

# OUR STERLING BALANCES

By

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**Prof. C. N. Vakil**

One of the most controversial problems facing the country in the economic sphere at present is that of the settlement of our Sterling Balances. Negotiations for this were started some time ago when a British Delegation came to the country and had discussions with the representatives of the Government of India at New Delhi. These were known as exploratory talks. Further negotiations at a high level are due to take place in the near future in London.

Though a good deal of literature has been published on the subject, there is room for a simple exposition of the problem in all its bearings so that the layman can understand its significance with ease. By reviewing briefly the background of the problem in which he explains the way in which India was made to pay for Imperial policy in the past and by discussing the true nature of the Sterling Balances in all its aspects, Prof. Vakil makes out a convincing case for their repayment at an early date. He also proposes a scheme for the settlement of the Sterling Balances which differs in several important respects from suggestions hitherto made in this connection. It is hoped that this scheme will serve as a basis of discussion among those interested, and that the Handbook will stimulate interest in this vital problem.

# OUR STERLING BALANCE

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## EDITOR'S PREFACE

The object of these handbooks is to present in a simple manner different economic problems relating to India as well as others in which India is likely to be interested. The Series will aim at covering the entire range of economic problems in course of time. Special attention will be given as far as possible to current topics. The treatment will be scientific, and each handbook will be written by a person who has specialised in the particular subject and will, therefore, be authoritative. The exposition will be such that it may be easy for the layman to understand the problem. The Series will thus stimulate interest in the complex and changing economic problems of the country and promote better understanding of the same. The need for an intelligent appreciation of such problems by the public under the new political conditions in the country is obvious, and it is hoped that this Series will supply the want.

In the present handbook, material from my former publications, "Financial Developments in Modern India, 1924" and "Financial Burden of the War on India, 1943" has been freely drawn upon. Statistical data have been taken from the Reports on Currency and Finance issued by the Reserve Bank of India, and Budgets of the Government of India, unless otherwise specified.

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28th April 1947.

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### NOTE

This book was in the press when the recent statement of Dr. Dalton, the British Chancellor of the Exchequer, in favour of scaling down of sterling debts of the U.K. was made and was supported by the British Premier to the effect that this was the official British policy. Though this was not known at the time of writing, a suitable reply to this attitude will be found in the book in appropriate places. In fact, the object of the book is to refute this attitude, which if enforced will result in a situation similar to that created by Germany in occupied countries.

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# OUR STERLING BALANCES

## I. THE BACKGROUND: ECONOMIC AND FINANCIAL ASPECTS

IN order to grasp the problem of the sterling balances of India and the controversy which has developed round the same, it is necessary to have clear ideas about certain factors. Unless the background relating to this problem is clearly understood, it is easy to confuse issues and arrive at wrong conclusions. Those who have entered into the controversy have, in order to suit their pre-conceived notions, often suppressed relevant facts and emphasised or even exaggerated side issues. For the sake of convenience, this background may be divided into two parts : (1) that relating to economic and financial aspects ; and (2) that relating to military policy and defence expenditure of the Government of India.

### HOME CHARGES

Since the establishment of British connection with India, Indian trade has been characterised by an excess of exports. There are, however, exceptional years in which the balance of trade has been adverse to India in the sense that there has been an excess of imports. On the whole, however, it is true to say that India has been sending abroad more merchandise than she is importing. In return for this excess of exports, India has received precious metals and some services such as shipping for which India has to pay. But such a return does not account for the entire excess of exports part of which are utilised to pay the sterling dues charged by England to India from year to year. An analysis of these charges, technically known as "Home Charges" in the Accounts of the Government of India, shows that they are mainly due to the payment of interest and capital on sterling debt incurred by India ; payments for the expenditure on the India Office ; payments for leave and furlough

allowances to officers, for effective and non-effective military charges, for supply of stores and so on. From early days the nature and magnitude of these charges have raised considerable controversy.\* They have been characterised as a drain on India's resources amounting to a tribute levied by England from India. It has been argued, on the other hand, that these charges are in lieu of valuable services and materials sent by England to India and that there is, therefore, a commercial equivalent for which India need not complain. One has, however, merely to recall the fact that the debt which the East India Company incurred mainly for the conquest of India, with the help of Indian troops, was transferred to the Government of India; that the stock of the East India Company was redeemed at a 100 per cent. premium out of the resources of India, and that the Government of India, after the Company's rule came to an end, started with this legacy, viz., interest and capital of the debt which was definitely in the nature of a tribute.

\* For a fuller discussion of this problem, see Chapter XI entitled "English Charges" of *Financial Developments in Modern India* by C. N. Vakil. The amounts of these charges are given below :-

		Figures in million £
1834-1856	...	75.7
1857-1860	...	28.4
1861-1874	...	146.6
1875-1898	...	357.8
1899-1913	...	283.4
1914-1920	...	167.7
1921-1935	...	438.0
		1497.6
		in crores of Rs.
1936-1938	estimated ...	135
1939-1945	.. ...	368
		503

## NATURE OF PUBLIC DEBT

This fact has been concealed by drawing attention to the nature of the debt in later years, which was supposed to have been incurred for the capital expenditure on railways and irrigation in this country. In order to raise the necessary capital for the construction of railways and irrigation works in India a policy of diverting surplus revenues to capital expenditure was adopted. Taxation was kept at a high level, and by under-estimating revenue and over-estimating expenditure from year to year, surpluses were realised. These surpluses were transferred to capital account. The public debt of India was divided into ordinary and productive : the ordinary debt being that due to wars and famines, the productive debt being that due to railways and irrigation works. In any particular year when a given sum was to be spent for productive works and a surplus was available, a transfer was made from the ordinary to the productive debt to the extent of the surplus. The amount of the surplus was treated as capital for the public works, and the ordinary debt was treated as reduced to that extent. By this process, the ordinary debt was reduced to a small figure by 1914, and it appeared to the public that most of the public debt of the country had assets in the form of railways and irrigation works, out of the receipts from which interest could be paid. The fact, however, remains that the original debt of the East India Company as well as the debt incurred for subsequent wars such as the Burmese and Afghan wars were added to the public debt of India, the interest and capital on which were wholly paid by India in the manner explained above. The ordinary debt increased



once again due to the first World War, and now on account of the second World War.\*

#### OTHER ITEMS IN HOME CHARGES

It is not necessary to go into the details of the other items under Home Charges, the nature of some of which also shows that these charges were not wholly justifiable. For example, the expenditure on railways and irrigation works in this country was on a lavish or extravagant scale; the loans raised for this purpose in London were spent in the U.K. to obtain materials from British manufacturers, who thus had an interest in the continuation of the lavish expenditure for the so-called development of this country. The expenditure incurred on military and civil services, their recruitment, leave and pension allowances and on the India Office which were all charged to India, was the means by which Britain held its control over this country. It is difficult to distinguish between the cost for genuine services rendered by the various parties who were paid by India all these years, and the political aspects involved in the same cost, which enabled England to continue its rule over India.

#### CURRENCY POLICY

The payment in sterling to England from India which grew

*Public Debt of India*  
(in crores of Rupees)

Year	Productive	Ordinary	Total
1913-14	452.7	26.7	479.2
1921-22	538.6	203.5	742.1
1938-39	950.0	208.0	1158.0
1944-45	993.2	590.8	1584.0
1945-46	1010.2	707.0	1717.2
1946-47	1075.0	875.0	1950.0

from time to time in the above manner thus resulted in a compulsory excess of exports, which this country had to organise in order to be able to pay these charges. Apart from the drain on India's resources thus involved, this situation resulted in another difficulty. Anxious to secure the regular payment of these charges, the British authorities introduced a rigid control on Indian currency and exchange policy, irrespective of India's requirements. The history of Indian currency system can be mainly explained by this desire which dominated the decisions regarding Indian currency policy.\* The linking of the rupee to sterling since 1898-99 and the maintenance of sterling reserves in London in order to maintain the sterling value of the rupee, are all results of that policy. The sterling reserve was utilised several times to meet Home Charges, when India could not send the requisite excess of exports. Nominally the sterling reserve was for some years partly in the form of a gold standard reserve and partly in the form of a paper currency reserve. More recently, with the establishment of the Reserve Bank, the sterling reserve has been transferred to the Issue Department of the Reserve Bank of India against which rupee notes are issued in India. The Reserve Bank was required to give sterling exchange at the fixed rate and to maintain the convertibility of the rupee at 1s. 6d. and was expected to utilise the sterling reserve in London for this purpose. At the same time payments could be made to the India Office in lieu of Home Charges from this reserve, if necessary, merely by changing its composition, a reduction from the reserve in London resulting in an addition to it in India in rupees or rupee securities.

#### EXCHANGE BANKS

Not only was the currency and exchange mechanism controlled in this manner to ensure regular payments to England of these heavy sterling charges, but its counterpart on trade

\* cf. *Currency and Prices in India* by Vakil & Muranjan.

account, viz., the exchange bank business, was also controlled in practice as a virtual monopoly in the hands of British Exchange Banks. The exchange banks operating in India are all branches or agents of similar institutions in the U. K. In recent times a few other exchange banks, which are agents of independent countries trading with India such as the U.S.A. and till 1941 Japan, have been in existence. All efforts at the establishment of Indian Exchange Banks have met with miserable failures because of the attitude of British Exchange Banks. The way in which these banks favour British trade and control the exchange business has often been a matter of serious complaints, examples of which can be found in the reports of the Central Banking Enquiry Committee.

Whereas in the case of independent countries, the currency policy has been determined with a view to the requirements of the country itself, in order to maintain a stable price level within the country or in order to give encouragement to its trade in any desirable direction, in the case of India the main consideration has been of a different nature irrespective of its results either on the price level or the trade of the country. This aspect of the currency history of India has just come to an end by the recent change in the Reserve Bank of India Act, by which the rupee has been delinked from sterling. This arrangement is the logical conclusion of India's membership of the International Monetary Fund.

#### CONCLUSION

The conclusion is obvious that the economic and financial resources of India were controlled by the U.K. in order to obtain some of these resources for herself under various pretexts from year to year, and in order to benefit her own trade and industry.

## II. THE BACKGROUND: MILITARY POLICY AND ITS FINANCIAL BURDEN ON INDIA

### THE STATUS AND USE OF THE INDIAN ARMY

A brief review of the defence expenditure of India and of military policy in general is of interest in connection with the issues now under consideration in connection with the settlement of sterling balances. It is well known that the Indian Army has been maintained as a part of the Imperial Army. In matters of recruitment and rates of pay of the British personnel of the Indian Army the arrangements have been entirely under the control of the War Office. The British troops in India were transferred from time to time to the U.K. This involved heavy transport charges both ways and a continuous charge for recruitment of new troops. The War Office also charged for non-effective payments such as contribution to the pension charges of British troops who served in India. The higher personnel of the army from the Commander-in-Chief downwards have been members of the Imperial General Staff and are liable to discipline and orders of the War Office. From time to time, whenever changes in technique and equipment of the British Army have been made, these have been simultaneously applied to the Indian Army with consequent increase in charges to India. The fact that the Indian Army has been maintained as a part of the Imperial Army is further proved by the fact that it has been made available in the past for expeditions with which India has had no connection.

### EMPLOYMENT OF INDIAN TROOPS OUT OF INDIA

In the following table a list of the more important expeditions in which Indian troops were employed at the bidding of the Imperial Government for non-Indian purposes and outside the frontiers of India, has been given. The way in which the cost of the troops was apportioned between England and India on each occasion has been shown. In

some cases, the actual or estimated cost to either country has been given. The detailed discussion which follows is confined to expeditions after 1860 :—

*List of the more important expeditions in which Indian troops were employed outside the frontiers of India, showing the way in which the cost was apportioned on each occasion.*

Date	Expedition	Ordinary Charges		Extraordinary Charges	
		Paid by India	Paid by England	Paid by India	Paid by England
1838-42	1st Afghan	All	—	—	All
1839-40	1st China	All	—	—	All
1856-57	2nd China	—	All	—	All
1856	Persia	All	—	Half	Half
1859	3rd China	—	All	—	All
1867-68	Abyssinia	All	—	—	All
1875	Perak	All	—	—	All (colonial govt.)
1878	Malta	—	All	—	All
1878-81	2nd Afghan	All	—	All but 5 m. £	5 m. £
1882	Egypt	All	—	All but ½ m. £	½ m. £
1885-86	Sudan	All	—	—	All
1885-91	Burma	All	—	All	—
1896	Mombasa	—	All	—	All
1896	Suakin	All	—	—	All
1898 to 1914	South Africa, China, (Persia, etc.)	Some charges in case of Persia	All	Some charges in case of Persia.	All
1914 to 1920	The World War I and After.	All	—	—	All

The actual or estimated cost to India in some of the expeditions was as under:—

Perak	...	£	41,000
2nd Afghan	...	£	12,516,000
Egypt	...	£	1,250,000
Burma	...	£	4,705,600
Suakin	...	£	231,900
World War I	...	Rs.	287,70,00,000

(Based on Welby Commission, Vol. II, p. 305; Parliamentary Paper 13 of 1900; and Annual Financial Statements.)

We shall briefly review the charges on expeditions after 1860.

1867-68—*The Abyssinian expedition*:—The decision to charge the ordinary cost of the Abyssinian expedition was challenged in Parliament.

Mr. Fawcett said :

“ Heavy taxation was infinitely preferable to this country incurring the reproach of having cast the slightest injustice on the unrepresented millions who lived in our dependencies.”

Lord Salisbury said :

“ Having regard to the future, I do not like India to be looked upon as an English barrack in the Oriental seas from which we may draw any number of troops without paying for them. It is bad for England, because it is always bad for us not to have that check upon the temptation to engage in little wars which can only be controlled by the necessity of paying for them.”

The Secretary of State in his letter to the War Office of 9th August 1872, referred to this question. After enumerating the occasions on which India was called upon to supply troops for Imperial purposes, he said :

“ It is certain that all these wars were dictated entirely by the Imperial Government and that the interests of British commerce, the grievances of British merchants or the honour of the British Crown, were the determining considerations in them all.”

Referring to the arguments that India had her own share of interest in these wars, he replied that,

“ Community of interests within certain interests may fairly be alleged ; but it must not be alleged only when it tells in favour of the Imperial Exchequer, and repudiated when it tells in favour of the Indian taxpayer.”

He pointed out that in all cases, when reinforcements were sent from England to India, the whole pay of the troops so sent was charged to India, from the moment of their departure from the shores of England; whereas whenever India was called upon to provide troops for foreign expeditions she was charged with their ordinary pay during their absence.

1875—*Perak Expedition* :—At the time of this expedition, the Government of India protested that if the precedent of the Abyssinian war was followed, a principle would be established, which would be inequitable to Indian revenues. The ordinary cost of the expedition was, however, thrown on India, though the Secretary of State agreed that it would not be regarded as a precedent for any future case.

1878-81—*2nd Afghan War* :—This war was considered to have been undertaken solely in the interests of India. It was objected that the war was the outcome of the Imperial policy adopted by H. M.'s Government, that it was aggressive, and not required for the defence of India. The Government of India, however, asserted that it "was undertaken for the protection of India from the menaces of foreign aggression." It was to remove the imaginary possibility of new conditions on the North-West Frontier, which might disturb the foundations of English power in India, that this war was fought. The Finance Member held that "great as is the interest of England in preventing such consequences, the questions at issue were primarily and essentially Indian questions." The actual expenditure of the war went beyond all estimates, and the Government in England at last felt the force of the arguments against throwing the whole burden on India. A subsidy of £5 million was given from the Imperial Exchequer. India had to provide for £12.5 million.

1882—*Egyptian Expedition* :—At the time of sending troops for the Egyptian expedition, the Government of India again protested against the charges that were proposed to be

levied on India. The chief arguments were : (a) That the interests of India were not involved to such an extent in the maintenance of the established rights, either of the Sultan, or of the Khedive, or of the people of Egypt, or of the foreign bondholders as to justify, so far as those interests only were concerned, a resort to arms, and, in consequence, the expenditure of large sums of money to be borne by the Indian taxpayer.

(b) That though India had some interest in the transit through the Suez Canal, the interest of England was greater. Both countries were equally interested in the trade dependent on the Canal, but almost all the ships, under the British flag, passing through the canal, were owned by H. M.'s British subjects. Again, though India had greater interest in the Suez Canal than Australia and other Eastern possessions, India should not be asked to pay for armed intervention in Egypt, unless the Australian and other colonies paid their proportionate share.

(c) That the proposal was likely to exercise an injurious effect upon the political connection between England and India. The taxpaying community of England was among the wealthiest, whilst that of India was among the poorest in the world ; and it was pointed out that it could not be in consonance with justice or sound Imperial policy that the wealthy and dominant race should relieve itself of charges at the expense of the poor and subject race, if the smallest doubt could be thrown on the equity of such a proceeding.

(d) That a nation, which through its representatives could decide whether peace or war was desirable, is, in so far as the question of taxation consequent on the war is concerned, in a very different position from one which has never in the slightest degree been consulted upon the advisability of war, but which is required to pay the cost of the war by order of a distant authority.

(e) That the finances of India were exposed to special difficulties.



This protest, however, failed to convince the Government in England. They gave a contribution of half a million, and India was asked to provide for the whole of the remaining cost of the expedition, both ordinary and extraordinary, which amounted to £ 1½ million.

1885-86 --*Sudan Expedition* :—With reference to this expedition, the Government of India again recorded a strong protest. They urged that the operations in the Sudan had no connection with any Indian interests, that they were altogether outside the sphere of their responsibilities, that the pretensions and aims of the leaders of the rising in Africa were a matter of indifference to the Government of India, and that the question of the safety of the Suez Canal was not involved as in 1882. But before their despatch had reached England, the Parliament had passed a resolution that India should bear the ordinary charges of the expedition. Referring to the discussion on this matter, the Secretary to the Treasury wrote, “as my Lords understand the proposed arrangement, there is no desire on the part of the Indian Government to save money by means of the expedition.” The Government of India, in answer to this, cited the case of the Mutiny, and repeated the words of Lord Lawrence :—

“All the troops and all the material which were sent from England to aid in putting down the Mutiny in 1857 and 1858 were paid out of Indian revenues. It was never urged that, because the measure afforded a temporary relief to the British Exchequer a portion of the ordinary cost of these troops should be paid by England.”

1885-91—*Burmese Wars* :—Large additions were made to the strength of the Indian Army after 1885, on account of the fear of a Russian invasion. This increased military power made it possible for the Government of India to pursue an aggressive policy towards Burma, which resulted in protracted campaigns extending over several years, ending in the conquest and annexation of that country. The expenditure due

to the wars in Burma amounted to £ 4.7 million. The cost of the civil administration of Burma, also, became a heavy burden on Indian revenues for many years. The people of Burma were brought under British subjugation, at the cost of the Indian taxpayer.

1896—*Mombasa Expedition* :—On this occasion the Foreign Office and the Treasury tried to throw some burden on India, but the Secretary of State remained firm, and pointed out "the absence of reciprocity in such arrangements." All the charges were, on this occasion, as in the case of the expedition to Malta in 1878, defrayed from the English Treasury.

1896—*Suakin Expedition* :—But in the same year, another expedition was sent to Suakin, the ordinary charges of which were proposed to be levied on India. The Government of India again protested in vain as under :—

"In order to strengthen Suakin, and to set free Egyptian troops for employment on the Nile, we have been asked to provide a garrison composed of troops from the Native Army of India. We cannot perceive any Indian interests, however remote, which are involved in carrying out the policy above described ; it cannot be alleged that the safety of the Suez Canal is involved ; and the taxpayers of India, who have to bear the cost of ordinary charges of the Indian troops proceeding to Suakin, will hardly comprehend the reasons for taxing them for troops which are not serving in India, in order to maintain order on the Egyptian frontier, to reconquer part of an Egyptian province, or to assist the Italian forces."

They concluded :—

"In these circumstances, we feel it our duty, in the interests of the country of which the administration is entrusted to us, to protest once more in the strongest terms against a policy which burdens Indian revenues

with expenditure connected with services in which India has no interest ; which is unjust to India, because it applies, to the payment of Indian troops lent to England, a different principle from that which England imposed when English troops are lent to India ; and which is inexpedient, because it exposes our Government to attacks to which there is no adequate answer. ”

In reply to this, the Secretary of State in his despatch of 30th June 1896 laid down three propositions which he thought should govern the relations between the two Governments :—

“ (1) That on all occasions, when the temporary loan of a military force is urgently required either by Great Britain or by India, such assistance will be promptly given, so far as the ability, resources, and the situation of either country at the time may permit. (2) That if the object for which such assistance is required is one in which the Government supplying the troops has no special interest beyond that which must be common to all members of the Empire, the whole cost of the force, so long as it is required, including both ordinary and extraordinary charges, must be borne by the country that needs the assistance. (3) That if the circumstances are such that the Government supplying the troops has a distinct and special interest in the matter at stake, then, although the interest may be less strong than that of the Government requiring assistance, the Government supplying the troops should be content to bear, in one form or other, a portion of the burden which the operations involve. ”

The Welby Commission agreed to these propositions, but they said that the real difficulty was to discover the means by which the interests of the two Governments, might be most accurately and authoritatively ascertained. As a solution of this difficulty they recommended that the geographical scene of the operations should be the basis for the allocation

of cost between the two Governments and they laid down certain geographical limits within which India might be considered to have a direct and substantial interest. They desired that the propositions laid down by them should be entered in an official document to which the two Governments should be parties. The propositions were :—

1. That India has not a direct and substantial interest in the employment of forces in Europe ; in Africa west of the Cape of Good Hope ; in Asia east of China.

2. That India has a direct and substantial interest in keeping open the Suez Canal, and in the maintenance of order and established government in Egypt so far as the security of the Suez Canal is affected thereby. This interest might extend to the coasts of the Red Sea only so far as to maintain the inviolability of that shore, but not to the Sudan, or further extensions of Egypt up the valley of the Nile or its affluents.

3. That India may have a modified interest in questions affecting the east coast of Africa as far as Zanzibar, and the African islands in the Indian Ocean, except Madagascar.

4. That India has no direct or substantial interest in the African coast south of Zanzibar.

5. That India has a direct and substantial interest in questions affecting Persia, and the coast and islands of Arabia and of the Persian Gulf.

6. That India has a direct and substantial interest in questions affecting Afghanistan and that part of Central Asia which is adjacent to the borders of India or Afghanistan.

7. That India has sole interest in punitive expeditions on her borders.

8. That India has a direct and substantial interest in questions affecting Siam.

9. That India has a modified interest in questions affecting China and the Malay Peninsula.

10. That India has no direct or substantial interest in Japan or countries or Islands east and south of China.

11. That special cases may arise giving to India a direct and substantial interest in questions connected with Europe or other territories in which the minute declares her to have, as a general rule, no interest.

12. That in every case where the two Governments are not agreed, no contribution should be made by India until the sanction of Parliament has been obtained.

These recommendations were accepted. The practice against the injustice of which the Government of India had so repeatedly and strongly protested received the approval of a Royal Commission, and was embodied in an official document to which the Treasury and the India Office became parties. A direct and substantial interest of India could now be shown in many remote places with ease. Where this would be difficult India would still have a modified interest. That India had no interest in Europe and other territories had to be accepted, but provision was made for special cases. In case of disagreement between the two Governments, Parliament was to decide. It is well known that the sanction of Parliament in such matters is a mere formality of which the Cabinet need be in no fear. If the Government in England decided to charge India with the cost of a certain expedition against the wishes of the Government of India, the sanction of the Parliament would follow automatically. Besides, it is to the interest of members of Parliament to lessen the burdens of those whom they represent.

1898-1914.—*Expeditions to South Africa, China and Persia* :—During this period we frequently hear of the despatch of Indian troops for service in South Africa, China or Persia and other places. These expeditions, with the exception of that connected with the South African War, were on a small scale and the expenditure, in most cases was small, though the aggregate must be large. As a general rule, in accordance with the above arrangement, both the ordinary

and extraordinary charges were met either by England or by the Colony concerned, which resulted in a temporary saving to the Indian Treasury. A considerable part of the expenditure due to operations in the Persian Gulf was taken from India.

### WORLD WAR I

During World War I, large numbers of Indian troops served in the allied cause in different frontiers. India was not attacked during this war but her resources were used in a variety of ways. So far as the expenditure on Indian troops sent abroad was concerned it was decided that the ordinary cost of these troops should be borne by India. In this connection the Finance Member observed that "although we sent a large number of our best troops out of the country at a time when mere considerations of local safety might well have dictated their remaining here, we pay for them just as if they were still employed in India and at our beck and call."

As the war dragged on and more resources were required for the purpose, other devices were adopted to obtain the same from India. In 1917 a special war contribution of 150 crores of rupees was given by India to H. M.'s Government. This was provided out of loans; the resources of the Government of India were increased by Rs. 9 crores a year to meet the consequent interest and sinking fund charges. In September 1918, the Imperial Council passed a resolution to the effect that an additional war contribution, then estimated at Rs. 67.5 crores be given by India in view of the prolongation of the war. This expenditure was to be met from revenue and spread over two or three years. Soon after this, however, two events occurred: (1) the Armistice was signed, and (2) the Government of India entered into hostilities, firstly, with the Amir of Afghanistan, and then with the frontier tribes. In view of the heavy expenditure which India had to provide for the Frontier Wars (Rs. 39 crores in all), the

above resolution was revised in March 1920, with the effect that the additional war contribution contemplated in September 1918, was reduced to Rs. 21.6 crores.

It is difficult to form an estimate of the charges which India met on account of the war. We shall, however, hazard an estimate on the following basis. From 1914 to 1920 (taking into consideration the period of demobilisation), the military expenditure of India increased directly or indirectly on account of the war, including the payment of "Ordinary Charges" for the troops sent abroad. In 1913, the total expenditure on "Military Services" amounted to about Rs. 32 crores. If no part of the cost of the troops that were sent out of India was paid by her, the military expenditure during the subsequent years would have been less than this amount. Not stressing this point, however, let us suppose that the military expenditure of India would have remained the same as in 1913, if the war had not affected us. The total excess of the actual military expenditure during 1914-20, over the normal military expenditure during the same period on the basis of the expenditure of 1913, amounts to Rs. 176.6 crores. From this if we deduct the expenditure due to the Afghan War and other Frontier Operations (Rs. 38.9 crores) we are left with Rs. 137.7 crores. This includes the additional war contribution of September 1918, which ultimately amounted to Rs. 21.6 crores. Of course, this figure of Rs. 137.7 crores does not include the recurring liabilities of Rs. 9 crores on account of the first war contribution of Rs. 150 crores, which was given by means of loans.

If we take it as approximately correct that "the extraordinary charges" of the Indian troops sent abroad during the war must have amounted to Rs. 150 crores we may say that in reality India bore both the ordinary and, by means of the war contribution of 1917 (Rs. 150 crores), also the extraordinary expenditure of her troops, lent for

Imperial Service, partly out of revenue and partly out of loans.

### THE CHATFIELD COMMISSION

After the passing of the Government of India Act of 1935, and particularly with the growing political consciousness in the country and the declaration of the policy of gradual self-government, it was realised that the fact of the Indian Army being a part of the Imperial Army could no longer be concealed. Anticipating that the control of civil power in India would have to be transferred to Indian hands as soon as possible, the British authorities thought of arranging for an effective military control in India, partly for strategic reasons and partly in the interests of British trade and industry. When the Chatfield Commission came to the conclusion in 1939 some time before the war, that the Indian Army should be mechanised, it also recommended that a large part of the cost should be met by the British Government. This was on the one hand a recognition of the long existing but concealed fact that the Indian Army was part of the Imperial Army, that it should now be openly treated as such and on that account the additional cost be borne by the British Government. It was well known at that time that there was no threat to India then requiring mechanisation of Indian troops ; these preparations in India were part of the sudden war preparations in England and the Empire, because of the failure of Britain to appease Germany and the prospect of a world war in which such mechanised Indian troops could be used.

### WORLD WAR II

It is well known that during the last war Indian troops served both in the West and in the East ; in Europe, in North Africa, in the Middle East on the one hand and in Burma, Malaya, China, South-East Asia and Japan on the other hand. Eloquent testimony in highly appreciative terms from the highest British authorities is available regarding the



work of these troops in the various theatres of war. Mr. Churchill, Mr. Amery and the various Commanders-in-Chief under whom these troops served have acknowledged with gratitude the services rendered by these troops. In order to meet their requirements, vast military preparations were made in India. Recruitment on a large scale was carried on ; training establishments were increased ; similar activities were organised in connection with the Royal Indian Navy as well as the Indian Air Force. At the same time, active preparations were made for mobilising all available supplies not only for Indian troops but for the allied war effort in general. Life in India was dominated by the war effort as much as in any other active belligerent.

It is clear, therefore, that the British Government used India as a base of operations, as an arsenal of war, as a recruiting ground for lakhs of troops, and as a source of numerous supplies. It is equally clear that all these activities were primarily for the defence of the Empire both in the West and in the East, and that the defence of India was incidental. The only period when the actual defence of India was involved was when the Japanese made an attack on the eastern border of India in the year 1944. It is obvious that the allied campaigns in the West and in the East would not have been possible but for the fact that these huge preparations could be made in India. It is necessary to appreciate the fact that the military machine thus organised in India was an Imperial affair controlled by the British Government, the Government of India acting as subordinate agents in various spheres.

#### AUTOCRATIC RULE DURING THE WAR

It is necessary to bear this aspect in mind, particularly because all these activities were carried on against the wishes or without the consent of the representatives of the people. The Government of India Act, 1935, was implemented in the Provinces but not in the Centre. In the Provinces, the

popular Ministers were in power in 1939 at the outbreak of the war. In the Centre, the Viceroy with his nominated Executive Councillors was still supreme as the Legislature had no control over military expenditure. As such vast preparations for a world war would of necessity involve the co-operation of the Provincial Governments as well as of the people at large, the obvious thing for the British Government to do was to take the representatives of the people into confidence in connection with the war preparations. It was possible to change the constitution of the Viceroy's Executive Council by inviting the political parties to join the same and to work the Central Government in practice as a Dominion Government. This was not done; the political parties were not taken into confidence, nor were the Provincial Governments. In consequence, the Provincial Governments found themselves in an awkward position. They could not with a clear conscience co-operate with the British authorities in organising things for the war effort in which they had no voice. They could not appeal to the electorate or to the people of the country at large to undergo sacrifices for the war, which was not undertaken for the defence of the country, but for Imperial purposes and in which they had no say. In eight out of the eleven Provinces, the Provincial Ministries resigned as a protest against this situation. The British authorities seemed to welcome this step inasmuch as it gave them an opportunity to introduce complete control of their own in the Provinces by enabling the Governors to assume full powers under Section 93 of the Government of India Act, and to carry on the administration with the help of nominated Advisers, senior members of the I.C.S., mostly Englishmen. The Legislatures in these Provinces therefore became defunct and complete autocratic rule was introduced. It must be borne in mind, therefore, that whatever was done in India during World War II was done on the sole responsibility of the British authorities without the consent of the people of the country. For a time the political parties were

patient ; gradually the discontent at the prevailing situation in the country began to find expression. This culminated in the famous session of the All-India Congress Committee in August 1942 in Bombay, which passed the Quit India Resolution, and authorised Mahatma Gandhi to launch Civil Disobedience, after giving due notice to the British Government, if he thought it necessary to do so. The British Government did not allow time to Mahatma Gandhi and his associates, who were immediately put into jail. This merely embittered the feelings of the people, who refused to co-operate with the Government in the war effort, and particularly in the increasing controls on account of the war.

#### CONCLUSION

Before reviewing the growth of sterling balances which grew during the war and the problems connected therewith, we must fully appreciate the significance of the above background firstly, of the economic and financial drain which India has suffered on account of the British connection in the past ; and secondly, the nature of military policy carried out by the British authorities both in the past and in recent times, during the two world wars, and the burdens imposed on India on that account ; and the fact that the entire war preparations in World War II were carried out against the wishes of the people with the leaders of the people in jail.

### III. THE FINANCIAL SETTLEMENT RE: WORLD WAR II

#### THE FORMULA

As pointed out above during World War II, the Imperial military machine was organised in India for the defence of the Empire both in the West and in the East, the defence of India being incidental in these activities. For the purpose of carrying on this machine the expenditure in India had to be in rupees. The Government of India, whose nature

and composition has been explained above, took upon themselves the responsibility for providing the rupee finance required for the purpose in the first instance. In practice the war activities in India which were run as one organised affair controlled by the British Government, were carried on without reference to the parties who were to bear the burden of financing them in the end. Those in charge of the military machine in India had not to worry about the problem of the sources from which the funds they required were derived; they had merely to ask for the funds in rupees which the Government of India was ready to supply.

Having thus paid in rupees for the war expenditure in India, the Government of India then tried to reimburse themselves from the British Government for part of this expenditure. The method adopted in this connection was to determine the expenditure that should be charged to India, the balance being a British responsibility. But this responsibility remained on paper as the share of the U.K. thus determined was recovered by India in sterling, which could not be utilised for importing goods to India, and which is the main source of the accumulation of sterling balances. We shall refer to this aspect in some detail later; for the present we shall discuss the financial settlement which was made between India and H. M. G. regarding the allocation of the war expenditure in India between the two Governments. It should be pointed out even at the risk of repetition, that the party negotiating on behalf of India was a British Finance Member of a Government, which was subordinate to H. M. G. in all important respects. In view of this, whatever else may be said about the nature of the settlement, it could not at all be urged that the settlement was in any way unfair to the U.K. It is possible to point out that in the settlement itself and its working, there have been many items, which in fairness ought not to have been charged to India. According to this settlement India was to bear :—

- (1) a fixed annual sum, representing the normal net effective costs of the army in India under peace conditions, plus
- (2) an addition to allow for rise in prices, plus
- (3) the cost of such war measures as can be regarded as purely Indian liabilities by reason of their having been undertaken by India in her own interest, and
- (4) a lump sum payment of Rs. 1 crore towards the extra cost of maintaining India's external defence troops overseas.

The effect of this formula on the defence expenditure was as follows :—

Year	Net Defence Expenditure (in crores of Rs.)
1937-38	... 47
1938-39	... 46
1939-40	... 50
1940-41	... 74
1941-42	... 104

Japan entered the war in December 1941. The full implications of this were realised when a large slice of the Empire in the East was occupied by the Japanese, and Burma had to be evacuated. The importance of India, which was hitherto a base of operations for the Middle East, now increased more than ever, not only for the defence of the Empire in the East, but also for the re-acquisition of lost territories. By exaggerating the danger to India of a Japanese invasion, this important aspect of Imperial need was often kept in the background. The story of war activities in India, after the entry of the Japanese into Burma, must be studied with the clear recognition of the fact that they were designed primarily for the defence of the Empire *in* and *through* India, and the defence of India was not only a part of the larger Imperial

scheme of things, but was also thus essential for the defence of the Empire.

#### PROPOSED REVISION OF THE FINANCIAL SETTLEMENT

With the sudden and vast expansion of the Imperial war machine in India in 1942, the expenditure also increased, and the question of revising the Financial Settlement with a view to debit a much larger share of the total expenditure to India was raised. The Finance Member proceeded to the U.K. to discuss the problems that arose. Among other things, he pointed out that "owing to the developments in the situation since the entry of Japan into the war, the cost of the measures necessary for the defence of India and for which India is liable under the existing Settlement, was so great as to impose a very heavy strain on India's limited financial resources." Though it was then agreed that the Financial Settlement should not be disturbed, it was also decided to adjust the new items of expenditure by an elastic interpretation of the principles of the Settlement.

#### MILITARY PREPARATIONS DURING 1942-43 AND AFTER

In order to have a proper idea of the additional burdens involved we must review briefly the magnitude of the new activities which were organised in 1942-43 and subsequent years. It was decided to make substantial increases in all the three Arms of the Defence Services—particularly the Air Arm. This was intended to "protect India against the fresh danger to which the course of the war has exposed her." Recruitment for the army was increased; training establishments were increased; internal communications, particularly telephone and telegraph systems, were vastly extended; the housing of the additional troops, the storage of the new equipment and the workshops led to great building activities. The opening of the neglected land route between India and Burma which became necessary with the withdrawal of the troops from Burma increased the engineering difficulties. To

these were added the "massive requirements of the Air Forces." At the same time the Royal Indian Navy was considerably expanded.

### THE THEORY OF JOINT WAR MEASURES

As pointed out above, in practice no distinction was made as to whether a particular measure was meant for the defence of India or for that of the Empire. It was easy to point out that in most cases, the work was such that it helped the defence of India while defending the Empire. By the very geographical position in which India is situated, and the great strategic use to which she was put, it was possible to confuse the defence of India with that of the Empire. This led to the theory of joint war measures. Various measures were included in this category on the above consideration, and the cost of them was divided between India and the U.K. It was not clear whether the share of both the countries was equal in each case. But it is obvious that there was great room for arbitrary decisions in such cases, which might have resulted in increased burdens on this country, particularly because the decisions were not in the hands of representatives of the people. To take an illustration: all expansions in the land forces in India were considered as one joint war measure, the cost of which was divided as under:—

(a) That India would pay for raising, training and equipping from Indian resources of all land forces raised in India and for their maintenance as long as they stayed in the country, and were available for the local defence of India. When they left for overseas, the cost to India of raising and training them and also of equipping them would be recovered from His Majesty's Government, who would assume all further liability for them.

(b) All imported equipment and stores for such expansive measures of the land forces from whatever source (except vehicles, armoured or otherwise, from elsewhere other than

the U.K.) would be provided by His Majesty's Government.

That all land forces recruited in India were not meant merely for the defence of India is well known. The practice was to send large numbers of these forces overseas and at the same time to bring into India large numbers of white troops. The cost of the white troops which India paid was much greater per head than that of the Indian troops sent abroad which was paid by H. M. G. This proves the remark made above regarding the defence of the Empire in and through India. In spite of this, by treating the land forces raised in India as a joint war measure, their cost was charged to India so long as they were in India. When they were sent overseas the cost of raising, training and equipping them was to be recovered from the U.K. but not the cost of maintaining them during the period they were in India waiting for service outside. It is obvious that more troops were raised in India than were required for the defence of India, and yet the Finance Member referred to such measures as having been intended "to protect India against the fresh danger to which the course of the war has exposed her."

Similarly in connection with the Air Force in India, the liability of India was for "the capital outlay incurred in India on the provision of air-fields and other ground and operational facilities; and the recurring costs of these squadrons and connected services while employed in India." Whether these Air Forces working from India were really defending India or the Empire was a difficult question, though, no doubt, a large part of their work was obviously in the nature of Imperial defence. In spite of this, their entire cost so long as they operated in and from India became an Indian liability.

These illustrations show the extent to which the burden on India was extended far beyond that contemplated under the Financial Settlement. Though nominally the Financial Settlement was not disturbed, in practice, by these measures large arbitrary burdens were put on India. In keeping with



the usual British practice, though the form of the settlement was kept up, its content was materially altered by these methods. It would require elaborate calculations from the original records of the Defence Department of the Government of India for one to ascertain the exact amount of the burden thus imposed upon India. The proposal to modify the Financial Settlement was dropped which enabled the Indian Finance Member to create a psychological satisfaction in India. The obvious connection of this decision to the large increases in our financial liabilities referred to above was however not revealed. Is it not proper to infer that with the threat of a modification of the Financial Settlement, the British Government obtained the transfer of as much of the war expenditure in India as possible to India, by the various devices explained above and that the threat was withdrawn when they found that a revision of the Settlement would not be more advantageous to them, than what the Finance Member offered by the ingenious interpretation of the existing Settlement by including in it joint war measures and similar other things referred to above?

#### BURDEN ON INDIA

In consequence of these arrangements the allocation of war expenditure in India, between India and the U.K., was as under :—

Year	Defence expenditure charged to India	Defence expenditure charged to U. K.
(in crores of Rs.)		
1939-40	49.54	4.00
1940-41	73.61	53.00
1941-42	103.93	194.00
1942-43	267.13	325.48
1943-44	395.86	377.87
1944-45	458.32	410.84
1945-46 (Revised Estimates)	391.35	347.07
1946-47 ( " " )	240.11	41.66
1947-48 ( Budget " )	188.71	

The working of the theory of joint war measures is reflected in the above figures. The share of U.K. shows a sudden jump in 1941-42, after which the new theory came into operation. The expenditure charged to both countries increased considerably in subsequent years, but the share of India became larger in 1943-44 and later years. The total defence expenditure charged to India from 1939-40 to 1946-47 amounts to Rs. 1,980 crores, and that debited to U.K. in the same period amounts to Rs. 1,754 crores.

#### IV. THE NATURE OF STERLING BALANCES

##### FINANCE OF BRITISH EXPENDITURE

What we have pointed out above is the injustice of putting undue burdens on India in connection with the war. But this is only half the story. It should not be construed from the above that the U.K. found the other half of the war expenditure in India, which was nominally debited to her, as shown in the above table. All this expenditure whether debited to India or to U.K. was incurred in India in rupees. The Government of India was required to finance the entire expenditure in rupees in the first instance. India was reimbursed from time to time to the extent indicated in the above table by payments made in London by the British Government in sterling. While sterling accumulated to the credit of India in this manner, India was all the time continuing the process of finding rupee finance for the U.K. India could find the additional resources for the expenditure charged to her by means of taxes and loans, but it was not possible for her to do so, so far as the additional expenditure debited to U.K. was concerned. In order to meet this, the procedure adopted was to issue more rupee currency by printing notes from time to time. The sterling payments received in London were converted into sterling securities and deposited in the Issue Department of the Reserve Bank of

India against which, according to the Reserve Bank Act, notes could be issued. In other words, the U.K. paid for the war expenditure in India for which she was liable, only by means of her I. O. U.'s, and the method of financing British war expenditure in India by means of adding to the currency as stated above resulted in a serious inflationary situation with its consequent evils. Prices suddenly began to rise on account of this and led to serious difficulties for the majority of the people. The following table indicates the increase in the volume of currency and the rise in prices :

Year	Notes in circulation (crores of rupees.)	General Index of wholesale prices.*	
1937-38	182.19		
1938-39	174.39		
1939-40	198.13	125.6	(for 7 months ended March 1940)
1940-41	228.03	114.8	
1941-42	287.48	137.0	
1942-43	513.44	171.0	
1943-44	777.17	236.5	
1944-45	968.69	244.2	
1945-46	1162.64	244.9	
1946-47	1212.52	266.4	

#### THE DEGREE OF INFLATION

In interpreting these figures, it should be borne in mind that they understate the actual state of the price level. The figures taken into account for calculating the Index are of controlled prices. It is common knowledge that controlled prices have been an exception in actual practice and that black market prices have been the rule. The common man is forced to pay much more for his essential articles than what is indicated in the above table. The actual prices may be taken to range from 350 to 400 compared with the pre-war level, in place of the recorded index of 266.

\* Base: week ended 19th August 1939 = 100.

## EFFECTS OF INFLATION

This inflation caused serious dislocation in the economic life of the country and affected large masses of the people severely. As it usually happens under such conditions the rich became richer and the poor became poorer. The distribution of monetary wealth under inflationary conditions is usually uneven and the same was true of war conditions in India. In other countries, profiting by the experience of World War I, timely arrangements were made to introduce effective economic controls to prevent inflation and to distribute scarce resources equitably among all classes of people. The alien Government in this country was conscious of the difficulty of instituting economic controls, which presupposed co-operation from the people for their successful working. In consequence, no effort was made to introduce economic controls in the beginning. In fact the Government of India tried to delude themselves and the public into the belief that their policy of financing the war was not really inflationary. When circumstances went beyond their control and when the inflationary situation was exposed mainly by the efforts of economists in the country, the Government of India reluctantly introduced anti-inflationary measures as late as the middle of 1943. Partly because these measures came late, and partly because the administrative machinery was not properly organised and the officers had no experience of such work, these measures were not likely to succeed. In fact such interference in the economic life of the people was construed as an additional inroad by a foreign Government, which the people thought was trying to drain away their resources for the war. In consequence, there was a general feeling of distrust towards these measures, resulting in an attitude of non-co-operation towards them. The situation was further complicated by the fact that the officers put in charge of such controls, under such an atmosphere, did not mind stooping to low levels, and utilising the opportunities that they had to make large gains by corrupt methods.

The widespread existence of black markets and the equally widespread prevalence of corruption in the administrative machinery, alienated the sympathies of the people to such an extent, that they refused to believe in the efficacy of economic controls altogether. Here is an illustration of the way in which a sound principle could not be believed in because those in charge operated it in a wrong or corrupt manner.

The effects of inflation and the mal-administration of controls led to general scarcity, particularly of food and cloth throughout the length and breadth of the country. The extent of the difficulties could be gauged by the fact that the Bengal famine resulted in the death of one and a half million persons due merely to starvation. One-tenth of the population of Bengal or six million persons are known to have suffered from the effects of malnutrition, which will have their effects on their capacity as well as on the future generation. This shows that the masses of the people lived on the margin of existence, had no powers of resistance and were therefore not able to suffer the sacrifices imposed on them by the war situation. Conditions in other parts of the country were more or less similar to those in Bengal, except in a few areas where food was surplus and people could obtain it in spite of the controls. It is not necessary at this stage to go into the details of the economic unrest caused by these difficulties spread over a number of years. In course of time industrial workers in cities were given dearness allowance. Agriculturists got higher prices and some adjustment took place in some quarters. This, however, did not bring in happiness to the people, because though some people had more money, the money did not fetch goods. And of all people, the middle classes were the worst sufferers. Their remuneration did not increase in proportion to the rise in prices; the majority of them had fixed incomes and the dearness allowance given to persons in this category was extremely meagre. The standard of life of the middle classes approaches that of the

comparatively well-to-do. The number of earners in middle class families in India is usually smaller compared with those in working class families. The middle classes crowd mostly in cities for employment where life has become increasingly difficult.

#### MEASURE OF SACRIFICE FOR THE WAR

In assessing the contribution of India to the war we must therefore take into account not merely the cost of defence which the Government of India themselves had to bear, and which in itself was large and unjust, but also the fact that the people of India were made to pay for the entire cost of the war operations in India irrespective of its allocation. No account is taken in these discussions of the loss of human life suffered by India on the fields of war and in the country because of starvation. It is a travesty of truth to say that the British Government financed the war in India, because the only way in which they did so was by their I. O. U.'s as explained above. Vast resources were drained away for the war from the people of India, who suddenly found themselves poorer because of inflationary methods. The fact that a few people in the country made phenomenal gains out of the situation did not help the country at large. A statistical measurement of the human and economic sacrifices undergone by the people of India for the war is impossible. That these sacrifices have been immense and much beyond the capacity of the people can be observed by any one passing through the cities or the rural areas of the country even at the present moment. Life in the country today is characterised by scarcity of essential goods. Efforts to make up the gap have not yet succeeded. We have still to depend on imported foodstuffs for our existence. The continuation of economic controls with all its attendant evils is exasperating the people mainly because they do not seem to work satisfactorily. Whereas other belligerent countries, particularly the U.S.A. and the U.K., have taken important strides on

the way to economic recovery, in India it is not possible to say that we have been able to make a beginning in that direction. It is well known that our industries which were worked to capacity during the war require immediate rehabilitation. It is not however possible to do so because of the want of machinery, for which we are dependent on the U.S.A. and the U.K., countries which are not in a position, for various reasons, to supply the same in the near future.

### EXCESS OF EXPORTS

We have so far explained the principal reason which is responsible for the accumulation of our sterling balances. Another factor which has led to the same is the excess of exports during the war period. Certain quantities of goods were exported for war purposes; the corresponding import was small. As we could not be paid for the excess of exports during the war, the only way in which we got credit was an addition to our sterling balances. The following table gives figures for the excess of exports during the war period :—

Year	Merchandise and Treasure		(in crores of Rs.)
	Exports	Imports	Balance +
1937-38	189.21	173.79	+ 15.42
1938-39	169.22	152.37	+ 16.85
1939-40	213.57	165.29	+ 48.28
1940-41	198.70	156.97	+ 41.73
1941-42	252.89	173.15	+ 79.74
1942-43	194.97	110.44	+ 84.53
1943-44	210.84	117.77	+ 93.07
1944-45	227.12	203.59	+ 23.53
1945-46	263.86	240.61	+ 23.25
			Total + 426.40

It is well known that we had a sterling debt at the beginning of the war, the nature of which has been explained above. It was obviously absurd to have a sterling debt on

which interest had to be paid on the one hand, and to have an increasing amount of sterling balances on the other. Arrangements were made therefore to cancel the sterling debt with the help of sterling balances. A few other adjustments were also made with the help of these balances. The following table shows the way in which sterling resources were disbursed from year to year and the outstanding balance at the end of each year :—

*Acquisition and Disposal of Sterling*

(in crores of rupees)

	Sept. 1939 to March 1940	1940-41	41-42	42-43	43-44	44-45	45-46	Sept. 1939 to March 1946
<i>SOURCES</i>								
1. Sterling Assets held by the Reserve Bank at the end of the previous period...	64	142	144	284	511	945	1363	64
2. Sterling purchased by the Reserve Bank (gross) ...	86	76	99	127	145	142	138	813
3. Sterling payments by H. M.'s Govt. ...	16	43	199	310	365	357	342	1632
4. Other Sterling credits ...	—	4	2	3	9	12	15	45
<b>Sterling available for disposal and disposed ...</b>	<b>166</b>	<b>265</b>	<b>444</b>	<b>724</b>	<b>1030</b>	<b>1456</b>	<b>1858</b>	<b>2554</b>



## OUR STERLING BALANCES

	Sept. 1939 to March 1940	1940-41	41-42	42-43	43-44	44-45	45-46	Sept. 1939 to March 1940
<i>DISPOSAL</i>								
5. Sterling Amounts utilised for repatriation schemes ...	22	89	110	160	16	14	—	411
6. Sterling Commitments on account of Government	2	32	48	48	67	74	73	344
7. Sterling sales to public ...	—	—	2	5	2	5	61	75
Utilisation of Sterling: ...	24	121	160	213	85	93	134	830
8. Sterling holdings of the Reserve Bank at the end of the period ...	142	144	284	511	945	1363	1724	1724

It may be mentioned that the composition of the balances on 4th April 1947 was Rs. 1,135.3 crores worth sterling securities in the Issue Department, and Rs. 466.4 crores worth sterling in the Banking Department of the Reserve Bank of India or a total of Rs. 1,601.7 crores.

## NATURE OF STERLING BALANCES

A dispassionate consideration of the various factors leading to the accumulation of these balances, and the way in which India has been treated by U.K. in the past in connection with military policy, military expenditure and so on, must convince any one of the fact that these balances represent forced payments from a dependent country. It cannot by any stretch of imagination be treated on a par with lend-

lease facilities given to the Allies by the U.S.A. It should not at all be confused as war debts between two equal belligerents, because India was not a willing belligerent and India did not enter the war of her own choice. The only thing with which these forced loans can be compared are the similar exactions taken by Germany from occupied countries. For example, the foreign assets of Bulgaria increased from 2,340 million leva to 11,776 million leva within a year from 1940 to 1941. The process is described by the "World Economic Survey" as under :—

"The clearing balances arose not only from Bulgaria's exports to Germany but also from supplies and services to German troops and from financial transactions such as the acquisition by Germany of shares in concerns." The German borrowings "through clearing accounts and otherwise provide the Reich with practically unlimited monetary means for the purchase of goods and services and capital assets in all occupied territories . . . it is not money that sets a limit to the German purchases ; it is the increasing shortage of raw materials and food-stuffs. . . . The fact that the Germans pay out money for what they buy may give their individual transactions a semblance of legality. But the money is additional money which the local central bank is forced to create ; it involves no real payment by Germany. Germany's elaborate financial methods do not, therefore, for the time being at least, differ in essence from simple seizure and expropriation."

By way of comment, we shall only repeat the words of the Fabian Society's pamphlet on sterling balances :—

"Substitute Britain for Germany and India for Bulgaria in the above quotation, and the parallel is unpleasantly close. Assume that Britain insists on

India's sterling balances being scaled down, and the parallel is almost exact."

The economic effects of these sterling loans are exactly the same on the life of the people in India as they were on the life of the people in German-occupied countries. Perhaps the capacity in the case of some of the German-occupied countries to bear such losses may have been greater than in the case of India. The difference in the case of India is only this : India has a nominal claim against the U.K. for these balances and is waiting to recover the same in order that she may be able to put her economy on a proper footing with the help of these balances. Unless this is done within a reasonable time, India will be permanently impoverished and the planning of her economic life will become extremely difficult.

#### ATTITUDE OF U.S.A.

The clause in the Anglo-American loan which requires of the U.K. that her sterling debt to other countries should be settled by a particular date, with the suggestion that a part of the debt may be scaled down is therefore wrong in principle, and wholly ignores the facts related above. The American authorities were naturally anxious to secure the repayment of their loan to U.K. and in that desire tried to dictate a clause which affected other countries like India. It may have suited the U.S.A. to relieve the Allies from their lend-lease obligations. History has yet to show whether the terms on which the Anglo-American loan was granted to the U.K. can be considered generous in the light of all relevant facts. In any case the suggestion that the sterling credit of a country like India obtained under the circumstances related above should be scaled down in order that the U.K. may be able to pay her debt to U.S.A. is obviously uncharitable. If the U.K. has any difficulties in relation to her creditors in the future, the only party from whom she can expect relief is the U.S.A. herself, which is in a position to grant relief without difficulty, and which has been financially and eco-

nomically the greatest gainer out of the war. For such a country even to suggest without reference to facts or without a reference to the party concerned, that our credit should be reduced, seems to be a dangerous precedent in the history of international economic relations, and the earlier this suggestion is withdrawn the better for all concerned.

### STERLING DEBTS OF U.K.

So far as the U.K. is concerned, it is true that she financed the war by adopting methods similar to those introduced in India in other countries also. The sterling balances of India happen to be the largest debt among similar balances that U.K. owes to several other countries. The liabilities of the U.K. are summarised in the following table :—

#### *Net Sterling Balances* (£ million)

	As at June 30, 1946	Later figures of Estimates where available.
<i>Sterling Area</i>		
(a) Dominions:		
Australia ...	118	178
New Zealand ...	64	91
South Africa ...	33	23
Eire ...	179	191
	<hr/> 394	<hr/> 483
(b) Other Major countries:		
India ...	1,116	1,217
Burma ...	11	...
Egypt and A.-E. Sudan ...	400	470
Iraq ...	71	100
Iceland ...	17	...
	<hr/> 1,615	<hr/> 1,787
(c) Colonies, Mandates, etc. (total)	<hr/> 650	<hr/> 650
<i>Non-Sterling Area</i>		
II. Liberated Europe: Total.	304	143
III. European Neutrals: ..	108	119
IV. South America: ..	142	216
V. Rest of the World: ..	64	64

## OUR STERLING BALANCES

Total Sterling Area :	...	...	2,658	2,948
Total Non-Sterling Area :	...	...	618	542
Grand Totals: June 1946			...	<u>£3,277</u>
Later estimate, March 1946			...	<u>£3,500</u>

(Compiled from the *Economist*: February 1, 1947, p. 204)

It is well known that the U.K. strained all her resources towards the successful prosecution of the war and though she has come out as a victor, she has been economically weakened compared with U.S.A. In fact the U.S.A. obtained certain advantages out of the war which the U.K. could not. The U.S.A. is, therefore, the leading country at the moment in the economic and financial affairs of the world, a position which the U.K. enjoyed for over a century. This does not mean however that the U.K. has been permanently impoverished. There is scarcity in the U.K. of certain essential articles, but it does not lead to starvation and death as in India. With their capacity to organise and their traditional habit of adjusting to changing circumstances, the people of the U.K. are trying to rise to the occasion and put their country on a sound economic footing without delay. There are bound to be difficulties during the transition period for the U.K. but these can be easily exaggerated. So far as the capacity of U.K. to pay her sterling debts is concerned, we have merely to take into account her annual income which is estimated at £8,483 million for 1945. The total sterling credit of India thus amounts to about 14% of the annual income of U.K. for one single year. It will thus be obvious that this debt is not so heavy or beyond the capacity of the U.K. to pay as is often made out in some quarters. If one merely remembers the way in which this debt was created and its effects on the so-called creditor countries, and further the fact that it was with the help of such arrangements that the Empire could be saved, including the very existence of the Anglo-Saxon race, it is inconceivable how certain parties in

the U.K. have been thinking in terms either of repudiation of the sterling balances or of partial scaling down or of other methods of getting out of the difficulty, instead of facing it squarely and honourably.

## V. SCHEME FOR THE SETTLEMENT OF STERLING BALANCES

### THE FABIAN SOCIETY PAMPHLET

Various suggestions have been made for the actual method of settling the terms by which the value of the sterling balances may be paid back to India. It is not possible to go into all these points, but a reference may be made to the suggestions given in the Report prepared for the Indian Affairs Group of the Fabian Society by Mr. A. C. Gilpin, which has been issued by the Fabian Society with a foreword by Mr. G. D. H. Cole. These suggestions are in refreshing contrast to the various arguments put forward in British financial journals regarding the scaling down of sterling balances. The Fabian Society's pamphlet admits in essence the case for India and takes a reasonable attitude on the whole. For example, it repudiates the theory put forward in some British quarters that India charged Britain at inflated prices for various goods supplied to her. The conclusive statement of the Parliamentary Committee on National Expenditure in this connection is taken as the final word, inasmuch as the British and Indian Governments were able to secure extremely favourable and controlled prices for the bulk of their purchases. The pamphlet characterises the suggestion for scaling down the debt as the traditional argument of the bankrupt who seeks a composition of his debts. It points out, however, that England still holds substantial overseas investments of the order of £2,000 to £3,000 million, and refers to the national income of the U.K. to show that the capacity of the British to repay this debt is quite strong.

## FUNDING OF THE DEBT ?

One common feature of the suggestions for the settlement of such debts between two countries is that after making any immediate adjustments that may be possible, the debt should be funded over a period of years to be repaid in instalments. In view of the fact that such international settlements, however solemnly made, have a tendency of either being revised in the light of new situations or repudiated, it would not be proper for India to enter into such long-term arrangements as far as possible. The history of the settlement of British debt to U.S.A. as well as of inter-allied debts after the last war, may be referred to as illustrations of this tendency. If a powerful ally like the U.S.A. could not succeed in enforcing payment of British debt to her in the past, we may well assume that the capacity of India, in spite of her independence, will not be sufficiently strong to enforce such payments in future over a period of years. In other words, the honouring of international debts must depend on the goodwill of the parties concerned or on the capacity of the creditor to enforce payment from the debtor, as was the case when India was treated as a debtor for so many years by England, which utilised her political power to enforce payments to her just or otherwise.

## LOANS OUT OF DEFICIT ECONOMY

Whereas it may be possible for a rich country like the U.S.A. to wait for the return of her loans over a long period, it is not possible for a poor country like India to do so. In the case of the former the loans are a surplus, and the creditor is not in immediate need of the same. In fact, in such cases, the creditor would like to continue to grant more credit to the debtor in the hope of future gains. This was the practice in the case of the U.K. when she was the creditor country in the world for about a century. In the case of a country like ours, where the loan has been taken by force out of a deficit economy, the need for repayment to put that

economy on a sound footing without delay is unmistakably urgent. We should not, therefore, imitate the usual methods of repayment of loans between richer countries, but adopt methods suited to our own requirements.

In view of these considerations, the wise policy for India in the impending negotiations would be to accept concrete or tangible returns or advantages in kind that are available now or in the immediate future, than to wait for the return of the debt by instalments spread over a long period. Whereas that would be a desirable line of approach from the point of view of India, difficulties are bound to be raised from the point of view of Britain regarding her capacity to pay immediately or in the near future, and arrangements will be suggested for a long-term plan, which will however be subject to the difficulties mentioned above. Keeping both these points of view in mind, the following tentative scheme is suggested as a practical basis for consideration by both sides.

#### TENTATIVE SCHEME : (1) FUNDING OF PENSIONS

India will be liable to pay pension charges for civil and military officers which have already accrued or which will accrue on the cessation of British political power in the country. It is not possible to dispute at this stage the justice of this claim. Instead of having to pay to Britain a certain amount on this account from year to year till it is extinguished, it would be wiser for India to agree to the funding of these pension charges into a reasonable (capital) amount which may be set off against the sterling balances. The U.K. on the other hand should not insist on funding it at a high rate and should agree to a reasonable figure. A sum of Rs. 150 crores may be suggested for this purpose.

#### (2) PURCHASE OF BRITISH GOVERNMENT ASSETS AND EQUIPMENT

The British Government have some fixed assets and equipment in this country mainly created during the war. It is



not possible for them to remove these assets physically to their country. Their commercial value is not easy to ascertain. India may not be in a position to utilise advantageously all these assets. But it would be reasonable to agree to a figure for the acquisition of these assets, taking into view the fact that it is not possible for U.K. to make advantageous use of these assets herself. A figure of Rs. 50 crores may be put down for these assets. In doing so, it should be remembered that the financing of a large part of these assets in rupees was done by India herself and in consequence the people have suffered in a variety of ways as explained above.

### (3) FOREIGN EXCHANGE RESERVES

By a recent amendment of the Reserve Bank Act, the obligation of the Reserve Bank to convert the rupee into sterling and vice versa at the rate of 1s. 6d. has been removed. The Reserve Bank will however be asked to convert the rupee into various currencies including sterling at rates to be fixed from time to time. Whereas for such purposes India used to have a sterling reserve in the past, it will be necessary for her to have in addition to the sterling reserve, reserves in dollars and some other leading currencies as well. Under the present uncertain conditions of the world, it is difficult to estimate the amount of reserve that may be so required. We may however put it down approximately at Rs. 200 crores sterling and Rs. 200 crores in dollars and other currencies. This would be in addition to whatever dollar resources that may accrue to India on the termination of the Empire Dollar Pool. This means that whereas Rs. 200 crores of the sterling balances will remain as they are, another Rs. 200 crores will have to be immediately converted into dollars, or other foreign currencies.

A summary of the suggestions given above is as under :

(Rs. in crores)	
150	... Funding of pensions.
50	... Purchase of British Government fixed assets and equipment.
200	... Sterling exchange reserve.
200	... Dollar exchange reserve (including other currencies)
<b>Total:</b>	<b>600</b>

Out of a total of Rs. 1,600 crores of sterling, this accounts for Rs. 600 crores, leaving a balance of Rs. 1,000 crores. For the recovery of this amount the following suggestions are made.

#### (4) SALE OF BRITISH COMMERCIAL INVESTMENTS IN INDIA

We do not have even an approximate estimate of the value of these investments. At the current prices their value would be high. Another difficulty would be whether the acquisition of such investments should be on a voluntary basis or they should be acquired compulsorily by the British Government to be transferred to India. What is suggested is that a reasonable price should be fixed for the transfer of each of these investments and an impetus should be offered for their actual transfer to India. The impetus may be in the form of the prevailing high price or willingness to accept adjustments in other directions. It would be for the British Government to decide whether in return for this impetus they would apply the compulsory or the voluntary method to transfer these investments to India.

#### (5) SHARE IN BRITISH SHIPPING AND AIR SERVICES

At the same time India should be given a share in those British concerns which will be operated in India hereafter such as British Shipping Services and British Air Services. Both from the commercial and strategic points of view, India

should have a voice in these services in the form of a shareholding, accompanied by a corresponding amount of control, employment of Indians in these Services and so on.

#### (6) SUPPLY OF DEFENCE EQUIPMENT

India will require some equipment for the Defence Services for all the three Arms, Land, Sea and Air. It is possible that the transfer of some of the British equipment now in the country may ease the situation. Subject to detailed enquiry however, it is possible that she will require more naval craft as well as more air craft for the Navy and the Air forces. The British Government should arrange to deliver such equipment either out of her own resources or out of the materials which they might obtain by way of reparations from Germany or Japan. The value of such equipment should be set off against sterling balances.

#### (7) SUPPLY OF CAPITAL GOODS

In connection with schemes of development in the country such as railways, roads, hydro-electric power, irrigation and so on to be undertaken by Central or Provincial Governments, certain heavy equipment will be required by the Indian authorities. Plans for such equipment would be ready by now with the Governments concerned or could be made ready in the near future. The British Government should agree to deliver such equipment at a price to be settled now over a period of five years. The total value of such deliveries should be set off against the sterling balances.

#### (8) TRAINING FACILITIES

The British Government should agree to give adequate facilities for the training of Indians in the various training establishments in the U.K. connected with all the Defence Services as well as those connected with technical establishments and higher University education. Certain seats should be guaranteed in these institutions for Indians to be

selected by the Government of India. Their allowances while in the U.K. and charges for passage both ways could be estimated. The expenditure on this account in sterling should be defrayed by the U.K. over a period of five years and the total estimated amount should be set off against sterling balances.

#### EFFECTS OF THE SCHEME AS A WHOLE

Though it is not possible to give exact estimates of each of these categories referred to above it is easy to see that the British Government would be in a position to transfer such assets of the aggregate value of Rs. 1,000 crores in five years. The type of assets or services suggested are such that it would not involve serious inroads on British resources or capacity to pay, nor would it involve any awkward transfer problems on current account ; and at the same time it would help India to preserve more effectively her independence and plan her economic progress with greater speed.

The funding of pensions (Rs. 150 crores) and the amount set apart as sterling exchange reserve (Rs. 200 crores) are mere paper adjustments. The purchase of British Government assets and equipment by India should be welcome to the U.K. as she is not in a position to make effective use of these assets. The amount required for training facilities to India will be spread over five years and will be spent in the U.K. and does not involve any physical transfer of goods from the U.K. Besides it will be a source of goodwill between the two countries. The only item which will require immediate convertibility of an amount of sterling into dollar and other currencies is Rs. 200 crores, which is small compared with the total and is not likely to cause any serious difficulty to the U.K.

The supply of defence equipment and the share in British Shipping and Air Services are intended to enable India to stand on her own legs for the purposes of defence in future. It cannot be the intention of the U.K. that India should not

be able to defend herself in future. The supply of defence equipment from existing sources or from German or Japanese reparations will not create difficulties of fresh production or a serious transfer problem. The share in Shipping and Air Services will have the compensation of goodwill in trade between the two countries in peace time and possibilities of co-operation in war time.

The supply of certain Capital Goods referred to above are not intended for industries which may compete with British goods ; they are intended for the basic development of the country for which there can be no two opinions. Some of this work has been neglected on account of the war. Such development will help the economic progress of the country and enable her internal and external trade to grow.

So far as the sale of British commercial investments in India are concerned, they are the last vestiges of British domination in India and should be handed over in the interests of healthy relations between the two countries. In fact, the process has already begun ; some of these have been sold to Indian concerns ; in others their character is being changed by taking Indians as equal partners and so on. Such a procedure is the accepted method of payment for foreign debts and has been adopted by the U.K. herself in other cases. In view of the desire of the U.K. to give up political power in India, it would be equally desirable for her to sell at a price her commercial assets in India to India—assets which are known to have flourished because of British political power, and assets which are known to have been responsible for creating many an obstacle in the progress of India. It would be statesmanlike for the U.K. to remove all possible doubts in this connection and enable Indo-British relations to be started on a clean slate in the future.

The aggregate effect of these proposals is to free the U.K. from her debt honourably and in a short time, without serious economic difficulties for her and with assured

goodwill from India ; and to enable India to obtain in a short time additional resources for defence which she will require, and for internal development on which she is intent. This will make up to some extent for the sacrifices of the war and enable India to start her career of independence with an amount of economic and military strength required to maintain that independence.

It should be understood that the various items in this scheme should be treated as interdependent. It is possible to criticise any one item from the point of view either of India or the U.K. But if the aggregate effect of the items is taken into account with due regard to the points of view of both parties, the proposed scheme as a whole is likely to be considered fair and result in the solution of a complex problem in the near future, generating mutual goodwill, and much needed improvement in the economic condition of India without impairing that of the U.K.

#### CHANGE IN THE ANGLO-AMERICAN LOAN TERMS

The settlement proposed above is on lines different from that envisaged in the Anglo-American loan. Apart from immediate convertibility of Rs. 200 crores, the rest of the balances will be repaid either in goods and services or by other adjustments in sterling. Such an arrangement should not involve any infringement of the terms of the Anglo-American loan. If, however, any objection is raised by the U.S.A. in this connection, the terms of the Anglo-American loan should be revised to suit the requirements of the Indo-British settlement. The various factors relating to India which have been pointed out above, were wholly ignored when reference was made to the sterling debt of the U.K. in the Anglo-American negotiations. Once the U.S.A. is made aware of these factors, it should not be difficult for her to appreciate the Indian point of view and to agree not to interfere in the terms of our settlement with the U.K.

## INTERNAL DISTRIBUTION

One more suggestion could be made in conclusion regarding the way in which the acquisition of the balances should be distributed within India herself. It would be necessary for the Government of India to see that the advantages of the return that we get for these balances accrue to the people at large enabling them to raise their standard of living, and that the rich should not be in a position to profiteer by this arrangement. In the case of those assets which are retained by the Government of India under their own control, the question does not arise. But there are some other assets which will, on transfer, be handed over to private enterprise. In return for this, the Government of India would be in a position to obtain the value of such assets in rupees from the parties concerned. The amounts so realised should be available to the Government of India for schemes of reconstruction, particularly schemes for development of health and educational services. By suitable grants to the Provinces, this developmental work can be pushed forward, so that the masses of people who have suffered on account of the war, may get some relief in the form of improvement in their productive capacity.

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