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International Financial Institutions and Sterling Balances

The period 1945-51 witnessed important developments in the sphere of India's external financial relations. Outstanding among these were India's joining the two Bretton Woods institutions, the I.M.F. and the I.B.R.D., and the successful conclusion of a series of agreements regarding the utilisation of accumulated sterling balances. In respect of both these matters, the Reserve Bank played a very important role.

The Governor of the Bank as head of the Indian Delegation gave effective leadership at the inaugural meeting of the Board of Governors of the I.M.F. and the I.B.R.D. held at Savannah in March 1946, where far-reaching decisions affecting India's place in the two institutions were taken. He was also largely responsible for persuading the Committee of the Indian Legislature on Bretton Woods Conference Agreements to endorse Government's action in joining the Fund and the Bank as an original member. As Governor for India on the Boards of Governors of the two institutions, Sir Chintaman Deshmukh played an important role in those formative years both in safeguarding India's interests and in establishing sound traditions of international monetary co-operation. Officers of the Bank also served in these institutions either as members of the Executive Board or as staff members.

The successful negotiations for the settlement of the question of sterling balances, ending as they did in India's realizing fully value for war-time accumulations of these balances, constitute a saga in international financial relations, with few known parallels. In the face of the tremendous propaganda in the British press that was let loose against India concerning this subject, unfortunately aided to an extent by the British politicians and the American Government, it was extraordinary that the accumulated balances came to be drawn upon fully and freely-perhaps too freely one might say in retrospect. The happy outcome of the negotiations was doubtless due as much to the sagacity and the sense of fair play of the British Government, with substantial support in this behalf from the British officials in charge of the Government of India at New Delhi, as to the strong attitudes taken by Indian national interests. The uncompromising stand taken by the Reserve Bank Board as well as the Governor on the question of arriving at a settlement satisfactory to India helped to strengthen considerably the Government of India's hands in taking a firm line with Whitehall. The Bank's expert technical analysis of the problems involved in the repayment of the sterling balances made it clear that the task was not an impossible one for the U.K. The Bank's representatives took an active part in the entire series of negotiations and also assisted the Government in working out the technical details of implementing the decisions reached.

There were other important events in the sphere of external finance, namely, a substantial extension of the scope of exchange control, for which purpose a comprehensive Act was passed in 1947, and devaluation of the rupee in terms of the U.S. dollar in September 1949.

All these developments are narrated in this and the following chapter.

MEMBERSHIP OF THE I.M.F. AND THE I.B.R.D.

SIGNING OF THE BRETTON W OODS AGREEMENTS

The Articles of Agreement of the International Monetary Fund and the International Bank for Reconstruction and Development adopted at the Bretton Woods Conference, in July 1944, were to become effective any time after May 1, 945 when the Agreements were signed on behalf of countries with at least 65 per cent of the total quotas in the Fund and the same percentage of total subscriptions in the Bank. The Articles provided that the Bretton Woods participants, i.e., countries which were represented at the Bretton Woods Conference and included in Schedule A of the Articles, were to qualify as original members only if they signed the Agreements by December 31, 1945. Under the Articles, member Governments were required to transmit to the Government of the U.S.A., at the time the Agreements were signed on their behalf, 1/100 of 1 per cent of their total subscriptions in gold or United States dollars for meeting the administrative expenses of the Fund. If the Agreements did not come into force by December 31, 1945, the Government of the U.S.A. were to return the above amount.

Though the Articles were adopted as early as July 1944, the Government of India did not seem to be in a hurry to take up for consideration the question of India's joining the two institutions; their intention was to wait till the attitudes of the U.S.A. and the U.K. were known. The U.S. Congress ratified the Agreements in July 1945, but it was only in December 1945 that the relevant legislation was passed in the U.K. In India, the Legislature had been dissolved on October 1, 1945. However, with a view to securing for India the advantages of original membership, the Government of India decided to adhere to the Agreements before the close of 1945 and then place the matter before the Legislature for its approval. The Agent-General for India in Washington was therefore authorised to sign the Agreements on behalf of India on December 27, 1945, along with the representatives of other participating countries, including the U.S.A. and the U.K. In consultation with the Reserve Bank, the Government of India also issued, on December 24, 1945, an Ordinance to provide themselves with the necessary legal authority for the assumption by India of the obligations imposed by the Agreements. A press communique was issued along with the Ordinance, explaining the advantages of original membership and declaring Government's intention to place the matter before the new Legislature whose decision, whether in favour of continuance of membership or of withdrawal, was to prevail.

The International Monetary Fund and Bank Ordinance, 1945, empowered the Central Government to make from time to time necessary payments to the Fund and the Bank, in terms of the Articles, out of the revenues of the Central Government and to create and issue to the Fund and the Bank, if Government thought fit, any non-interest bearing and nonnegotiable notes or other obligations in place of any portion of Indian currency. The Reserve Bank was to be the depository of the British Indian currency holdings of the Fund and the Bank. In terms of the Ordinance, the Central Government, and also the Reserve Bank, if so authorised by the Central Government, could require any person to furnish such information as might be required by the Fund. The Ordinance also empowered the Central Government to make rules for carrying out the purposes of the Ordinance.

Efforts to Secure Legislative Approval

The matter came up for ratification by the Legislative Assembly on January, 28, 1946. To assist the deliberations, Dr. B. K. Madan, who it may be recalled had been Secretary of the Indian Delegation to the Bretton Woods Conference, was nominated by the Government as a Member of the Legislature.

At the outset, the Finance Member, Sir Archibald Rowlands, moved a resolution to the effect that the House welcomed the proposals for setting up the two institutions and also the action taken by Government in adhering to the Agreements as an original member. The Finance Member observed ‘that the issue before the House, from Government point of view, is whether or not India has now to withdraw from the Bretton Woods arrangements’. The Finance Member explained the circumstances in which Government were not able to honour the pledge to bring the matter before the House for decision before adhering to the Agreement. What led the Government to take quick action was explained by the Finance Member in the following words:

> Indeed, I have no doubt that if Government had not adhered, another motion of adjournment would have been put down censuring Government for not doing so. It would have been alleged that this irresponsible Government does not hesitate to break pledges when it pleases it to do so but is prepared to take its stand on the sanctity of a pledge when it is not in its interest to break it. I, therefore, proceeded on the principle that whatever you do is likely to be wrong and so you might as well do it quickly.

Referring to one of the amendments proposed to be moved by a Member suggesting that the question should be referred to a committee of nine Members elected by the House, before final decision was taken, the Finance Member observed that he was prepared to accept the amendment on behalf of Government, as in his view it was advantageous to have the matter thrashed out by selected Members of the House, since the details were highly technical. The Finance Member concluded his speech thus:

> This Agreement affords India the opportunity, at a moment of grave import to the whole world, of taking full part in a new organisation of great significance and thus of assisting to shape the future course of world monetary history. It is not merely that by not joining the Fund and the Bank India runs the risk that decisions may be taken which are not to her interest or that by non-adherence she would be debarred from the benefits of these new organisations. These are important considerations, but to my mind they are not the decisive ones. The decisive reason is that India is now by far the strongest and economically best organised country in Asia and should feel that economic leadership of the East is her proved prerogative.

Following the Finance Member’s speech, two Members, Mr. Manu Subedar and Seth Yusuf Abdoola Haroon, moved that for the original motion of the Finance Member, the motions moved by them be substituted. Mr. Subedar’s motion was in two parts. The first part condemned Government's action in joining the institutions in disregard of the assurances given to the House that such action would not be taken till full information was given to the country at large and till the assent of the Assembly was secured; the second part recommended the appointment of an ad hoc committee consisting of three nominees of the Congress Party, two nominees of the Muslim League Party and two Government nominees, to go into the question and report at an early date 'in order to determine what steps should be now taken'.

Seth Yusuf Abdoola Haroon's motion just recommended the constitution of a Committee of nine Members to be elected by the House for examining the proposals for setting up the two institutions and to report before March 1, 1946, as to what action would be 'in the highest interest of India'.

A few amendments to these two motions were moved by Members. All excepting one related to the Committee to be appointed and its terms of reference; an amendment moved by Mr. Ananthasayanam Ayyangar sought to prevent Government from taking further action in respect of the Fund or the Bank pending the consideration by the Assembly of the Committee's report.

The debate which followed indicated that in defining their attitude towards membership of the Fund and the Bank, Members seemed to have been concerned more with the future of India's accumulated sterling balances than with the many advantages the membership conferred on India.

Amendments to Mr. Subedar's motion were then adopted and the amended motion was put to vote. The Assembly was equally divided in respect of the first part of the motion condemning Government's action. The President observed he would go with the ayes 'on the merits'; part one of the motion was thus adopted.

The second and third paragraphs of Mr. Subedar's amended motion which proposed that:

> (i) a committee of the House consisting of nine Members be elected to go into the question and report at an early date to the House, and
> (ii) pending consideration by the Assembly of such Report, no further action be taken by Government in respect of the Fund or the Bank

were then put to vote and adopted.

As only nine* nominations were received for serving on the Committee, they were all declared duly elected, on February 1, 1946.

* These were: Archibald Rowlands, Geoffrey W. Tyson, N. V. Gadgil, K. C. Neogy, Manu Subedar, M. Ananthasayanam Ayyangar, B. K. Madan, Sir Zia Uddin Ahmad and Yusuf Abdoola Haroon.

First Interim Report of the Bretton Woods Committee

First Interim Report of the Committee on the Bretton Woods Conference Agreements was presented to the Legislature by the Finance Member on February 26, 1946. It became necessary to submit an Interim Report, as decision had to be taken about sending India's representative to attend the inaugural meeting of the Boards of Governors of the I.M.F. and the I.B.R.D. to be held at Savannah (Georgia, U.S.A.), from March 8, 1946.

The Committee's Report was unanimous, but subject to a supplementary note signed by four Members. The Committee strongly endorsed the Finance Member's statement made during the course of a debate that India was not bound in any way by the terms of the Anglo-American Loan Agreement * of December 1945. In the Committee's view, the final decision whether it would be to India's advantage to remain a member of the Bretton Woods institutions might be determined to a very considerable extent by the outcome of the negotiations on sterling balances. If the negotiations were unduly delayed, India might find it necessary to withdraw from the institutions even before the negotiations took place, being unable to shoulder commitments which she might be called upon to undertake under the Bretton Woods Agreements. Similarly, India might withdraw from the two institutions if the proposals for the settlement of sterling balances were not satisfactory to India. The Committee observed that it had been informed by the Finance Member that Sections 40 and 41 of the Reserve Bank of India Act, under which the Bank was legally compelled to sell and buy sterling in exchange for rupees, would be amended as part of the action of adherence to the I.M.F. Agreement.

The Committee recommended to the Assembly to authorise the Government to appoint, when necessary, a Governor, an Alternate Governor, and Executive Directors and Alternates, but no further financial commitments were to be undertaken by the Government before the matter was further considered by the Committee. The Committee was to have from the Governor of the Reserve Bank, who was appointed Governor for India on the Boards of the two institutions, a report on the inaugural meetings of the Fund and the Bank. 'We expect', the Committee observed, 'that he may be able to bring additional information bearing on the probable scope and manner of operations of these international institutions in relation to the requirements of this country, which may assist the Committee in arriving at a

* Clause 10 of the Agreement provided for dividing the accumulated sterling balances into three categories viz., (1) balances to be released at once, (2) balances to be released by instalments over a period of years and (3) balances to be adjusted as a contribution to the settlement of war and post-war indebtedness.

considered recommendation to the Assembly on the question of continuance or discontinuance of membership'.

Four members* of the Committee, in a supplementary note, urged Government to act promptly to put a stop to sterling accumulations by amending relevant sections of the Reserve Bank of India Act, or otherwise.

On March 1, 1946, the Finance Member moved a motion in the Legislative Assembly stating that the Assembly agreed with the interim Report of the Bretton Woods Committee. A few amendments were tabled, an important one amongst them being:

> That the Governor, his alternate, the Executive Directors and their alternates, in the Bank and the Fund shall be Indians approved by the Committee.

The Finance Member assured the House that the nominees would, no doubt, be Indians, but pointed out that making appointments was an executive act, and he considered it 'inappropriate and contrary to all constitutional practice to set the approval of a particular nomination by a committee of the House'.

The Finance Member's motion was adopted without any amendment.

INDIAN DELEGATION AT THE SAVANNAH MEETING

Even before the first interim Report was presented to the Legislature, the Finance Secretary wrote to Governor Deshmukh stating that Government desired to appoint him (the Governor) as the Indian Governor on the Boards of Governors of the I.M.F. and the I.B.R.D. and that they would be grateful if he could accept the nominations and obtain the Central Board's approval. In the event of his accepting the Governorship, he was required to attend the Savannah meeting and to send a report to Government on the proceedings of the meeting. The proposed nomination was approved by the Central Board: which suggested as Alternate Governor Sir Manila1 B. Nanavati or Sir A. Ramaswami Mudaliar, in that order.

The Indian Delegation left India on March I, 1946 and comprised Sir Chintaman Deshmukh, Mr. J. V. Joshi, the Bank's Economic Adviser, who was to be nominated as Executive Director for India on the International Monetary Fund and Mr. H. D. Cayley, Deputy Controller of Exchange in the Bank. Owing to restricted plane service

* These were: Manu Subedar, M. Ananthasayanam Ayyangar, K. C. Neogy and N.V. Gadgil.

and also bad weather and engine trouble, the Delegation could reach Savannah only on March 12.

The Government of India, anticipating that the Delegation would not be in time to attend the meeting, instructed Sir A. Ramaswami Mudaliar, who was in Washington in connection with the Indian Food Delegation, to act as temporary Alternate Governor of the Fund and the Bank until Sir Chintaman Deshmukh arrived.

It would appear that a highlight of the meeting was the close collaboration between the U.K. and the Indian Delegations. To quote Sir Chintaman: *

> this meeting remains memorable mainly as the occasion when the Indian delegation worked in effortless accord with the British delegation under Lord Keynes and there were many occasions when there happened to be agreement between us on the need to take some step which would increase the utility, independence and creativity of the international bodies.

At the first business meeting of the Boards of Governors held on March 11, 1946, the Governor for the United States (Mr. Fred M. Vinson) was appointed Chairman and the Governors for the U.K., China, France and India (countries with the largest quotas after the U.S A.), were appointed Vice Chairmen. Separate committees for the Fund and the Bank but composed of identical delegates were set up for dealing with matters like membership, site, bye-laws and functions and remuneration of Executive Directors; India was represented on all these Committees.

India's Permanent Directorship Uncertain.

It will be recalled that on the basis of quotas fixed at the Bretton Woods Conference, India stood sixth, the first five countries with largest quotas being the U.S.A., the U.K., the U.S.S.R., China and France. However, as the U.S.S.R. did not sign the Agreements before December 31, 1945 -the date laid down in the Articles of Agreement -India became the fifth largest quota country entitled to appoint an Executive Director on the Boards of management of the Fund and the Bank.

During the deliberations of the Membership Committee, the U.S. delegate proposed the extension, by six months from the date of the resolution, of the time limit up to which a country which participated at the Bretton Woods Conference but which had not signed the Agreements by December 31, 1945, could join the Fund and the Bank on the same terms as original members. † This was a matter of vital

* Economic Developments in India -1946-1956, being the Dadabhai Naoroji Memorial Prize Fund Lectures, delivered at Bombay in February 1957.

† The resolution finally adopted extended the time limit up to December 31, 1946.

importance to India, for if the U.S.S.R. joined the international institutions during this extended period, the right of India to have an appointed director would be in jeopardy. India considered that, apart from the size of the country and the population, her economic importance justified that she should have a seat in her own right on the Board of management of any international institution.

A study of the Articles of Agreement of the Fund and the Bank revealed that there was inconsistency between Sections 3(b) (i) and 3(f) of Article XII of the Fund's Articles of Agreement. The relevant portions of these Sections read as under:

> Section 3(b) There shall be not less than twelve directors who need not be governors, and of whom
> i) five shall be appointed by the five members having the largest quotas;
> Section 3(f) Directors shall continue in office until their successors are appointed or elected. . . . . .

There was also some lack of conformity between the Articles of the Fund and the Bank in respect of the period for which an appointed Director was to remain in office. In the Fund Article, no time limit was specified for the appointed Director, whereas in the Bank it was fixed at two years*. Another point of difference was that Article XII Section 3(b) of the Fund's Articles laid down that 'there shall be not less than twelve Directors . . .' whereas according to Article V, Section 4(b) of the Bank's Articles, 'there shall be twelve Executive Directors . . . . ' . All these aspects were of considerable importance to India, if her right to appoint a Director were to continue even if Russia joined. The Indian Delegation's efforts to retain the appointed director for India on the Board of Executive Directors of the Fund and the Bank till the next regular election, even if the U.S.S.R. joined the institutions during the extended period, met with success.

At the meeting of the Membership Committee held on March 12, Sir Ramaswami Mudaliar sought clarification as to what would be the position of (i) a country with a quota entitling it to appoint an Executive Director, if it were to become a member within the extended period, but after the election of the Executive Directors, and (ii) the country which already had an ex-officio (appointed) Director and which had the smallest quota of the ex-officio Directors.

The Membership Committee considered that the question raised was an important one, but that it was not within its province to decide and therefore it requested the Board of Governors to consider the same. When the Committee's Report was discussed at the full meeting of the Board of Governors on March 13, Sir Ramaswami referred to the difference in the Articles of the Fund and the Bank regarding the term

* Article V, Section 4(b) of the Bank's Articles of Agreement stated '. . . . . . Executive Directors shall be appointed or elected every two years'.

of the appointed Directors and suggested that in the Fund at least, the position of the old member should be safeguarded, probably by increasing the number of appointed Directors from five to six, if necessary. In the case of the Bank, it was necessary to ensure that the appointed Director served for a minimum period of two years. He wanted the Board of Governors to consider the question at that stage only, and not leave India's position 'in an uncertain state'.

Separate Ad Hoc Committees for the Fund and the Bank to consider the matter were set up, with the U.K. as Chairman and Chile, China, Czechoslovakia, France, India and U.S.A. as members. The question before the Committee was 'what steps could be taken to protect the position of India, now entitled to appoint an Executive Director, if a Schedule A country with a larger quota than India should become a member prior to the second election of Executive Directors'. The Committee recognised that the problem arose through 'inadequate foresight in drafting the Articles of Agreement', and was not the result of the resolution extending the period during which Schedule A countries could sign the Agreements. In view of the inconsistencies between Sections 3(b)(i) and 3(f), a suggestion was made that Section 3(b)(i) be interpreted to mean:

> that any member having one of the five largest quotas at the date of a regular election, or at any date between regular elections, shall been titled to appoint an Executive Director, who shall hold office until the next regular election. This interpretation would be without prejudice to the right of a subsequently admitted member to appoint a director if it has one of the five largest quotas.

There was another suggestion, which was submitted in the form of a resolution, as under:

> The Board of Governors of the International Monetary Fund Resolves: There shall be one additional Executive Director who shall hold office until the second election of Executive Directors if, at any time before the second election, both of the following conditions exist:
> 1. There have been admitted to membership the governments of one or more countries not listed on Schedule A; and
> 2. The members not entitled to appoint Executive Directors, whose votes are not included in those entitled to be cast by Executive Directors holding office at the time the additional director is elected, have votes totalling 4,000.
> Those members not entitled to appoint directors, whose votes are not included in those entitled to be cast by directors holding office at the time the additional director is to be elected, shall participate in the election . . . . .

This resolution and a similar one for the Bank too, were agreed upon. However, to meet the situation of there being no election to choose an additional Director, which would have meant that India had no Director for some time, the Committee further recommended as under:

> if, in spite of the foregoing resolution, a member now included in the five members having the largest quotas were to be placed in the position where it might be represented, neither by an appointed nor by an elected director until the next regular election, the Executive Directors should immediately reconsider the position, with the object of preventing such a situation from eventuating, either by an interpretation in accordance with Article XVIII of the Articles of Agreement or otherwise,

A similar recommendation was made by the Ad Hoc Committee of the I.B.R.D.

At the meeting of the Board of Governors on March 15, the Reports of the Ad Hoc Committees were approved. In this connection, the Governor for India, Sir Chintaman Deshmukh, made a statement explaining India's position fully. In his view, when inconsistencies in the Articles of Agreement were discovered, and when there was a danger of such inconsistencies imperilling the position of a member, the 'obvious course' was to amend the Articles of Agreement, 'because the best way of dealing with a Gordian knot is to cut it'. However, he realised the practical difficulties in promoting amendments to the Articles at the inaugural meeting of the two bodies and therefore he had provisionally agreed to the conclusion reached by the Ad Hoc Committees. In saying this, however, the Governor made certain reservations:

> The first is, that if, and when, the contingency which we anticipate arises, we should have the right to urge the interpretation of these two provisions which were just read out. In other words, we should claim that, so far as the appointment by us of an executive director to the Bank is concerned, we are amply protected by the Articles of Agreement as they stand, and insofar as the Fund is concerned, there is at least the view possible that there is no term to the appointment or that if there is, then that particular clause is subject to the ingenious interpretation which has been urged here in the report of the Ad Hoc Committee.

The interpretation was that India could continue to have its appointed director until the next election. The Governor made it clear that he was not promising that-he would not urge the Board to give a ruling regarding the interpretation of the Articles, till the contingency he had referred to arose, viz., till the election took place and India failed to obtain a seat.

Later, at the Board's meeting on March 18, when the United States and the United Kingdom delegates sought interpretations of certain Articles, under instructions from their respective Governments, Sir Chintaman urged that the interpretation regarding the appointed Director for India should have the same order of priority and this was agreed to. The Governor sent to the Fund Secretariat a draft of a resolution he wished to refer to the Board of Executive Directors of the Fund for their decision. The draft resolution read as:

> that with reference to the Ad Hoc Committee's report on the position of the Executive Director for India adopted by your Governors at their meeting on the 15th of March and in view of the inconsistency between Section 3(b)(i) and Section 3(f) of Article XII that these sections be interpreted to mean that any member having one of the five largest quotas at the date of a regular election or at any date between regular elections shall be entitled to appoint an Executive Director who shall hold office until the next regular election without prejudice to the right of a subsequently admitted member to appoint a Director if it has one of the five largest quotas.

The meeting of the Executive Directors of the Fund decided on May 8, 1946 that the interpretation suggested by India was the correct one. A similar resolution was passed the next day by the Board of Directors of the Bank, according to which it was decided that India, which had once appointed her Director, could not be deprived of her representation until the next election even though a country with a larger quota joined within that period.

Directors: Remuneration and Functions

The remuneration of the Executive Directors and whether they should devote full time or part time to the business of the Fund/Bank were other points of dispute. The Committee on Functions and Remuneration agreed that the Executive Directors and Alternates should devote all their time and attention to the business of the Fund/Bank and, between them, be continuously available at the principal office of the Fund/Bank. Lord Keynes considered that the Executive Directors were national delegates and that their remuneration should be provided or shared by the appointing Governments. He was also opposed to Executive Directors and Alternates devoting full time to the business of the two institutions.

The real point at issue in this matter was the concept of functions which the institutions were to undertake. The U.K. wanted the work to be limited to the purposes set out in the Articles, while the U.S.A. visualised a wider and active role to be played by the two institutions. The U.S. view was that the staff should make studies and be in a position to offer assistance and advice, so as to forestall the development of exchange and financial difficulties and not deal with problems only when they reached a stage necessitating reference to the institutions. Sir Chintaman, in his report on the proceedings, observed:

> It is difficult to say now what will be the result of this wider concept of the functions of the Fund and Bank, as any attempt by either institution to interfere in the financial or fiscal policies of a member country might well be strongly resented.

Location of Fund/Bank

Another matter which proved extremely controversial was the location of the principal offices of the Fund and the Bank. Under the Articles of Agreement, the principal office was to be located in the territory of the member having the largest quota/holding the largest number of shares -i.e., the, U.S.A. According to Sir Chintaman's report on the proceedings of the inaugural meeting, the U.S. representative had recommended Washington but the U.K. delegate proposed New York, the reasons advanced in favour of New York being (i) the institutions would lose their international character if they were in Washington and the Executive Directors would be subject to political influences,(ii) it was desirable that the Fund should be located in a financial centre, and (iii) since the principal seat of the U.N. was to be New York, it was desirable to have the Fund and the Bank in New York to facilitate co-operation. Canada, France and India supported this view, but the selection of New York was vigorously opposed by the United States delegate, who argued that the Fund was an international organisation dealing with Governments and therefore it was more appropriate that it should be situated in the administrative capital of a country, rather than its financial centre, where it might be subject to private business interests; the U.S.A. was supported by Mexico and China. Since Canada and France later agreed that the final decision of the choice of site should rest with the host country, the U.K. delegate agreed to accept Washington, though Lord Keynes remarked that the U.K. Government considered the selection 'a grave error'. India, France and Canada withdrew their objections to the selection of Washington in order to make the report unanimous.

Referring to this matter about ten years later in the Dadabhai .Naoroji Memorial Prize Fund Lectures delivered by him, Mr. Deshmukh observed:

> the fact that we, on the threshold of national independence, could and did take an independent line on such questions was warmly appreciated, particularly by Lord Keynes personally.

Governor's address at the Closing Plenary Session

It will be appropriate to close this section on the Savannah Meeting with a few extracts from Sir Chintaman's valedictory speech at the closing plenary session of the meetings of the two institutions on March 18, 1946.

> Much earnest labour and deliberation have contributed to the creation of these institutions and many hopes and aspirations have been expressed for their success in the future. I do not therefore feel called upon to say much on this occasion. We may however pause to glance at and admire the edifice we have all helped to build and say with pride "this is the house that Jack built", on foundations well and truly laid by John Maynard and Harry under the judicious eyes of Fred.
>
> We have fashioned a bright and shining instrument of global importance, but we must remember that it is only an instrument, and that the conditions in which it is to be wielded are yet to be established. To vary the metaphor, we have the cart all tight and ready, well sprung and well oiled, with attentive coachmen, but the horse has yet to be selected and put between the shafts. That horse is the trade and commercial policy that the world will elect to follow. He is rash who predicts unqualified success for our twin institutions in advance of a satisfactory agreement on the trade and commercial policies of the nations of the world. For, easy optimism is the twin brother of a surprised defeatism. The coming international parleys on trade and commercial policies are therefore of the utmost importance, and the success of these parleys will depend on you, and by you, I mean largely the U.S.A. and the U.K.
>
> On India's behalf I confidently give a pledge that we shall give of our best to the Fund and the Bank and that we shall choose men who would play their part worthily, with dignity and independent judgment and we shall see that they are placed in a position to give to these institutions the time and attention that the interests of the institutions demand. Sir, we shall remain as members of these institutions only so long as India can play her part in them worthily and with profit not only to herself but also to the world.

APPROVAL OF LEGISLATURE OBTAINED

Second Report of the Committee of Legislature on Bretton Wood

The Governor's report on the proceedings of the Savannah meeting and the discussions with him were of considerable assistance to the Bretton Woods Committee of the Legislature. The Committee's second interim Report presented to the Legislative Assembly on April 17, 1946, while taking a note that no clarification had been made by the British Government on the issue of sterling balances, reiterated what it had said in the first interim Report, viz.,

> (i) it endorsed the Finance Member's statement that India was not bound by the terms of the Anglo-American Loan Agreement of December 1945, and

(ii) the final decision whether to remain a member of the Bretton Woods institutions would be determined by the outcome and the timing of the sterling balances negotiations.

Since the whole question of India's constitution was under examination, the Committee suggested postponement of further action till the outcome of such examination became known. The Committee, therefore, recommended that Government should take advantage of every possible provision in the Articles to postpone payment of subscriptions to the Fund and the Bank till the last moment, but if it became necessary to take a final decision before the Assembly met again, Government should summon the Committee and a decision should be taken in consultation with it.

A motion approving the course of action proposed in the Report was moved by the Finance Member on the 18th and was adopted after some discussion. During the course of the debate, tributes were paid to the Governor for his work at Savannah. Mr. Geoffery Tyson (belonging to the European Group), a member of the Bretton Woods Committee, stated:

> We have had the benefit of meeting the Governor of the Reserve Bank since he returned from Savannah and he has presented a long and interesting report to the Bretton Woods Committee. I do not think that any of us are in two minds at all about the question that we got in the person of Sir Chintaman Deshmukh the best possible Governor which India could send to this International Institution. When this subject was first introduced into this House, now nearly three months ago, I said on behalf of the European Group that what we wanted was that India should exercise full responsibility as a member of the Fund and that it should be exercised on behalf of India by an Indian and in the interest of India. I would like to say that I repeat what was then said and I am quite sure that the report which Sir G. D. Deshmukh has presented to the Bretton Woods Committee endorses the very considerable confidence which the Legislature, the banking community and the country at large has reposed in this distinguished officer of the Government.

In his concluding speech, the Finance Member, while endorsing the tribute paid to the Governor by Mr. Tyson, remarked:

> I am glad to have the opportunity of saying that I have, from independent sources, evidence of the admiration which his dignity, his ability and his general handling of the situation evoked in Savannah in the recent negotiations. It was of the very highest.

The Governor's own account of what happened in the Legislative Assembly and the role he played in getting the Legislature to approve India's membership of the two institutions is given below*:

* Economic Developments in India -1946-1956.

> The performance of our delegation was praised with unwonted warmth but the concern with sterling balances arrangements still predominated and bedevilled any final decision. It was then my duty to try and exorcise what Dr. Sir Zia Uddin Ahmad -who was, incidentally a contemporary of Keynes at Cambridge -had called “the bogey of the present session”. I met the members of the Bretton Woods Committee and sought to remove misunderstandings and apprehensions regarding the financial involvements resulting from our membership as also to inform them about the widespread benefits bound to flow from them if we then co-operated in the establishment of such bodies. I was gratified to see that subsequently, in October, the Legislature decided that India should, join the Fund and the Bank.

Between April and October 1946, there were other developments with regard to the organisation of the Fund and the Bank, including the declaration of initial par values. These may now be described before coming back to the matter of the Legislature’s approval.

Appointment of Executive Directors and Alternates

Once the Bretton Woods Agreement was signed, the next important step was to select really able persons to represent India on the Board of Executive Directors. The Finance Member, Sir Archibald Rowlands, sought the Governor’s advice in the matter sometime in January 1946. The Governor indicated that he could think of only two suitable persons of the requisite experience, standing and technical competence, viz., Mr. N. Sundaresan (Joint Secretary in the Finance Department) and Mr. J. V. Joshi (the Bank’s Economic Adviser). He was also of the view that the appointment should not be for more than two years. The Governor further suggested that whosoever was selected should have an Alternate ‘to learn the ropes, stand by in emergencies and help organize a small economic advice section in the Office of the Agent-General for India’. The Governor’s advice was accepted. On April 22, 1946, a notification was issued announcing the appointments of Sir Chintaman Deshmukh as Governor of the I.M.F. and the I.B.R.D., Mr. N. Sundaresan as Alternate Governor of the Fund and the Bank and also Executive Director of the Bank and Mr. J. V. Joshi, as Executive Director of the Fund. No Alternate Executive Director was appointed to start with.

However, within a few months, it was realised that full-time Alternates were absolutely essential. On request to that effect from Messrs Sundaresan and Joshi, the Governor in consultation with Mr. Joshi, decided that Dr. B. K. Madan (the Director of Monetary Research), whose services had been loaned to the Tariff Board, would be the best choice as Alternate at the Fund. The Governor considered that pending the choice of another suitable Alternate for the Bank, Dr. Madan would be to work as an Alternate for both Mr. Joshi and Mr. Sundaresan. The Government issued a notification on September 4, 1946 appointing Dr. Madan as Alternate Executive Director in the I.M.F. and Mr. Joshi, who was Executive Director at the fund as Alternate Executive Director in the World Bank (i.e., the I.B.R.D.). Shortly thereafter (i.e. on February 14, 1947), however, Dr. Madan was appointed as Alternate Executive Director in the World Bank too. Following the completion of Mr. Joshi's term, Dr. Madan was appointed India's Executive Director at the I.M.F., effective November 1, 1948. His place as Alternate was taken by Mr. D. S. Savkar, an Officer of the Bank's Department of Research and Statistics. Mr. Joshi was reappointed Executive Director, effective January 11, 1950.

It appears that at the time of Dr. Madan's appointment as Alternate, the Viceroy remarked that all the appointments made till then had gone to Hindus. The Finance Member, Sir Eric Coates, explained that such 'representative' appointments needed men with special training and experience in financial matters and that no non-Hindus with the necessary qualifications were immediately available. He, however, added that for future appointments, both in 'representative' capacity and on the staff of the two institutions, the Governor 'would no doubt be looking out for qualified persons from different communities'; this was communicated by Sir Eric to the Governor. The Governor replied in very strong terms, remarking that he nominated the best men available irrespective of any communal considerations. The letter observed:

> It must be remembered that we are dealing with a very specialized field and are making whole-time appointments to very important international bodies on which there should be no occasion for India to hold down her head by reason of having failed to send of her best . . . . .
> I might add that even if I had been looking out for persons from different communities, by which I take it is meant the Muslim community, I could not have recommended anyone else in either case. The only field in which conceivably one would look for suitable material would be the Indian Audit and Accounts Service, and so far as the Executive Director of the Fund is concerned, I should not have agreed to the appointment of anyone from that service who had no knowledge of current economic problems, especially problems of currency and exchange.
> I suggested him† as an Alternate primarily to the Director on the Fund, which Government have conceded would be the body dealing largely with problems cognate with the Reserve Bank's activities. It follows that India's representative should be someone on the staff of the Reserve Bank, and I am in the position to say that I have no Muslim officer who could be considered for a moment for an appointment of this kind . . . . . . I submit that it would have been harmful to India's interests to have ignored him and to have selected "a qualified person from a different community" merely for the sake of achieving political

† Dr. Madan.

> balance. So far as these representative appointments are concerned, I regret it will not be possible for me to undertake to nominate any but the best, irrespective of community. My advice to Government would also be to ignore communal considerations in making these appointments on international bodies, where we must hold our own with the best of other nations.

Later, in March 1947, when the Governor was consulted by the Finance Department regarding India's Delegation to the Annual General Meetings of the World Bank and the Fund, the Governor considered it desirable to state the background to the nominations he was required to make in his capacity as Governor for India on the two bodies in regard. to the posts of Executive Directors. In the Governor's words:

> I had had a general talk with him* about the matter and, although it is nowhere set down in my records, we had agreed that while the Executive Director on the Fund should be the principal concern of the Reserve Bank in that he will have to attend to matters intimately connected with Exchange Control and pars of exchange, the nomination of the Executive Director on the Bank should be principally the concern of the Finance Department, as he would have to deal with long-term schemes of development and the finance required for the purposes. I imagine that Finance Department will not wish to make any modification in this basic division of responsibility as long as they wish me to continue as Governor for India.

In another connection, the Governor reiterated in December 1948 that in the light of his own four years' experience from the very inception of the two institutions, he felt that two different types of Directors were required for the two institutions, one with a good background of economics and the other with considerable experience of Government finance and administration.

The functional relationship between the Government, the Governor and the Executive Directors was clarified by the Governor with the Finance Department at a very early stage. The Finance Department's letter dated June 17, 1946, to the Governor stated:

> I confirm that Government's view of the position is the same as yours, namely, that with regard to the Bank and the Fund the Governor of these institutions is responsible to Government and the Executive Director is responsible to the Governor, there being no direct constitutional relationship between either Government and the Director or Government and the Alternate Governor who, though he may exercise the Governor's powers vis-a-vis the Bank and the Fund, may not exercise those powers vis-a-vis Government.

As regards channel of communication, the letter observed that 'there should be no direct correspondence between Government and the Executive Directors or Government and the Alternate Governors'.

* Sir Archibald Rowlands.

However, as the Government and the Governor were situated at a considerable distance from each other, the Finance Department was to make routine enquiries from the Executive Directors direct through correspondence.

Indian Representation on the Fund/Bank Staff

In terms of Article XII Section 4(d)of the Articles of Agreement of the Fund (Article V, Section 5(d) of the Bank), the selection of staff was to be on as wide a geographical basis, as possible, subject to the paramount importance of securing the highest standards of efficiency and of technical competence. Though India did not have much of a locus standi, since the appointments were to be made by the Fund's and Bank's management, the Governor, in his capacity as the Governor for India on the Fund and the Bank, was keen that India should not miss any opportunity of staking her claim for appointment on the Fund and the Bank staff. The search for the right men took some time, and Mr. Sundaresan, in his letter dated June 3, 1946 to the Managing Director of the Fund (in his 'capacity as Director Joshi's Vice and Governor Deshmukh's Alternate') explained that the delay was due to 'the preoccupations of the political issue now on the anvil', and requested him to defer finalisation of recruitment proposals till the end of the month to enable India to make suitable recommendations in the meantime. To quote the letter:

> I am not unmindful of the need for efficiency -which will rule out National considerations -in an International Organization but I venture to state that even as man does not live by bread alone, international organizations cannot thrive on efficiency alone. Good will is equally essential. Unless we give appropriate consideration at this stage to possible candidates from such countries as China and India, we are likely to be accused of having made this institution an asylum for unsuccessful economists of various countries (however theoretically proficient they may be), whose names seem to have been presented to us. China and India are unknown except geographically and historically to the rest of the world and if they cannot conjure up names of people who have published theses, it does not follow that they have not men of the calibre we require.

Mr. Sundaresan's letter was circulated amongst Board members; it was decided that the Managing Director would not fill all the posts till he had an opportunity of reviewing recommendations from India.

The Governor, in the meantime, sought talent outside the Bank and the choice fell on Dr. Gyan Chand, Professor of Economics and Head of the Department of Economics in the Patna University and Mr. J. J. Anjaria, Reader in Economics at the Bombay School of Economics and Sociology, for the posts of Chief of Division and Assistant Chief, respectively. Later, for about a decade Mr. Anjaria was Economic Adviser to the Union Finance Ministry and from August 1961 through January 1967, he served as India's Executive Director at the Fund, and from February 1967 through February 1970 as a Deputy Governor of the Reserve Bank of India.

The Governor was requested to suggest a third Indian for another post, and Dr. P. J. J. Pinto, an Officer in the Bank's Department of Research and Statistics, was deputed. Later, two other Officers of the Bank's Research Department, Messrs B. R. Shenoy and S. L. N. Simha, were deputed to serve on the Fund's staff for a period of about two years. All the three of them later returned to the Fund as Alternate Executive Directors for India. From the Universities, three more appointments were made in the Fund, namely, Dr. S. A. Pandit, Dr. I. G. Pate1 and Dr. A. K. Dasgupta; Dr. Patel later became India's Alternate Executive Director and also Executive Director. As regards the World Bank, the first and for many years the only Indian staff member was Mr. S. R. N. Badri Rao, an employee of the Ministry of Finance, who later was deputed to study at the Harvard University.

Fixation of Par Value of the Rupee

Under Article XX Section 4 of the Articles of Agreement, the Fund was required, when it considered that it would shortly be in a position to begin exchange transactions, to notify members and request them to communicate within thirty days the par value of their currency based on the rates of exchange prevailing on the sixtieth day before the coming in to force of the Agreement, i.e., on October 28, 1945. A period of ninety days from the date of the receipt of the request was allowed to a member, under the same Section, within which it could notify the Fund if it regarded the par value communicated as unsatisfactory, or conversely the Fund could notify the member that in its opinion the par value could not be maintained. The Fund's request was sent on September 12, 1946; the par value was thus to be notified by October 12, 1946.

It appears from Finance Department's letter to the Governor in July 1946 that even before the Fund's request for communicating the par value of the rupee was received, the informal understanding was that the then existing par value was not to be changed the decision was based on memoranda prepared by Mr. J. V. Joshi and Sir Theodore Gregory, the Economic Advisers to the Bank and Government, respectively, which recommended no change. The Governor was also requested to communicate to Government the Bank's formal views on the matter. After the receipt of the Fund's request a couple of days before mid-September 1946, the Government of India invited Chambers of Commerce, Bankers' Associations and other interested bodies or persons to send their views in writing to them before October 31, 1946. Views of the members of the Bretton Woods Committee and a few other Members of the Legislature were also sought; the majority expressed themselves in favour of the maintenance of the status quo. On October 10, 1946, the Government of India communicated to the Fund the par value of the rupee at .0086357 ounce of fine gold per rupee; this worked out to Re. 1 = 1S. 6d.

In the Bank, the matter was placed before the Central Board at its November g, 1946 meeting. A memorandum prepared by Deputy Governor Trevor, together with notes by Mr. J. V. Joshi and Professor D. R. Gadgil, Director of the Gokhale Institute of Politics and Economics and a nominated member of the Western Local Board, whose views the Governor had sought, had been circulated to the Board members earlier.

Mr. Joshi's note pointed out that the attempt to fix the exchange rate of any currency immediately after the war presented almost insurmountable difficulties, as neither the price levels nor wages nor cost levels reflected the true purchasing power of the currencies. Prices of many commodities were controlled by Governments, but with uneven success in different countries; the same was even truer of wage rates and cost levels. Further, changes in the terms of trade and the balance of payments position had been completely held in check as a result of trade controls and such devices as lease-lend or other methods of financing war purchases. With the end of the war, the special devices were expected to be removed; the resulting position regarding the country's balance of payments was therefore difficult to predict. In the circumstances, the fixation of the exchange rate of any currency, the note remarked, was 'bound to be a shot in the dark or a plunge into the unknown'. However, for the restarting of international trade and exchange, some exchange rate would have to be provisionally fixed.

The note pointed out that much of the relevant data for the fixation of the exchange value of the rupee were not available in India, the only data available being in regard to monetary circulation and prices. Even in regard to monetary circulation, the data were incomplete. On the basis of certain reasoning, the note came to the conclusion that Indian prices, in all probability, would decline during the early post-war period and the index might be stabilised at about double the pre-war level, i.e., at 200. On the other hand, prices in the U.K. were likely to rise by about 5 to 10 per cent to 180-190. The note mentioned other factors which were likely to exert an upward pressure on the exchange value of the rupee. For instance, India had paid off all her foreign debt on Government account. Mr. Joshi's conclusion was that the exchange value of the rupee might be left undisturbed at 18 pence for the time being.

From the point of view of countering inflationary tendencies, the note considered it safer for India to err on the side of a slight overvaluation of the rupee rather than its undervaluation. If, later, some modification in the value of the rupee was necessary, this could be carried out by the exercise of the right of every member country to change the par value of its currency by 10 per cent unilaterally. Even a change of greater magnitude could be accepted by the I.M.F. if it was required 'to correct a fundamental disequilibrium'.

Professor Gadgil, in his note, observed that at the then existing rate of exchange the external value of the rupee was much higher than its internal purchasing power, but he was not in favour of a lower rupee ratio immediately. In his view, as soon as the scarcity of supplies which obscured the effects of the disparity disappeared, full results of the maladjustments would become apparent and a depression and at least a partial devaluation would be inevitable. This could be avoided, he observed, only if Government planned an intelligent policy for the period of transition and successfully carried it out through that period.

The note laid stress on measures to be taken by Government to bring about the necessary adjustment between the internal and external values. Government should aim at bringing down over the next three-year period the controlled prices of cereals and oilseeds by about a third and of cloth by at least a quarter of the existing levels. 'This is the central and the most important of the problems of adjustment', Professor Gadgil observed. To ensure that the supply position regarding imports was not exploited solely to the advantage of the foreign producer and the Indian intermediaries, purchases on Government account, control of prices, control of distribution, etc., should be tried. Action should also be taken in the form of 'detailed and specific regulation' of certain types of imports to protect the claims of smaller industries started during the war.

The Central Board concurred with the recommendation of Mr. Joshi and Professor Gadgil. At its November 9, 1946 meeting, the Board resolved:

> That a recommendation be made to Government that no change be made in the par value of the Rupee already communicated by the Government of India to the International Monetary Fund on the 10th October 1946 viz.,.0086357 ounce of fine gold per rupee.
>
> It was further resolved that Government be requested to consider the economic implications of this decision on the lines indicated in Professor D. R. Gadgil's Note on Exchange Parities circulated to Directors of the

> Central Board, and to take appropriate measures from time to time in order to ensure that the rate decided upon is not out of equilibrium.

The recommendation was accepted by Government. Although in view of this there was no need to send any fresh communication to the Fund, the Government of India wrote to the Fund stating that in the interests of accuracy, they preferred the par value to be expressed as under:

> Using gold as common denominator, Rupee one is to be regarded as having a theoretical gold content of 4.145142857 grains of fine gold; this weight of gold producing Rupee /Dollar rate of Rs. 3.3085194 per U.S. Dollar and a parity price of gold of Rs.115-12-9.25056 per ounce of fine gold.

In the earlier communication of October 10, 1946, the par value had been expressed in terms of ounce of fine gold, calculated only up to 7 decimal points; this worked out to 4.1451360 grains, and was therefore not quite accurate. It may be mentioned that as early as October 9, 1946, Deputy Governor Trevor had suggested that the par value should be fixed in terms of grains troy of fine gold.

Third Interim Report of the Bretton Woods Committee

It will be recalled that the Bretton Woods Committee in its Second Interim Report of April 17, 1946, had recommended that the Government should postpone payment of subscriptions to the Fund and the Bank till the last moment, but if it became necessary to take a final decision before the Assembly met, the Committee should be summoned and a decision should be taken in consultation with it. Accordingly, on being informed that the World Bank was likely to start making calls on the share capital towards the end of June 1946, the Government of India instructed the Indian Executive Director on the Bank's Board to find out whether it was possible to postpone payment so that the final decision might be taken by the new Government, in consultation with the Legislature; the Government were informed that it was not permissible.

On June 19, 1946, the World Bank notified the Government of India that it would start operations on June 25. 1946 and that India should pay (i) 2 per cent of the subscription (i.e., $8 million less $40,000 already paid) in gold or U.S. dollars on or before August 24, 1946 and (ii) 3 per cent of the subscription in rupees on or before November 25, 1946. A further 5 per cent in rupees would also become payable on or before November 25, 1946; a formal demand for this was to follow later.

The Bretton Woods Committee was assured by the Finance Member that the dollars required for payment of subscription would be made available from the Empire Dollar Pool, the effect of which would be an equivalent reduction in sterling balances. He also informed the Committee that the British Government had indicated that they would be ready to issue an invitation for commencing negotiations on sterling balances, as soon as a representative Government was formed in India.

The Committee in its Report* dated July 29, 1946, observed that in considering the three alternatives before it, viz.,

(i) to authorise the payment for which demand had been made,
(ii) to instruct Government to withdraw from the membership of the Bank, and
(iii) to continue membership but default in payment,

the Committee had the benefit of the advice** of the Reserve Bank Governor (who was also the Governor for India of these two institutions). Of the three alternatives, the Committee 'unhesitatingly' rejected the third. As regards the second, it was not sure whether it 'would be correctly interpreting the wishes of the Assembly in recommending withdrawal'. The Committee, therefore, recommended to Government to pay $7.96 million, which had to be paid on or before August 24, 1946, leaving it to the Legislature to decide whether to pay the remaining 8 per cent of the subscription by November 25, 1946. The Report observed:

> We do not wish, however, to take upon ourselves the responsibility of authorising payment of the remaining 8 per cent of the subscription which has to be paid by the 25th of November. We strongly recommend, therefore, that, irrespective of the political situation at the time, a session of the Legislative Assembly should be called on or about the10th November 1946 at the latest, in order to allow the Assembly to make up its mind finally whether it wishes to continue India's membership of the Bank or whether it wishes India to withdraw from that institution.

Mr. Manu Subedar, a member on the Committee, submitted a Minority Report, in which he observed:

> I have no hesitation in saying that India should withdraw from the membership of the Bank at this stage.

The main reason advanced by him was that India would be unable to shoulder further credit obligations, until her own position regarding repayment of sterling balances was made clear.

* The Report was signed by only four members viz., K. C. Neogy, N. V. Gadgil, Zia Uddin Ahmad and M. Ananthasayanam Ayyangar.
** It appears one of the members on the Committee told Sir Chintaman after the meeting in which the Committee examined him:

We are satisfied that it will be in India's interests if India joined the Bank -if you say so, -you are one of us.

The Committee's Report was presented to the Legislative Assembly on October 28, 1946, when the second session commenced.

The Finance Member of the Interim Government, Mr. Liaquat Ali Khan, moved:

> That this Assembly having considered the third report of the Committee on the Bretton Woods Agreements do hereby approve India's continued membership of the International Monetary Fund and the International Bank for Reconstruction and Development.

The Finance Member pointed out that he was seeking the approval of the House not only for the immediate payment of 8 per cent of the subscription which had to be made, but 'for a declaration of its policy with regard to these international organisations'. He urged Members to look at the problem 'only from the point of view of India's interests and of no other interests'. The motion approving India's continued membership of the Fund and the Bank was adopted.

FORMATIVE YEARS OF THE FUND AND THE WORLD BANK

In the formative years of the International Monetary Fund and the World Bank, there was much work for the Board of Executive Directors and the Governors. Since India was one of the big five, she had an active share of responsibility in the formulation of policies and procedures for the grant of assistance and in the interpretation of the flexible Statutes, especially in the case of the Fund. With Sir Chintaman Deshmukh as the Governor for India on the Fund and the World Bank, the Reserve Bank was in intimate touch with the working of these two institutions. The Executive Directors kept the Governor informed of all the developments and took instructions from him regarding the stand they should take on various matters coming up before the Fund and the Bank Boards. There was of course very close consultation between the Reserve Bank and Government on all important issues.

Even after his retirement as Governor, Sir Chintaman continued to be the Governor for India on the I.M.F., while Sir Benegal Rama Rau was appointed Governor for India on the World Bank. Effective August 2, 1950, Mr. Deshmukh, who had then become Finance Minister, became the Governor for India on both these institutions, while Mr. Rama Rau was appointed Alternate Governor.

The Reserve Bank was designated as the depository for all the Fund's and the World Bank's holdings of rupees and rupee securities. Also, India being the fifth largest quota country, was entitled to designate a depository in which the Fund and the World Bank might hold their other assets, including gold; the Reserve Bank was thus designated by the Government of India as a gold depository of the Fund and the Bank.

Payments towards India's quota of $400 million (Rs. 132.34 crores) were made as under:

(1) Gold subscription: (equivalent to 10 (equivalent to India's official holdings of gold)	$27 .53 million or Rs.9.11 crores
(2) Currency subscription (i.e. rupee subscription)	
(i) Cash	$40.00 million or Rs. 13.23 crores
(ii) Non-negotiable non-interest bearing securities	$332.47 million or Rs. 110.00 crores

The gold payment was made not out of the Reserve Bank's holdings but out of the Bank of England's gold stocks held by the Reserve Bank, which credited the Bank of England's account with the rupee equivalent. The gold, cash and securities, in connection with India's quota, were all held by the Reserve Bank on the 1.M:F.'s account.

In respect of the World Bank, 20 per cent of the subscription of $400 million was payable initially, of which 2 per cent (i.e., $8 million less $40,000 paid on December 27, 1945 towards administrative expenses) was to be paid in gold or U.S. dollars before August 24, 1946; this was paid, the dollars being made available from the Empire Dollar Pool. The remaining 18 per cent was paid in three calls between November 25, 1946 and May 26, 1947. Almost the entire amount was in the form of securities. The Bank held the cash and the securities on the World Bank's account. Taking cognisance of a communication from the Government of India embodying a copy of the Indian Independence (International Arrangements) Order, 1947, it was decided at the second annual meeting of the Fund and the World Bank that the quota of the pre-partition India in the Fund and her subscription to the capital stock of the World Bank should continue to be the 'quota' and 'subscription' of the Dominion of India.

Following devaluation of the rupee in September 1949, additional contribution equivalent to the reduction in the gold value of the Indian currency held by the two institutions became payable, Rs. 68. 66 crores in respect of the Fund-and Rs. 10.46 crores in respect of the World Bank, and these were paid in the form of non-negotiable non-interest bearing securities.

It is outside the scope of this chapter to deal with the operations of the two institutions. A brief reference will be made to the assistance which India received from the two institutions in the period covered by this narrative. On account of the difficulties in the way .of conversion of India's sterling balances to dollars and other hard currencies under the Sterling Balances Agreements, India had undertaken to purchase from the I.M.F. a maximum amount of about $150 million during the eighteen-month period January 1948 to June 1949. In January 1948, a request for a drawing was conveyed to the Fund. The Fund agreed, and drawings for a total of $100 million were made in seven instalments beginning with March 1948 and ending with March 1949.

In March 1949, the first fact-finding mission from the Fund, under the leadership of the Director of Operations, Mr. (later Sir) M. H. Parsons visited India, for the study of economic and financial trends, especially of the balance of payments, and discussions with the Indian authorities. An I.B.R.D. mission, led by Assistant Loan Director of the Bank, Mr. A. S. G. Hoar, also visited India early in 1949, to study the Indian economy in all its aspects and particularly the development programmes in regard to railways and agriculture, which had been put forward by the Government for the World Bank's consideration for loan assistance. The mission was also to judge the safety of the loan and the possibility of India earning sufficient dollars to repay the loan. In connection with the visit of these missions the Reserve Bank compiled a great deal of background material. The I.B.R.D.'s first loan to India was granted in August 1949. This was for $ 34 million for railway development. Towards the close of September, another loan of $10 million was made for the purchase of agricultural machinery. In April 1950 a third loan of $18.5 million was sanctioned for electric power development. The total amount disbursed to India against these loans till the end of June 1951 aggregated $ 42.98 million.

Over the years, the assistance received by India from the Fund and the World Bank has been substantial, India being the largest recipient of aid from the World Bank Group, that is, from the I.B.R.D. and its two affiliates set up later, namely, the International Finance Corporation and the International Development Association.

STERLING AGREEMENTS

Further Sterling Accumulation

The immediate post-war period was characterised by further substantial accumulation of sterling with the Bank. These balances, which stood at Rs. 1,363 crores at the end of March 1945, rose to Rs. 1,507 crores by the end of August and further to a peak of Rs. 1,733 crores in the first week of April 1946. The rise in the financial year 1945-46 was

Rs. 361 crores, as compared to Rs. 418 crores in the year 1944-45. The problem of the continuing accretion of sterling, which was of constant concern to the Central Board throughout the war years, engaged its attention again early :n 1946. A new factor in the situation was the possibility that a portion of the sterling balances might be scaled down as a contribution by the Government of India to the Allied war effort. The Anglo-American Loan Agreement announced in December 1945 in fact contained proposals to this effect.

Towards the end of January 1946, Director B. M. Birla informed the Governor of his desire to move a resolution at the next meeting of the Board, with the object of bringing to the notice of Government the unsatisfactory position regarding India's earnings of dollars and the mounting sterling balances of the Bank. The Governor himself was equally convinced that it was high time that the Government of India took the matter up with the British Government and had already impressed upon the Finance Member the urgent need to obtain clarification from the British Government of their intentions with regard to the liquidation of the balances that had accumulated during the war and of the methods they proposed to adopt for financing their subsequent expenditure in India.

The Government of India were not too pleased at the prospect of a discussion of these subjects at the Board meeting scheduled for February 25, 1946, owing to the close proximity of the budget. The Finance Member was to deal with these questions in some detail in his budget speech three days later. The rate of accretion of sterling was already substantially reduced. In regard to the Empire Dollar Pool the position was that India's balance of payments with the hard currency countries was actually running against her and some delay in the discussion seemed to be beneficial rather than otherwise. Besides, the termination of the Dollar Pool arrangements was already in a fair way of being settled, either as a result of the operation of the Anglo-American Loan Agreement * or of the inauguration of the I.M.F. For these reasons, Government earnestly hoped that the Board would agree to postpone consideration of Mr. Birla's resolution until its next meeting.

The Board did not comply with the Government's request. After discussing the matter from all angles, it passed the following resolution:

> Resolved
>
> That the Board of the Reserve Bank is alarmed at the continued accumulation of sterling even after the termination of the war and requests

* The Agreements contained a clause to the effect that the U.K. Government would complete arrangements as early as practicable and in any case not later than one year after it came into effect, under which the sterling receipts from current transactions of all sterling area countries would be freely available for current transactions in any currency area without discrimination ; in other words, any discrimination arising from the Sterling Area Dollar Pool was to be entirely removed and each member of the sterling area was to have its current sterling and dollar receipts at its free disposition for current transactions anywhere.

> the Governor to apprise the Government of India of the considered views of this Board-That all disbursements in future made by His Majesty's Government in rupees must be paid for either in free foreign currencies or in capital goods or in such consumer goods as are acceptable to India or in bullion.

Mr. Birla's earlier proposal that the Board should also insist 'that all foreign exchange accruing to India on account of her surplus exports should be made available for meeting the requirements of Indian trade' was, however, dropped when the Governor pointed out that it would be against India's interests to force that particular issue. Thus, the general purport of the resolution finally adopted was almost the same as that of the resolution passed in December 1944.

It would appear that the Board received no reply from Government although the question was raised again at the Committee meeting of May 8, 1946, when it was suggested that the Governor should remind Government, which the Governor did, urging them to send 'an early and considered reply'.

In his budget speech, the Finance Member (Sir Archibald Rowlands) dealt at length with these issues which agitated the public mind greatly. On the question of the further accruals of sterling with the Bank, he said that alternative methods of financing the British Government's expenditure in India were engaging the closest attention of Government, although the amount involved for the year 1946-47 (estimated at Rs. 42 crores) was insignificant as compared with the total of the sterling assets acquired by the Bank till then. There was even the possibility, he added, of the U.K.'s increasing her exports to India to such an extent as to avoid any further sterling credits. As for convertibility of the existing sterling balances, negotiations were to take place in the course of the year between the two Governments, the arrangements to be made being a matter for bilateral settlement between India and the U.K. The Finance Member also repeated his earlier assurances to the House, viz., that he would associate representatives of the leading political parties in the country and other non-officials with the delegation to be appointed for the purpose of discussions with the British Government and that ' India will be entirely free to take any line that she may see fit to pursue at these negotiations and any idea that she is committed in advance to a scaling down of the balances or to a continuance of arrangements under which such balances will continue to accrue is entirely without foundation'.

On the question of India's withdrawal from the Empire Dollar Pool, the Finance Member expressed the view that it would be 'premature and unprofitable' to do so. India's net contribution of hard currencies to the Pool during the period between September 1989 and

March 1945 had been Rs. 99.31 crores and after allowing for the net import of gold from the U.K. during the same period, valued at the world price of the metal, the balance in India's favour was Rs. 49.23 crores. If India could at all establish any claim on the Pool, he added, it would almost certainly be for a much smaller amount than what India could obtain by way of free foreign exchange by negotiation with the U. K. Government.

Mr. Joshi's Memorandum on Sterling Balances

While the Finance Member's attitude to the subject of sterling balances was thus on the whole satisfactory, the Bank, as a guardian of the national interests, considered it prudent to have a detailed study prepared, answering in particular the arguments for a scaling down of the balances. The study, which involved several technical matters relating to the transfer problems, was made by Mr. J. V. Joshi, the Bank's Economic Adviser. It was circulated to the Directors on March 20, 1946, apparently not so much for the purpose of bringing the matter up for discussion at a Board meeting later, as the Board and the management held similar views on the question, as for keeping the Bank's arguments ready for being made known to the Indian public, should the Government of India wilt under pressure from Whitehall and accept arrangements disadvantageous to India. Copies of the study were also sent to Government.

Mr. Joshi's memorandum contained an effective rebuttal of the arguments for the scaling down of the sterling balances. The argument that these balances were the result of the War Financial Settlement which was most generous to India and unfair to Britain was not tenable. It was, among other things, based on a misconception that the entire sterling balances of India were due to the Financial Settlement and the credits received by her under it from the U.K. Actually, out of the total sterling of about £1,515 million which accrued to India till the end of March 1945, the credits received from the Secretary of State accounted for. £ 969 million, the rest being the result of regular commercial transactions between the two countries.

Another fallacious argument of the scaling down school was that the Allied purchases in India were made at inflated prices. Mr. Joshi pointed out that there was no justification for making any such charges after the publication of the Fourth Report of the Select Parliamentary Committee on National Expenditure (Session 1944-45) which made an independent investigation of British expenditure in India and was satisfied that fair prices had, on the whole, been secured for war stores and food bought by the U.K. in India.

Mr. Joshi also established that Britain had the ability to repay the sterling debt. In this connection he quoted from the findings of a study made by the well-known U.K. organisation, the Political and Economic Planning Group (P.E.P.), the, conclusion of which was:

> Of the two problems as they apply to our total war debt, the physical problem is likely to prove less difficult than the financial, at least after the post-war period of scarcities. To see the physical problem in its correct perspective, the rate of repayment should be compared with our national income. An annual payment of £100 millions for instance would represent little more than 1 per cent of the nation's present income. This should not put an excessive strain on our national economy and the standard of living even if we fail to achieve full employment. Indeed, in such conditions debt repayment would contribute valuable employment-creating expenditure. It is in the financial mechanism of transferring such a large volume of goods and services that the strain may occur and, failing world-wide full employment, it will be the absorptive power of the creditors, specially of our wealthier creditors rather than the productive power of the debtor that is likely to be strained.

After considering all the possibilities concerning the manner in which India should receive repayment of the sterling balances, Mr. Joshi concluded that it would be in India's interests to receive repayment by expanding her imports rather than by cutting down her exports. In this connection, Mr. Joshi stressed the need for careful and comprehensive planning and a predetermined schedule of priorities for imports on both Government and private account so as to secure that while absolutely essential consumption needs were met the counttry's external resources were not frittered away on luxury imports, and that the balance was spent on the purchase of construction goods vital for the country's economic development programme. In the context of the large unilateral transfer of wealth represented by the repayment of the sterling balances, Mr. Joshi felt the situation needed careful watching to see that the rupee was not undervalued.

Mr. Joshi concluded his memorandum with suggestions for realisation of the sterling balances in the extreme contingency of Britain defaulting on her obligations. The sterling balances amounting to something over £1,000 million could be realised completely, he said, by offsetting an amount of about £ 250 million against a lump sum payment to the British Government to cover the Indian Government's liability for the pension and provident fund monies of the British personnel and by the legal acquisition of British private investments in India estimated at £900-1,000 million.

Governor's Views

As mentioned in an earlier chapter, the Governor had, for quite some time, been stoutly opposed to India's continuance in the Empire Dollar

Pool for the reason that India's surplus dollars which went into the Pool were not necessarily going to be available to her as a reserve for the future. The Finance Member's justification of India's continued membership of the Pool in his 1946 budget speech must, therefore, have irked him greatly. Finding that Government were contemplating the establishment of clearing agreements with certain countries in order to ensure that India's export surpluses with the countries concerned were kept out of the Sterling Area Dollar Pool, the Governor wrote again to Mr. Ambegaokar in the Finance Department in April 1946 to say that these proposals touched only the fringe of the problem as India's balance of payments with these countries was of minor concern as compared to that with the United States. He emphasised that a bolder and more straightforward policy was called for. As a way out, a suggestion was to be made to the British Government that the favourable balance that India would have with the United States after January 1, 1946, as might be-agreed upon between the Reserve Bank and the Bank of England, ' should be earmarked for India's future needs and should be excluded from any other allotments of foreign exchange that may be agreed upon in view of India's contributions to the Dollar Pool up to the 31st December 1945' (e.g., the Post-War Dollar Fund).

There was no immediate reply to the Governor's proposals from Government. Not, unnaturally, therefore, the Governor chose to express his views on the Finance Member's budget speech at the following annual meeting of the Bank's shareholders in August. Without making so much as an oblique reference to the budget speech, the Governor disagreed with the Finance Member over even his description of the Empire Dollar Pool as a modification, caused by war conditions, of the sterling area arrangement which had been in existence for a century. The war-time sterling area system, the Governor explained, was evolved essentially for purposes of exchange control, and although the pooling of scarce currencies had grown out of the sterling bloc system of 1931-39, it differed both in its structure and in its aims from that system which was organised for providing a limited amount of multilateral convertibility and avoiding the deflationary influences of the gold standard.

The Governor also challenged the view that it was ' premature and unprofitable ' for India to dissociate herself from the Pool as statistics of the succeeding months had invalidated the Finance Member's argument about India's drawals from the Pool exceeding her contributions to it. He disputed also the suggestion that the gold sales of Rs. 50.crores made in India on behalf of the U.K. and the U.S. Governments should be set off against India's contribution to the Dollar Pool; the gold sales had to be regarded as indicating only the extent to which further accumulations of sterling were obviated. Summing up, he made it clear that in his opinion, the Empire Dollar Pool had outlived its utility and, ' as far as India is concerned, can no longer exist, once the International Monetary Fund starts operations ' in the beginning of the next year. The Governor was equally critical of Government's restrictive import policy which was resulting in shortages of much needed supplies of capital equipment and essential consumer goods. The Governor also referred to the inflationary aspect of export surpluses.

Finally, referring to the mounting public criticism in India of the rising volume of sterling balances 'in the face of increasing demands on the other side for their scaling down' and the widespread resentment in regard to the provisions of the Anglo-American Loan Agreement contemplating the scaling down of a proportion of the balances held by third parties without reference to them, he expressed satisfaction at Government's stand as declared by the Finance Member in his budget speech.

This speech to the shareholders was yet another occasion when the Governor found it necessary to assert the Bank's independence from Government. Commenting on the draft speech which it was customary for the Finance Member to see beforehand, the latter (Sir Eric Coates) felt that the Governor's observations and criticism of the Empire Dollar Pool and import control would be ' most embarrassing ' to Government and ' might also lead to counter-attack from financial circles in the U.K.'. Moreover, the Government had already heeded the Governor's advice to relax control on the dollar exchange and imports. It was therefore the 'earnest' suggestion of the Finance Member that:

> it would be more helpful even from the public point of view if you confined yourself to a brief statement that now that the war is over, the dollar position is getting easier and the Government of India are fully alive to the importance of making dollar exchange available, especially for obtaining capital equipment, which it may be necessary to obtain from U.S.A.

Sir Chintaman could not see his way to acceding to the Finance Member's request; he felt that no embarrassment could be caused to the Government by stating facts and arguments which were solely in India's interests. Nor did he 'wish to be associated with the incorrect view expressed in the last budget session'. He then went on to justify the observations he wished to make at the meeting:

> I attach no importance to reactions in financial circles in the U.K., have already let loose a flood of anti-Indian material during the last two or three years. I also do not agree that disclosure of facts and arguments is prejudicial to our interests, especially as the possibility of "adjusting" our sterling balances has been embodied in the Anglo-American Loan Agreement. In the first place, they are my own personal

> opinions reflecting generally the sense of the Reserve Bank Board, but I do not venture to assume that these sentiments are shared by the Government of India, who are free to disown them if they wish to. The Empire Dollar Pool and Import Control have, in my opinion, no vital relevance to sterling balances negotiations. . . . . . If the assumption is that India is at present making no net contribution to the Pool, then there can be objection to its early termination. . . . . . As I consider that Government has not taken early enough or sufficient action as regards dollar exchange, I prefer to adhere to my observations. As regards import control, since I am reviewing the happenings in the Bank year, I cannot see how the trend of my argument can prove inconvenient to Government . . . . . . I regret, therefore, that I shall not be able to incorporate in my speech the general optimistic sentiments you have indicated.

Sir Eric Coates recognised that it must be left entirely to the Governor's discretion to say what he felt in his speech. Apparently fearing that he had been misunderstood, he even hastened to assure the Governor that he had also India's interests 'very much at heart'. Adverting to the ' flood of anti-Indian material ' released in the U.K. mentioned by the Governor, the Finance Member pointed out that what mattered was not what the press of either country said but the opinion of responsible authorities; no such authority in the U.K. had till then said anything prejudicial to India's interests. The best way of getting as favourable a settlement as possible out of England was to be 'quite friendly but quite firm' and to avoid mutual irritation and resentment in public in the meantime; 'if England goes sour', Sir Eric said, ' we stand to lose a lot'. As for the Empire Dollar Pool, the Finance Member added confidentially that he was willing to withdraw from the Pool at once, subject to the Executive Council's approval and to the Bank working out the necessary details. He was not, however, in favour of the Governor's suggestion (made in earlier correspondence) that India should claim her entire past net contribution of dollars to the Pool apart from and in advance of the sterling balances negotiations.

The Governor supplemented his remarks at the shareholders' meeting with further suggestions in a letter he wrote to Sir Eric Coates again a few days later. Since he had written to Mr. Ambegaokar in April advocating India's immediate withdrawal from the Pool, he had grounds to modify his recommendation to the effect that the withdrawal from the Pool or from the sterling area should not take place until the International Monetary Fund had come into operation in the new year; India had considerably to gain by the various monetary agreements made by the British Government. He therefore suggested advising the U. K. Government at that stage that the general pooling of U.S. dollars should be regarded as having ended on December 31, 1945 and that any dollars earned by India and paid into the

Pool since January 1, 1946 should be isolated and not taken into account when negotiating the general settlement on the sterling balances and the division of the Pool. The latter earnings were not to be taken back by India straightaway but allowed to be retained with the British Government for meeting India's expenditure in the U.S.A. during the rest of the year, as large disbursements of U.S. dollars on account of food imports were expected to be made during 1946-47. The Governor suggested also that as from October 1, 1946, banks should be instructed to transfer their surplus dollars (accruing from private merchandise transactions) to the Reserve Bank instead of surrendering them to the Bank of England, as this would enable the Bank to build up a dollar balance to meet the immediate requirements when the sterling area arrangement terminated. In case India's dollar earnings since January I, 1946 proved to be insufficient to meet her requirements, he expected the U.K. Government to provide the necessary dollars, perhaps by 'marking it off' against India's dollar surplus in previous years. Thus, the arrangement that the Governor had contemplated earlier, viz., immediate withdrawal from the Pool along with a claim on the British Government for India's past credits to the Pool, gave place to a suggestion for continuance in both the sterling area and the Pool until the International Monetary Fund began operations.

Sir Eric could not, however, deal with the Governor's proposals as he was stepping down from office on September 2. It would appear that these were not pursued further either by the Governor or the next Finance Member, as India had begun to be a net drawer from the Dollar Pool from the end of 1946. The Government, however, issued a press communique on October 7, to remove 'the considerable misgivings in the public mind about such matters as India's earnings and expenditure of dollars, the Empire Dollar Pool and the Post-War Dollar Fund'. The main theme of the communique was that India's expenditure of hard currencies was not related to or limited by what she had contributed to the Pool.

Beginning of Negotiations with the U.K.

The first official discussions between the Governments of the U.K. and India for exploring avenues of settlement of the sterling balances question did not take place until the beginning of 1947, although there were press reports that the British Treasury had asked the Government of India to send a delegation to London for discussion in July or August 1946. A British delegation consisting of Sir Wilfrid Eady of the Treasury and Mr. (later Lord) Cobbold, Deputy Governor of the Bank of England, visited India early in February 1947 for talks with the Government of India.The Indian side, headed by Mr. V. Narahari Rao (Finance

Secretary) included two officials from the Bank, Mr. J. V. Joshi and Mr. Ram Nath. The talks were intended to be largely exploratory, but they covered, in fact, the entire field. It was finally agreed that the existing arrangements should continue on the understanding that an early settlement would be reached providing for a ceiling on withdrawals for current expenditure, the regulation of capital transfers and other connected matters. Declaring that the talks were ' extremely useful to both sides', the Finance Member (Mr. Liaquat Ali Khan) announced in his budget speech in February 1947 that they were expected to be resumed on a more formal basis in April. He repeated the assurances of Sir Archibald Rowlands in the preceding year's budget speech and his own in October 1946 in the matter of securing a 'just settlement' of India's claims and stressed the importance of an early solution in view of the imminence of constitutional changes.

The actual position of the Reserve Bank's sterling balances at this juncture needs to be mentioned here. After having reached a peak figure of Rs.1,733 crores on April 5, 1946, the balances declined to Rs.1,602 crores by March 31, 1947, owing to the cessation of the Allied Governments' war expenditure and the heavy imports of food-grains, consumer goods and equipment. There was also some private capital repatriation, largely British.

At the talks in February 1947, the British delegation had admitted that both India and the U.K. had made the maximum sacrifice for the war. Also, there was no suggestion that the Financial Settlement by itself had been inequitable either to the U.K. or to India. The British delegation agreed further that no question would be raised as to the prices charged for war supplies. Thus, there was good reason to hope that the ghost of scaling down of the sterling balances had been finally laid, although at the end of the discussions the British Government reserved their right to reopen all the issues. Indian hopes were therefore completely shattered when Dr. Dalton, Britain's Chancellor of the Exchequer, addressing the Brazilian Chamber of Commerce in London in May 1947, declared that Britain should refuse to take on ' fantastic commitments which axe beyond her strength and beyond all the limits of good sense and fair-play ', that the war debts amounting ' nominally ' to more than £3,000 million were an 'unreal, unjust and unsupportable burden' and further that they 'must be very substantially scaled down'.* This out burst, from the most responsible sources in Britain, evoked strong protests all over India. Although the matter did not come up before the Central Board formally, individual Directors like Mr. B. M. Birla were extremely concerned and they wrote to the Governor about it. The Governor did not share their gloomy prognosis, and felt that the Chancellor's speech might well be

* The New York Times, May 7, 1947.

merely ‘part of a war of nerves’; there was no information officially that the U.K.’s attitude to the Indian debt was any different from that expressed earlier in February.

First Interim Agreement -August 1947

Fresh discussions with the U.K. Government could be held only in July 1947. For this purpose a delegation headed by the Finance Secretary, Mr. V. Narahari Rao, visited London. The meetings took place between July 9 and 25. The Reserve Bank was represented on the delegation by Mr. H. D. Cayley, Deputy Controller of Exchange. The British delegation was led by Sir Wilfrid Eady. In view of the far-reaching political changes in India, the scope of the talks was restricted to arrangements to be made for a period of six months in order to provide India with sufficient foreign exchange to cover the estimated deficit in her balance of payments during that period. These meetings were in a way the most important of the whole series, because the basic principles and the mechanism relating to the execution of all subsequent agreements were evolved at this time.

After exhaustive discussions, both sides agreed to treat the arrangements to be made up to the end of December 1947 as purely of an interim nature, and without prejudicing either side in any manner in regard to a final or another interim agreement later on. The agreement was to be made with the existing single Government of India, it being a domestic matter between the two new Dominion Governments and the Reserve Bank to make the necessary arrangements for dealing with import, export and exchange controls while the agreement was in operation. The Indian delegation opposed the proposal of the British delegation for freezing the outstanding balances at a certain figure on a given date by the issue of a formal freezing order, whereupon it was given the alternative of accepting the concept of two accounts, one available for being drawn upon freely and the other a blocked one. The arrangement was to cover only the sterling balances of the Reserve Bank, leaving out of account those of commercial banks and private individuals.

To enable India to meet certain heavy payments in early July 1947 outside the releases to be made under the interim agreement, the zero date was taken as July 14 and the Reserve Bank’s balances taken at the figure of £1,160 million, being approximately the balance on that date. The U.K. delegation proposed a release of £65 million out of this balance for that year, of which £30 million would be treated as a ‘working balance’ and the balance of £35 million as a straight release. Although the ‘working balance’ was in the nature of a reserve which was expected to be replenished in due course by the flow of trade, it was not envisaged that the whole amount would remain intact at the end of December 1947. Thus it was, in fact, available for drawal in addition to straight releases for meeting any temporary deficits.

The Reserve Bank's balances with the Bank of England were to be divided into two accounts designated No.1 and No. 2. On the date of the agreement, the No. 1 Account was to be credited with the release of £65 million less all amounts expended between July 15 and the date of the agreement. The balance in this account was to be available for all current expenditure in any part of the world; all future currency earnings and expenditure were to be credited and debited to this account. The remainder of the Reserve Bank's sterling holdings was to be transferred to the No. 2 Account and this was to be utilised for specified purposes only where the transactions were of a capital nature or involved 'once-for-all-payments'. It was also agreed that certain specified capital payments due from the U.K. to India were to be credited to the No. 2 Account.

The Government of India consulted Governor Deshmukh before signifying their assent to the terms negotiated by the Indian delegation in London, which the delegation itself considered to be very satisfactory in the prevailing circumstances. Under the proposed arrangements, India would remain in the sterling area with the benefit of all the monetary agreements entered into by the British Government. The agreement came into force on August 14, 1947 and was to terminate on December 31, 1947. The value of the Bank's sterling assets at the close of August I 4 was £1,134 million, which was lower by £26 million than the notional figure of £1,160 million. Hence Account No. 1 was opened on August 15 with £39 million, being £65 million less £26 million by which the balance of £1,160 million had decreased since July 14. Account No. 2 was opened with £1,095 million, being the remainder of the sterling assets.

Apart from the agreement itself, some points of understanding reached during the discussions were embodied in a series of letters exchanged between the leaders of the two delegations. The points covered related to the treatment of the sterling assets held in Government's Silver Redemption Reserve, the balance in India's Post-War Dollar Fund and Indian private sterling balances (comprising those of individuals and banks) and the manner of investment of the Bank's sterling holdings. In regard to the last, it was agreed that during the currency of the agreement, the Reserve Bank would not alter the disposition of its sterling assets in such a manner as to increase 'appreciably' the 'overall' rate of interest which such assets were then earning; subject to this understanding, the Bank was free to alter its investments 'in accordance with normal central banking practice'. (At that time approximately £250 million were invested in medium and long-term securities and the remainder in Treasury bills; the average yield on the Bank's sterling investments as on August 14, 1947 was 0.8101 per cent).

The service Mr. Cayley rendered to the Indian delegation came in for warm appreciation from its leader, Mr. Narahari Rao, on the team's return to India. In a letter to the Governor, Mr. Rao stated that he wished to place on record the immense help which his vast knowledge gave the delegation, especially in the technical discussions with the Bank of England. He went on to say that:

> Throughout his association with us, he displayed not only great ability and quickness of perception, but also a deep sense of loyalty to truth and fair-play. He showed great concern to ensure that India got a fair deal and spared no pains in the examination of the somewhat complicated proposals in connection with capital transfers and other operations on the No. 2 Account.

Second Interim Agreement -February 1948

With the attainment of independence and with the fears of scaling down of the sterling balances laid to rest, the Reserve Bank's role was mainly one of making its expertise in the spheres of balance of payments and exchange control available to the Government to enable them to negotiate for releases adequate for meeting the estimated balance of payments deficits in both hard and soft currencies. As mentioned in an earlier chapter, the Bank began to take special steps during this period to compile scientifically balance of payments data, the lack of which was proving a great handicap to the Government in their formulation of trade and payments policy. Being responsible for implementation of the agreements, the Bank remained in close touch with both the Bank of England and the Government of India throughout, for watching the pace of withdrawals as well as for deciding the eligibility of various transactions for releases from the blocked Account (No. 2).

A delegation from the U.K. under Sir Jeremy Raisman visited India in January 1948 for further negotiations with the Government of India for releases from January 1, 1948. Although the negotiations led only to the extension of the agreement of 1947 on the same basic principles, and the new agreement was also an interim one to cover the period up to the end of June 1948, there was a significant modification caused by the failure of the convertibility experiment in the U.K.* and the worsening in that country's balance of payments position. There was

* Sterling became fully convertible on July 15, 1947 (in accordance with the Anglo-American Loan Agreement of December 6, 1945) but convertibility was suspended after a brief while, from August 21 of the same year.

also the partition of the Indian sub-continent consequent on which separate releases had to be made for Pakistan's account. From the Reserve Bank Mr. Cayley was again the participant in these talks which, on the Indian side, were conducted by Mr. Narahari Rao.

Under the extended agreement, which was entered into by exchange of letters between the leaders of the two delegations on February 15, 1948, a sum of £18 million was transferred from the No. 2 to the No. 1 Account of the Reserve Bank for meeting current expenditure up to June 30, 1948. However, unlike the earlier agreement where the entire £65 million was convertible into dollars, a sum of £ 10 million* only could be converted out of this release. India was expected to draw from the International Monetary Fund an additional sum of between $40 million and $52 million to make good the estimated deficit in her dollar payments. Although the convertibility of sterling had been suspended soon after the terms of the first interim agreement were negotiated, India's current earnings of sterling as well as the amounts released under this agreement had not been rendered inconvertible. The U.K. Government had, however, made an appeal to India to keep her U.S. dollar expenditure to a minimum. The proposed limitation on the extent of convertibility introduced a new factor in India's relationship with the sterling area which had so far permitted each of its members to draw on the foreign exchange resources of the area according to its needs. While the Government of India sympathised with the U.K.'s dollar position, they regarded the proposed limit of convertibility as low and hoped the restriction would be removed soon. †

As regards Pakistan, it was mentioned in the previous chapter that she was to negotiate separately with the British Government for releases beyond January 1, 1948. Thus, under the extended agreement, the Reserve Bank was to transfer from its No. 2 Account to the Pakistan Account (opened in terms of the Partition Council's decision of December 1947) the sums agreed between the Governments of the U.K. and Pakistan to be made available to Pakistan for her current requirements. The Reserve Bank was also to transfer from its No. 1 Account to the Pakistan Account a sum representing the receipts less payments on behalf of Pakistan between January 1, 1948 and the date of opening of the Pakistan Account in addition to the amount arrived at in terms of the Partition Council's formula on account of imports into Pakistan ports between July and December 1947. It was also agreed that in view of the arrangements in connection with the partition, the question of providing gold and dollars which it might be

* This included the U.S. dollar balances as on December 31, 1947 of banks in India in excess of their normal working balances, which by agreement was fixed at £l million, and the whole of the remaining balance (of about £2 million) in India's Post-War Dollar Fund.

† Finance Minister's budget speech for the year 1948-49, paragraph 16.

necessary for Pakistan to pay by way of subscription if and when she became a member of the I.M.F. and the World Bank would be a matter between the Governments of the U.K. and Pakistan and not between India and Pakistan.

The Three-Year Agreement of July 1948

When the negotiations with the British Government were renewed in London in June-July 1948, the aim on the Indian side was to secure a long-term settlement to cover at least three years, with adequate safeguards for later years. It was also decided to take up at this time, the questions of fixation of a price for the British military stores and installations taken over by undivided India on April 1, 1947, settlement of all outstanding matters under the Defence Expenditure Plan and, if possible, reaching agreement on a scheme for capitalising the sterling pensionary and Provident Fund liabilities of the Government of India through the purchase of an annuity. The Indian delegation was a high-powered one led by the Finance Minister Mr. R. K. Shanmukham Chetty and consisting of the Reserve Bank Governor (Sir C. D. Deshmukh), the High Commissioner for India in the U.K. (Mr. V. K. Krishna Menon), two members of the Constituent Assembly (Sir V. T. Krishnamachari and Mr. T. T. Krishnamachari), Sir Purshotamdas Thakurdas and Mr. Laljee Mehrotra, President of the Federation of Indian Chambers of Commerce and Industry. The Governor was acccmpanied by Mr. P. J. Jeejeebhoy, who had since become the Deputy Controller of Exchange, and Mr. P. S. Narayan Prasad, Director of Monetary Research, as his official advisers. The Government of Pakistan also sent a delegation for participating in the talks.

The negotiations resulted in an extension of the agreement of August 1947 for three years, up to the end of June 1951, with some modifications. Letters were exchanged between Sir Stafford Cripps, Chancellor of the Exchequer, who headed the British delegation and Mr. Shanmukham Chetty on July 9, 1948, setting out the terms of the extended agreement. The main features of the agreement were:

(a) A fresh release of £8o million from the No. 2 Account was to be made for the whole period, to be made available in annual instalments of £40 million each for the two years ended June 30, 1950 and June 30, 1951. No transfer was to be made for the year July 1, 1948 to June 30, 1949 in view of the balance already available in the No. 1 Account. At the time the negotiations began, India had accumulated current sterling of the order of &8r million in the No. 1 Account, as a result of the restricted import policy initiated in the middle of the previous year, and the anxiety not to overstep the limit on convertibility fixed by the February 1948 agreement. It was, however, agreed that the arrangement for the release of the stated sums would be worked with flexibility and that the British Government would make advance transfers should India find during any period that she was running short of foreign exchange, that is to say, if the balance in the No. 1 Account fell below £30 million at any time during either of the first two years.

(b) Drawal on the central reserves of hard currencies for the first year July 1948 to June 1949 was fixed at £15 million ($60 million) on the basis of an estimated hard currency deficit of $160 million, of which India was expected to finance a portion, viz., $ 100 million, by borrowing from the I.M.F.; this was in addition to India's own earnings of hard currencies during the period. For considering the adequacy of this amount, two important factors were borne in mind, viz., the removal of certain currencies from the hard currency list as from July 1, 1948 and the special arrangement proposed with regard to the convertibility of India's favourable balance with Japan.

(c) India was to pay to the U.K. a sum of £100 million in full and final settlement of the cost of the military stores and installations taken over.

(d) The outstanding amount due from the U.K. Government under the Defence Expenditure Plan was agreed at £55 million; of this, £8.95 million was to be paid to Pakistan as her share and the balance to India.

(e) An agreement was reached in respect of the sterling pensionary liability both of the undivided Government of India, which had been assumed by the Indian Dominion, and of the Provinces of India. The Government of India were to pay to the U.K. Government capital sums of £147.6 million and £ 20.5 million for the Central and Provincial pensions, respectively, in return for which they were to receive from the latter over the next sixty years tapering amounts for paying the pensions as they fell due. The immediate annual requirements were estimated at £6.3 million for the Central pensions and £950,000 for the Provincial pensions. The capital sums were to be paid from the No. 2 Account. The arrangement thus obviated the recurring drain on the No. 1Account in respect of the pensionary liabilities. These amounts were arrived at on the basis of a rate of interest somewhat higher than that earned by the sterling balances as a whole.

(f) Further, the U.K. Government undertook to explore the possibility of securing for India from sterling area sources, certain raw materials which the latter used to obtain traditionally from soft currency or sterling area sources, but which she had been forced to buy lately from the hard currency countries.

(g) There was to be 'continuing and close co-operation' between the two Governments to enable India to obtain the maximum benefit out of the agreement. This was done through the machinery of the Joint Consultative Committee consisting of representatives of the two Governments, which met periodically to review the working of the agreement.

As on July 2, 1948, the balances in the No. 1 and No. 2 Accounts were £80.58 million and £1033.23 million, respectively, as against £41.41 million and £1088. 86 million, respectively, at the beginning of the year (January 2). During the half-year, drawings from the I.M.F. amounted to $44.12 million. (The drawings which were first credited to the Reserve Bank's account with the Federal Reserve Bank of New York were immediately made over to the Bank of England, i.e., to the central reserves, against which a corresponding credit in sterling was made to the No. 1 Account.) The transfers to No. 1 Account together with &IS million transferred to Pakistan No. I Account opened on February 28, 1948 accounted for the fall in the No. 2 Account.

There were heavy demands on the balance in the No. 1 Account during the year July 1948 to June 1949 due to a liberalisation in the import policy, begun in the middle of 1948; Indeed, by the end of June 1949, advance transfers to the extent of £81 million had been made by the Bank of England from the No.2 Account to the No.1 Account so as to maintain the balance in the latter at about the agreed minimum of £30 million. There was also a heavy decline of over £400 million in the balance in the No. 2 Account due to the payment for capitalising the pensionary liabilities and for acquisition of the defence stores and installations, release of Pakistan's share of assets and the transfers to the No. 1 Account.

India's hard currency deficit also turned out to be much larger than could be financed by the drawal of the equivalent of £15 million from the central reserves, and the drawings from the I.M.F. which amounted to $55.86 million (i.e., about £14 million) since July 1, 1948. The British Government agreed in February 1949 to advance India the necessary hard currency as an overdrawal till the next agreement. As on June 30, 1949, the overdrawal was estimated to be $84 million; this was to be reimbursed to the U.K. from the convertible sterling to be made available to India for the period 1949-50.

Further Negotiations in mid-1949

An Indian delegation headed by Dr. John Matthai, Finance Minister of the Government of India, held discussions with the British Government in London in June-July 1949 for the purpose of fixing the multilateral release for the 12 months ended June 1950, making arrangements for dealing with the overdrawal of £81 million during 1948-49, obtaining an additional release sufficient to meet the unexpectedly heavy drain caused by the operation of Open General Licence XI (introduced in July 1948 for imports from soft currency areas, as part of the liberal import policy initiated then) and increasing the previously agreed annual release of £40 million to £50 million. As in the past, the Reserve Bank assisted the Government in these negotiations, its representative being Mr. Jeejeebhoy from the Exchange Control Department. Sir C. D. Deshmukh, who was to relinquish charge of his post as Governor at the end of June, took part in the talks as Adviser to the Finance Minister at the latter's request. These bilateral discussions, particularly on the convertibility question, inevitably merged into the talks then being held with the Commonwealth Finance Ministers in London. As a result of the negotiations, not only was an additional release of £81 million made available for the year 1948-49, for which the 1948 agreement had made no provision, but the annual releases for the two years 1949-50 and 1950-51 were also raised to £50 million. The new agreement also provided for the release of an additional but unspecified sum sufficient to meet the cost of liabilities entered into under the old O.G.L. before its cancellation in May 1949. These liabilities were roughly estimated at £50 million. The existing arrangements for advance transfers from the No. 2 to the No. 1 Account to maintain the balance in the latter Account at an agreed minimum of £ 30 million were to continue.

Insofar as convertibility was concerned, the quantitative limitations on India's right to draw dollars from the central reserves were removed, that is to say, India was readmitted to all the rights (and duties) of full membership of the sterling area. However, as decided at the Commonwealth Finance Ministers' Conference, India, along with other members of the Commonwealth in the sterling area, was to keep her dollar-imports during the 12 months ended June 1950 down to 75 per cent of the level of such imports during the calendar year 1948. This in effect meant that India could draw on the central reserves to the extent of $140-$150 million, as compared with $60 million (£15 million) in the previous year. Any imports financed from loans obtained from the World Bank were to be excluded from these calculations. Further, it was agreed that the overdrawal of $84 million from the central reserves made during the previous year need not be reimbursed to the U.K.

The Reserve Bank was a net purchaser of sterling during both the financial years 1949-50 and 1950-51. With the introduction of severe restrictions on imports in the latter half of 1949 the trend of excess sales over purchases which began in June 1948 was reversed in August 1949. The sharp improvement in India's exports after September (when the rupee was devalued) coupled with the decline in imports, was responsible for a net purchase of sterling to the tune of Rs. 186 crores by the Bank for the whole year, as against net sales for Rs. 70 crores in 1948-49. The foreign exchange position improved further the next year with a continued increase in exports, caused partly by the outbreak of the Korean War, and decline in imports; the Bank's net purchases of sterling in 1950-51 were thus larger than in 1949-50, at Rs. 314 crores. The trend was reflected in the balance in the Bank's No. 1 Account which went up from £39.3 million at the end of September 1949 to £137.5 million in the middle of May 1951.

Owing to the favourable balance of payments position during the year 1950-51, India had no occasion to use the sterling releases negotiated with the U.K. in July 1949. The decision to restrict dollar purchases to 75 per cent of the 1948 level was reviewed at the Commonwealth Finance Ministers' Conference in London in September 1950, and while the quantitative limitation was removed, the obligation still rested on members to secure the maximum economy in their dollar expenditures.

A brief mention may also be made here of the last of the series of sterling balances agreements although the formal exchange of letters took place only in February 1952. The agreement covered a period of six years from July 1, 1951, on the expiry of which the No. 1 and No. 2 Accounts were to be amalgamated. Discussions were held between the Indian Finance Minister (Mr. C. D. Deshmukh) and the British Chancellor of the Exchequer (Mr. Gaitskell) towards the close of 1950 in London, and broad agreement was reached on the size of the annual releases, etc. As with the earlier agreements, the Bank's Deputy Controller of Exchange (Mr. Jeejeebhoy) played a useful role in working out the detailed terms of the agreement. The agreement provided for the immediate transfer from the No. 2 Account to the No. 1 Account of a sum of £310 million, to be held by the Reserve Bank as a currency reserve; the Government of India were not to draw upon this sum without previous consultation with the British Government. The agreement also provided for an annual drawal of £35 million for each of the six years, with a measure of flexibility in that un drawn releases were available for being carried forward to later periods and limited advance transfers were also permissible.

The negotiations for extension of the 1949 agreement resulted also in the Bank being left free to conduct the investment of its sterling assets 'in accordance with general central banking principles and their (the Bank's) own statutory obligations'. There was an exchange of letters between the Bank of England and the Reserve Bank in October

1951 confirming the restoration of the Reserve Bank's freedom of operations which had been taken away in August 1947. This was, of course, to be subject to prior consultation between the Reserve Bank and the Bank of England as in the past, so as to avoid any undue disturbance in the London market as also to enable the former to avail itself of the advice of the Bank of England.