Office (Rs. 10.11 lakhs), balances of India notes at certain chests in Burma (Rs. 2.65 lakhs) and the cash balances at the Imperial Bank branches at Moulmein and Mandalay (Rs. 0.09 lakh), all of which could not be evacuated in time before the Japanese occupation and were presumed to have fallen into enemy hands. The claim was not admitted either by the Government of Burma or the Secretary of State for Burma. Eventually, after an overall settlement of all the outstanding financial issues (including those regarding the amounts due to Burma on the termination of the joint monetary arrangements) was reached between the Governments of India and Burma, the Bank was advised by the Government of India in June 1958 to write off its loss (of Rs. 12.76 lakhs) from its Profit and Loss Account as the claim could not thereafter be separately proceeded with. The adjustment was made in the Bank's accounts for the year ended June 30, 1958.

With the attainment of political independence by Burma, the Government of Burma terminated with effect from July I, 1948, the legal tender character in Burma of the Reserve Bank 'India' notes and the Government of India one rupee notes without the superscription 'legal tender in Burma only'. With effect from June 1, 1950, the Government of Burma divested the old overprinted prewar Burma notes as well as the Burma notes of distinctive design issued by the Rangoon Office of the Bank and the B.M.A. notes issued since 1945 first by the B.M.A. and later by the Government themselves, of their legal tender character in Burma.*

The facilities granted for the encashment of Burma notes in India from January 1942 (these notes were not legal tender in India) at the offices of the Bank, certain branches of the Imperial Bank of India and certain Treasuries, to enable refugees from Burma to realise their value without difficulty, were continued for several years after the end of the war by arrangement between the Government of India and the B.M.A./Government of Burma. There were slight modifications from time to time as to the offices where the facilities were to be made available, the commission chargeable for the exchange and the limits up to which exchanges were permitted; in the later years, the facilities were extended to cover B.M.A. notes and Burma Currency Board notes. When the Government of Burma terminated the arrangements with effect from May 1, 1950, they permitted banks in Burma to import and sell Indian currency to travellers to India within the framework of their exchange control regulations.

The Government of Burma opened a Central Treasury to take up Government banking work in Burma from April 1, 1947, with the assistance of selected local bankers.† Exchange control work was taken

* The overprinted India notes issued by the Burma Currency Board ceased to be legal tender in Burma with effect from December 20, 1952.

† Under an Act which came into effect on October 1, 1947, the Union Bank of Burma was established with the obligation to act as banker to the Government and to manage the public debt. It could also act as the agent of the Currency Board on terms mutually agreed upon and approved by the Governor of Burma.

over by the Finance Department, an officer of which was got trained in the Bank's Rangoon Office. At the request of the Government of Burma, the Bank agreed to continue to act as their bankers in India, after the termination of the joint monetary arrangements. However, while under Section 17(1) of the Reserve Bank Act, the Bank was empowered to open and maintain accounts for any person and could therefore legally maintain the Burma Government account on its books, with the coming into force of the Reserve Bank of India (Amendment) Act, 1947, it was permissible for it to enter into an agency agreement with only the principal currency authority of Burma under Section 17(13) of the main Act. Hence, the services it could render to the Government of Burma were necessarily limited; in particular, the Bank was no longer authorised to grant overdrafts or advances to the Government of Burma.

In terms of the arrangements made, the Government of Burma agreed to maintain a specified minimum interest free balance in account with the Calcutta Office of Bank to remunerate it for the services rendered. The Bank undertook to meet the Government's disbursements from that account, to invest their surplus funds in Government of India Treasury bills and to replenish the account by rediscounting these bills whenever necessary. The was to be fed periodically by remittances in sterling from London. The Bank undertook also to issue remittances on behalf of the Government of Burma from their account to other centres in India at the rates applicable to the Provincial Governments in India for extra-provincial remittances. The continuance of the Burma Government account with the Bank facilitated the settlement of inter-governmental adjustments between India and Burma through its medium as was the case before April 1, 1947.

These arrangements continued till December 15, 1964, when at the request of the Revolutionary Government of Burma, the Burma Government's account at Calcutta was closed and the balance therein transferred to the Union Bank of Burma's account at the Bombay Office of the Reserve Bank.

INTEGRATION IN THE CURRENCY AND BANKING SPHERES

Partition meant a curtailment of the geographical area of the Bank's operations; on the other hand, the process of political and financial integration of the former British Indian Provinces and the princely States meant an extension of the Bank's role, in the spheres of currency and banker to Government. While British Indian currency circulated freely in these States and in most if not all States it was the only or predominant type of currency, some States issued their own coins and the Hyderabad State issued currency notes too. The aggregate amount of such currency in circulation was, however, very small in relation to British Indian currency. It may be sufficient to mention briefly the facts of the replacement of the Hyderabad currency by Indian currency. This did not, however, pose any knotty problems; nor did the Reserve Bank have much to do by way of offer of advice in the matter.

Hyderabad Currency

Though Hyderabad had its own currency notes (Hali Sicca currency), and the Indian rupee had never been legal tender in Hyderabad, Indian currency circulated freely in that State till about the close of 1947. Also, in December 1947, as much as 30 per cent of the cover in respect of the State's note circulation was in the form of Indian rupees and another 60 per cent in the form of Government of India securities. There were no restrictions on the exchange of Hyderabad currency into Indian currency, which throughout had a higher value. The Hyderabad Government had undertaken, through the agency of the Hyderabad State Bank, to buy and sell, out of the cash assets of the Currency Department, Indian currency from and to any person who made a demand in that behalf, at rates* fixed by Government from time to time.

On December 21, 1947, however, the Nizam's Government promulgated an Ordinance (effective December 22) in terms of which all cash receipts and payments in respect of goods sold, property conveyed or services rendered in Hyderabad were to be made only in the currency of the State, viz., the Hali Sicca currency. The Ordinance did not affect the position of banks in respect of accounts opened in Indian rupees and also did not restrict the free transfer of funds for settlement of trade and other liabilities in Indian currency outside the State.

The promulgation of the Ordinance was followed up by the institution of certain new arrangements which became operative from February 27, 1948. In terms of these arrangements, there was to be no restriction on the withdrawal of funds in cash from accounts maintained with banks in Indian currency and on the exchange of Hali Sicca currency into the Indian currency, when the amounts exchanged were paid into the credit of accounts in Indian currency. This arrangement helped flight of capital from Hyderabad to India; it appeared that some funds were transferred to Pakistan also. As a result of these developments, the Bank received urgent requests from the Hyderabad branch of the Imperial Bank to replenish the currency chest at Hyderabad.

* In December 1947, the rate was Hali Sicca Rs. 116-7-0 for India Rs. 100.

The requests were scrutinised and supplies were made on a rationed basis under either the general or specific authority of the Government of India. The Bank considered the question of continuance or otherwise of the currency chest in Hyderabad and since it was not under an obligation either under the Reserve Bank Act or under the agreement with the Imperial Bank to maintain chests at places outside British India, it was decided on June 24, 1948, with Government's concurrence, to abolish the chests at Hyderabad and Secunderabad. Remittance facilities between India and Hyderabad were also suspended.

Following the 'successful conclusion' of the police action in September 1948, the currency chests were re-established and remittance facilities resumed. The restrictions imposed on the use in Hyderabad of Indian currency were removed. A programme for the withdrawal of Hyderabad currency and its replacement by Indian currency was drawn up by the Government of India in consultation with the Bank.

In terms of the plan, the Hyderabad Government issued, on January 25, 1950, the Indian Currency (Legal Tender) Regulation, 1359 Fasli, in terms of which, effective January 26, 1950, the date on which Hyderabad acceded to the Indian Union, all coins, bank notes and currency notes which were legal tender in India became legal tender in the State of Hyderabad too. The Hali Sicca currency circulating in Hyderabad State also continued to be legal tender; arrangements were made for its conversion into India notes and coin at the rate of Hali Sicca Rs. 116-10-8 for India Rs. 100. Effective April 1, 1951, the Indian Coinage Act, 1906 and the Currency Ordinance 1940 were extended to the Hyderabad State under the Part B States (Laws) Act, 1951, and the corresponding State laws (the Hyderabad Currency Ordinance and the Hyderabad Currency Act) were repealed. With effect from April 1, 1955, Hali Sicca currency ceased to be legal tender.

On January 26, 1950, the circulation of Hali Sicca currency (notes, rupee coin and small coin) amounted approximately to Hali Sicca Rs. 48 crores or India Rs. 41 crores. With the progressive replacement of Hali Sicca currency by Indian currency as from that date, the circulation of Hali Sicca currency steadily declined and stood at Hali Sicca Rs. 6.4 crores (or India Rs. 5.5 crores) at the end of March 1955.

Banker to Part B States

Action was also initiated, during the period, for bringing Part B States (that is, former princely States) into the same pattern of relationship with the central bank of the country as Part A States (the former British Indian Provinces). With the coming into force in January 1950 of the Constitution of India, the Reserve Bank of India Act was amended in 1951 (effective November) by the insertion of Section

21 A which authorised the Bank to act, by agreement, as banker to the Governments of Part B States and manage their public debt and loan floatations. The relation of the Bank with the Part B States was somewhat different from that which obtained between the Bank and the Government of India or the Governments of Part A States; while in the case of these latter Governments, the Bank had a right to perform their banking operations in terms of Section 21 of the Reserve Bank of India Act, in view of the peculiar circumstances of Part B States, the new Section 21A was made permissive in character and laid down that the Bank's appointment as banker was subject to agreement with them in this behalf. The first of the agreements to be entered into in this connection were those with the Governments of Madhya Bharat and Travancore-Cochin, which came into effect from July 1, 1952. The culmination of the process of financial integration of the erstwhile Part B States was reached on November 1, 1956, when the Bank started functioning as banker to the Rajasthan Government. In fact, with effect from the same date, the classification of the States into Part A, Part B, etc., was discontinued, with the coming into effect of the States Reorganisation Act. Accordingly, the basis of the relation of the Bank with all States was also made uniform and the new Section 21A as amended by the States Reorganisation Act, 1956, laid down that the Bank's right or duty to act as banker to the States was to be by agreement with them in that behalf.