

OUR STERLING BALANCES

by

M. V. BHATAWDEKAR.

In this considerably enlarged and revised edition, diagnosis of the present Indian attitude is made and its dangers are pointed out. For the first time 'Sterling Balances' are treated as a Transfer Problem and with the analysis of Britain's capacity to export, it has been convincingly argued that British writers on the subject have unduly exaggerated their difficulties.



POPULAR BOOK DEPOT, BOMBAY 7.

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PREFACE TO THE FIRST EDITION

This little book needs no apology. While the subject is of the greatest importance, the available literature on it is dispersed in various journals and periodicals. Even a systematic presentation of the subject in one place would be of great help to the common reader.

But the object of this essay is not limited to a merely systematic presentation of the subject. I have tried to examine, as far as I could, the present Indian attitude towards the problem. It is for the reader and the critic to judge how far I am correct, and any suggestions as regards correction are welcome.

The subject of sterling balances cannot be discussed without reference to the kindred subject of inflation. I have condensed my views on the subject, in Chapter Two. But for a fuller exposition of the subject I would request the reader to refer to the last Chapter of my book, *A History of Indian Currency*.

The subject is too technical and in spite of my efforts to simplify it, some passages might appear obscure to the general reader. I shall be grateful if such passages are pointed out and such suggestions made, which will enable me to bring the subject within the reach of the intelligent layman.

In the preparation of this essay I have received help from many persons. I owe special thanks to Mr. P. M. Shah, M. A., of the Indian Merchants' Chamber for providing certain information, Principal L. N. Welingkar has taken interest in this writing and I am grateful to him for his criticism. My thanks are due to Prof. M. R. Palande who has been kind enough to read the manuscript and to make a number of valuable suggestions. My thanks are also due to three of my friends Mr. P. K. Garde, Mr. N. M. Ketkar, and Mr. G. P. Palekar who have helped me in various ways.

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October, 8, 1944.

PREFACE TO THE SECOND EDITION

This essay was published ten months back by the Padma Publications, Limited. For the quick sale of the book the selling organisation of the publishers and the growing interest which people are taking in matters economic are responsible. My thanks are due as much to the public as to the publishers.

But in spite of the quick sale of the book it is very difficult for me to say that the book has been well received. None of the leading financial weeklies to whom the copies were sent reviewed the book, and those that reviewed it, I am sorry to write, failed to see the purpose of the book. There was only one exception to the general reviews that appeared in the press. The Marathi newspaper 'Lokmanya' not only recognised the fact that the book had to throw new light on the problem but the reviewer suggested that I must supplement my argument by pointing out how the present attitude is inimical to the interests of the common man.

Similar suggestions were made by some readers and it was definitely pointed out by my friends that without a supplementary chapter describing the evils of the present attitude, the book gave an impression of an attempt to employ the scientific reasoning in support of Government action.

I am not concerned at all with the charge of taking a pro-government attitude as long as it is not combined with another charge of perverting the truth. No reader, as far as I am aware, has made that charge. I am, therefore, guilty of not having given full realisation of the truth about the sterling balances as I wanted to give. I must, therefore, take this opportunity to bring home to every common man how he is vitally concerned with the problem of 'sterling balances'.

II

It is generally believed that economic phenomena are too complex for the comprehension of the common man. Many times the writings on such subjects are so obscure that a clear view of the problem is rendered impossible, and the belief that economic matters are the concern of the experts only gains strength. The problem of 'sterling balances' is believed to be not only economic but also technical. Naturally, the common reader does not think that he is in any way concerned with the solution of the problem and so the attitude he accepts towards it is one of blank indifference.

For this state of affairs the writings on this subject are mainly spon- sible. The obscurity that prevails in the discussion of this subject emanates from wrong representation of the subject. The discussion of India's sterling balances was preceded by the discussion of inflation. The increase in the amount of money that was taking place due to the favourable balance of trade was wrongly described as 'inflation'. It was confused with inflationary methods that are adopted to finance the war when the government cannot raise sufficient funds and the usual attacks on inflation followed. Going a step further it was pointed out that the issue of notes was backed by sterling securities which are nothing but paper. These sterling securities, so was the argument, are under the control of the Reserve Bank and since the Reserve Bank of India was a State controlled institution, the 'sterling balances' was a problem between the Government of India and the British Government. Once this line of reasoning was adopted it was only a next step to suggest that since sterling balances represent a sum which the master country owes to the slave country, there was every chance of repudiation; And if not repudiation, there was every fear that the pound would depreciate. Much of the writing on this problem thus centred round two points only: viz (i) raising fears of repudiation and if not of repudiation, (ii) of a loss of value on account of the depreciation of the pound.

Because of the pseudo-nationalistic character alone the argument was bound to be popular. But since it was likely to be beneficial to certain classes of the community it was accepted and widely propagated.

However, since the problem of sterling balances will be soon pressing, this faulty reasoning should be thoroughly examined and abandoned once and for all.

To have a clear understanding of the problem, the point should be firmly grasped that sterling balances are not a problem between the British Government and the Indian Government. It is essentially a problem between the Indian people and the Government of India. When His Majesty's Government were in need of goods and services the Government of India undertook the responsibility to make purchases on behalf of the British Government. In order to secure goods from the Indian producers, the Government of India were required to pay hard cash in rupees. It was not necessary for the Government to tax

the Indian people to raise the rupee sums. After all the goods which would be sent to England were paid for by the British Government. But the payment was to be made in sterling. The problem before the Government was, therefore, to secure rupees for the sterling which they were receiving. Since the problem was that of conversion of sterling into rupees, the Government had to resort to the usual procedure. All the sterling sums were offered to the Reserve Bank and it was required to pay in rupees. It was a statutory obligation on the Reserve Bank of India, to give rupees in exchange of sterling and even though many such demands on private accounts could be ruled out, the Government demand could always satisfy the requirements of the exchange control. The Reserve Bank, therefore, using its power to issue notes against sterling, could satisfy this demand on the part of the Government.

Once this mechanism of issuing additional currency is carefully understood many points become at once clear. Since the Government of India are required to pay sterling to the Reserve Bank of India they had to see that the amounts were secured from the British Government. Thus for all purchases not only were the Indian producers adequately paid, but the Government of India also were paid. The sterling balances thus do not represent a sum which British Government owe to Indian Government. If the sums are thus paid out, it should be clear that it is no longer a problem between the two governments.

Similarly, because the Government of India have paid the Indian producers, these sterling balances no longer remain on their account; they have, therefore, no ownership rights over these balances. The major part of these sterling balances is held by the Reserve Bank in the form of sterling assets, and these assets will be utilised only in fulfilling the obligation to pay back in sterling whenever rupees are offered.

Now, it should become at once evident that all those people who can afford to offer rupees to the Reserve Bank will be able to acquire these sterling balances. The industrialists and the traders knew very well that, they alone had the rupee amounts and they alone would be able to acquire sterling balances whenever they will be released.

But an early release was in the interest of moneyed classes. There was every possibility that national government might be established.

Such a government at least to a certain extent was bound to pursue a policy that would not allow these people to utilise these balances for expanding their own private concerns but might use these sums for establishing such industries as would be government-owned and government-controlled. If the sterling balances had been released immediately it was certain that this class would have acquired those sums and succeeded in turning this national property into private property.

The writings on the problem were directly helpful to this class to achieve this objective. There were possibly two difficulties. Since people were made to suffer in order to accumulate these balances they would oppose this policy of releasing sterling and making it available to one class only. Raising the fear of total repudiation was useful to prevent such opposition to immediate settlement. No Indian could have objection to the gain of this class if it averted the possible loss to the country.

But the second difficulty could not have been overcome by this argument. It was not possible to bring pressure on the Government to relax the exchange control by saying that there was possibility of repudiation. To induce the Government for immediate release it was pointed out that the pound may depreciate in future and it would involve loss in value. It was, therefore, necessary to release these balances as early as possible.

Since the attitude taken by the writers on the problem was thus favourable to the capitalist class it should be no surprise that it was accepted and popularised by such a financial weekly as the 'Eastern Economist'.

In spite of all this propaganda, however, the conditions of the Exchange Control were not relaxed and as yet these sterling balances have not been converted into 'private property'. It is not late, therefore, for the common man to realise his position even now and establish his own claim.

Once the truth is known that there is no possibility of repudiation and that it is not a problem between two governments the entire attitude towards the problem changes. In order to accumulate these sterling balances expansion of currency was necessary. This continuous expansion caused enormous profits and the incomes of the richer

classes were increasing day by day almost beyond measure. Hence in spite of rising prices the richer classes did not suffer at all. In fact, they gained all the advantages of the so-called inflation while all the losses had to be suffered by the masses. Because of the rising prices it was not possible for lower classes to keep up their ordinary consumption and they were even required to sacrifice the bare necessities of life. The creation of sterling balances thus owes its origin to the vast sacrifices which were imposed on the masses. And it is only natural that those alone who have suffered should gain the advantage of the accumulation.

Any move on the part of the Government whereby sterling would be made freely available to the richer classes should be strongly opposed by those who have suffered because of 'inflation'. The problem of sterling balances can be said to be 'satisfactorily solved' only when these balances are used for the amelioration of the masses. With this view in mind only I have suggested means whereby it would be possible for the Government to acquire Rs. 500 crores worth sterling without any withdrawal of currency. The Government should proceed to spend such money on developing hydro-electric power, irrigation schemes, building dams, and building railways, etc. They will be of far greater help in stimulating the general economic development in the country and the resulting increase in the employment and the income level will be much greater.

Apparently the suggestion does not bring out any striking difference in the solution of the problem of sterling balances. After all, it might be argued, the private individual who will get the sterling will utilise it for expanding the existing plants or establishing new industries. Such a procedure also is bound to result in increasing income-level and employment. There is thus no reason to decry the demand for removing the exchange control and releasing the sterling balances freely to all the individuals.

There are two important reasons which should gain support for the policy outlined in this essay. In the first instance, the new nation building industries will ever remain the property of the nation and the dangers of capital accumulating in the hands of the few will be averted. Secondly development of these industries will give a stimulus to general economic development. Many new industries will be started

and our trade and commerce will flourish. The increase in employment and income-level is bound to be far greater than what private industries such as automobile industry or machine tool industry can provide.

III

Having made it sufficiently clear why the book was written for the common man, for the remaining part of the preface I can indulge in the academics of the problem.

For my own part, I have only succeeded in proving that there is no budgetary problem in connection with our sterling balances. Normally, there are two distinct problems connected with such payments as are to be made by one country to the other. Usually such transactions take place between two governments and the debtor government is reduced to that position mainly because of two reasons. A government might raise loans abroad and thus may place itself under the obligations of making payments to the other country or countries, or it might be required to make such payments because of war indemnities imposed upon it. Whether it is war indemnity or loan of capital from one government to another, the government, which owes the sum and has therefore to pay the annual instalments, is required to raise the sum by way of taxation or public borrowing. Thus the government must succeed in making provision in its annual budget of a sum equal to the value of the instalment to be paid to the creditor government. Now it may not be always possible for the debtor government to raise the necessary sum. There are limitations to taxation and borrowing, and as it is likely to happen in case of war indemnities, the government will be unable to manage its huge budget and pay the necessary instalments. Again, even if the magnitude of the instalment may not be exceeding the limits of the budget, due to extraordinary circumstances, e. g. long and severe depression, the revenue of the government might suffer and the same result will follow. When the budgetary problem thus becomes unsurmountable the only course open to the debtor government is to default. Precisely such a course was followed by England with respect to America when His Majesty's Government declared their inability to pay owing to the severe economic depression.

In the case of India the problem does not arise at all. For all the purchases of goods and services which they have made His Majesty's

Government have paid the sums and will not be required to have recourse to taxation and borrowing. The Government have already taxed the people so as to enable themselves to make these purchases. They are free from all payments and have not to face any budgetary problem. Hence there is no possibility of budgetary problem.

This indeed is an advantage of the peculiar mechanism that was adopted to secure goods and services for His Majesty's Government. This advantage was never seen by the Indian Economists and they made suggestions which would have added to our difficulties. It was suggested in the manifesto issued by twenty-one Economists that in order to check and prevent inflation, Government of India should tax the people and increase public borrowing to find out the necessary rupee amounts. It was further suggested that a loan should be given to His Majesty's Government. In all these cases, the payments, because of the sub-ordinate position of the Government of India, would have been postponed, and we would have added one more problem viz., budgetary problem, to many others which already exist. It is indeed gratifying that these suggestions which amounted to creating problems for the country were not accepted by the Government. Because of the fact that the same arrangements were continued today we find that at least one of the two problems is already non-existent.

The second problem is often referred to as "Transfer Problem." This term was used by Lord Keynes while discussing the problems of German reparations. In his article 'The German Transfer Problem' in the Economic Journal he pointed out that even though the debtor government succeeds in raising the required monetary sums it may not succeed in discharging the debts. Ultimately international payments are made in terms of goods and in order to achieve it the country shall have to create surplus export trade. It will be possible to create such surplus export, only if the production of export industries is increased and for increase in production it will be necessary to transfer some of the labour and resources from home industries to export industries. In a capitalist economy such transfer can be brought about only by reducing the wages in home industry. Lord Keynes wanted to contend that even if the budgetary problem is solved there are certain circumstances in which reduction in wages becomes difficult and even impossible and since increase in production of export industries becomes impossible the country cannot succeed in making the payment

in terms of goods. He gives the circumstances in which wage-reduction may become impossible. He writes, "Such a reduction becomes difficult and may be even impossible in the following cases, †

"(i) Where the output e. g. personal services or buildings cannot be exported anyhow:

"(ii) Where the world's demand for England's goods has an elasticity less than unity i. e. where a reduction in price stimulates demand less than in proportion so that the greater quantity sells for a less aggregate sum:

"(iii) Where England's foreign competitors fight to retain their present connection by reducing their own rates of wages *pari-passu*:

"(iv) Where England's foreign customers, reluctant to allow intensive competition with their own producers, meet it by raising their tariffs."

In order to find out whether the transfer problem with respect to our sterling balances presents difficulties which cannot be surmounted it must carefully be examined whether any of the above-mentioned conditions are present. The problem would be difficult or even unsurmountable if one or more of these conditions are in existence. On the other hand, if on the application of these principles, it is revealed that none of these conditions is present it must be said that there exists no Transfer Problem in the sense that the necessary changes in the production in export industry can easily be accomplished

(i) I am not quite clear as to what is suggested by the first condition. But it seems to me that the condition only indicates that the exports of these two items are incapable of contributing substantially towards creating a surplus to the desired magnitude and consequently they will ever remain items on which a country cannot depend to create a surplus.

Lord Keynes was writing with special reference to Germany and there it was natural to think in this way. However, it should be made very clear that the export of personal services is not as unimportant in case of India as it would be in other cases.

† Economic Journal-March 1929 - page 5.

I have substituted England for Germany so as to make the quotation more suitable for the discussion of Sterling Balances.

At present there are 72,000 English men in the services of the Government of India. † The number of such people employed in private services e. g. in factories, banks etc. is not known. Further in years to come there will be rapid economic development in the country and for that India will be required to import 'skilled labour' along with many other items. Taking into consideration this additional 'export of personal services' in future, it may be said that it will turn out to be of considerable importance.

There might arise one difficulty in the repayment of sterling balances in the case of 'export of personal services'. If all the income which the foreigners receive is spent in this country it will only have an effect of not creating demand for sterling balances. It will not reduce the volume of the sterling balances and the interest payment shall have to be continued.

To get over such a difficulty a definite plan shall have to be followed to reduce the volume of the sterling balances and consequently the burden of interest payment. His Majesty's Government will have to compell these people to subscribe to the national debt. They will be required to surrender to the Reserve Bank a definite percentage of their income and the Reserve Bank will transfer sterling securities of equal amount to them. Thus in course of time the balances will be reduced and the problem will be solved to that extent.

ii) No elaborate argument is necessary to prove that the elasticity of demand for English exports is not less than unity. Almost all of England's exports consist of manufactured goods and such goods do not have inelastic demand.

It must be remembered that substitubility is not the only factor which is responsible for elasticity of demand. Among other factors changes in income and the distribution of it are far more important. The demand for a commodity might be increased more than proportionately by slight reduction in the price if by that reduction the commodity is brought within the reach of classes having lower income. Similarly the demand for a commodity might increase even if the price remains the same provided that the income of the lower classes is raised. The same result will follow even though the distribution of income remains the same but the income of the community increases.

† 'Imperialism in action' by Margaret Pope.

The last two are likely to be the possibilities in India. The distribution of income may slightly change in favour of the lower classes. But more certainly the income of the community will rise. Due to development of industries in post-war years employment and income in general, are bound to increase and this increase will result in greater demand for English goods, even at the prevailing prices. There is thus no difficulty in the way of creating surplus export trade because of the nature of demand. On the contrary the nature of Indian demand is such that it would make it very easy for Great Britain to create a surplus export trade.

iii) For want of sufficient statistical data and other information it is very difficult to say whether the competition of other countries would prevent Great Britain from increasing her exports to India. But some of the factors which indicate that there will be no great difficulty of this sort might be stated.

The only powerful rivals to England are Russia and America. Both these countries are less interested in India and their keen competition will be felt in Central and Western Europe rather than in India. No doubt the percentage of these two countries in our foreign trade will increase. But that means nothing. In the first instance, India's foreign trade is not in a static condition, so that a gain by these two countries must necessarily mean loss to Great Britain. On the contrary India's foreign trade will be growing rapidly. In these circumstances to draw a conclusion that England will not be able to increase her export trade with India it must be assumed that (1) England will not be able to capture even a per cent of our additional imports and (2) that even those supplies which India secured from Germany and Japan and which it is impossible for her to secure from these two countries in near future, will be provided by Russia and America. When these factors are taken into consideration it seems almost inevitable that India's imports from Great Britain are bound to increase by a considerable amount.

In spite of all these factors if the costs are lower in Russia and America, no doubt it will be difficult for England to increase her export trade to the extent to which she can do so otherwise. No information regarding the price-structure and cost-structure of Russia is available. The economic structure of that country is entirely different.

In a planned economy as that of Russia the whole system is concentrated on home industries rather than on export industries. Normally the planning authorities develop such export trade only as is necessary for internal development. At present the country seems to be more busy with the internal problems and it seems very difficult that the planning authorities would change the internal structure in order to secure foreign markets on which the country does not depend to any significant extent.

The economies of U. S. A. and Great Britain are alike and the New World has increased its productive capacity so much that development of foreign markets is essential. It does not, however, seem likely that America will be required to lower the cost structure in order to capture the Indian market or other foreign markets. For, in the first instance there are many other Asiatic markets which America can develop without any competition from Great Britain. Recourse to the markets where English goods have already penetrated will be necessary only if other markets turn out to be insufficient for the increased exports of America. Again it should be remembered that Great Britain has succeeded in keeping her cost-structure on a low level by adopting various controls. The White Paper to which a reference has been made in chapter four, indicates that Britain's costs are actually lower than that of America. If this report is true, a reduction in American costs would only mean, in the first instance, enabling that country to achieve parity with Great Britain. In any case it might be safely concluded that England's competitors do not create difficulties which would make it absolutely impossible for England to repay her debt.

(iv) The last factor deserves a more careful consideration because it is generally feared that by using the political power such goods alone would be forced on India as would kill the existing Indian industries. If one takes into consideration the composition of our imports in pre-war days this belief gathers strength. The major part of our imports consisted of consumers' goods such as cloth, pastes, powders, drugs etc. Almost all these goods are now produced in the country and hence if additional goods of these types are imported it is likely that demand for home industries would suffer. Would not the repayment of sterling balances, it might legitimately be asked, be detrimental to our industries ?

It is not possible to find out a final answer to such a question unless the way in which the repayment of sterling balances will be effected is fully understood.

At present almost all our sterling balances now worth about Rs. 1,300 crores are invested in the sterling securities. They will be released only when rupees are withdrawn, not otherwise. The actual total amount which England will be required to pay will be determined by the amount of currency which Indian people will be prepared to withdraw. There seem to be two different methods of working out the magnitude of the probable withdrawal. The simplest and the easiest to follow is the one which is employed in making the calculations in Chapter four.† Assuming that the people are inclined towards the pre-war price-level the quantity of money needed for increased production will be in the neighbourhood of Rs. 300 crores. At present notes in circulation are over Rs. 1,100 crores, which means that almost Rs. 800 crores might be presented to the Reserve Bank in exchange for sterling. But this method cannot be relied upon as the safest method because it rests on the crude form of the quantity theory, ignores the possible increase in production in the next few years which might increase the demand for money, does not take into consideration hoards, and attaches too great importance to psychological factors.

Another method to work out the magnitude of currency withdrawal is to work out the surplus demand for foreign goods. There will be a greater demand for imports in post-war years because both the firms and the individuals had to live on capital during the years of war. The probable demand on the part of industries is worked out at Rs. 150-225 crores.× The various assumptions that have to be made are explicitly stated in chapter four. Here it is necessary to mention two more points. It ignores the machinery that has been imported during war-years, and the probable additional demand that might exist due to various schemes of expansion of industries. Due to want of information about the new schemes it is very difficult to calculate such demand. However, from the news that are published every day it might be said that the additional demand on account of new schemes would more than compensate the ignored imports of machinery during the period of war. Taking these two together it might be estimated

† See page 20

× See page 21

without much error that the demand on behalf of industries would be varying between Rs. 300 and 350 crores.

In the case of individuals it is very difficult to calculate such demand. In big concerns and factories regular procedure has to be followed in replacing the old machinery. Such regularity is not maintained by the individuals. No doubt men had to go without houses, vehicles and many other durable commodities. But there are no regular depreciation funds set apart and it cannot be said that there will be additional demand equal to five times the average annual demand. However if 50% of this demand that has gone unsatisfied is regarded as likely to arise from the replacement of individual capital goods, the figure need not be considered erroneous.

The average post-war demand (1918-39) for vehicles, instruments apparatus and appliances, hardware, building and engineering materials was Rs. 17,63,92,000. So that the additional demand which is likely to exist in immediate future may be somewhere Rs. 44 crores. Following the method adopted in case of industries, it cannot be said that because of higher price-level the total demand would be Rs. 132 crores. However, it may safely be said that individuals would be prepared to purchase goods at double the pre-war prices. So that the total demand for what might be termed as capital goods might be estimated round about Rs. 400 crores.

According to the first method the probable withdrawal would be about Rs. 800 crores while according to the second one it would be Rs. 400 crores. The difference is indeed too great and while considering the dangers of repayment to our existing industries this fact must always be borne in mind.

Before proceeding further one important point must be stated, As long as the whole payment is not completed India would be receiving from England payments on two different counts. Since all our sterling balances are invested in securities we shall be receiving payment by way of interest; and when the balances are released we shall be receiving the sums as the payment of principal. Even at one per cent rate of interest the interest charges would be over £ 11,00,000. So that we shall be importing goods in payment of this sum and in addition to that goods equal to the value of instalment which would depend upon how quickly the debt is repaid. Reasonably speaking it might vary between

£ 50 million and £ 100 million. Of course as the principal is repaid gradually the interest payments would be scaled down.

When the position as regards the different payments due from England is clearly understood it becomes obvious that we have to decide two different questions. First we must try to find out how far England will go in forcing consumers' goods in payment of these sums.

Clearly so far the demand for capital goods is concerned England should have no objection to give capital goods which are needed for replacement. Before this war these goods were supplied by England and since replacement of capital is essential and it does not mean expansion of Indian industries, there will be no restriction on such imports. But if the demand begins to exceed Rs. 400 crores it means that it is for further Industrial development and such imports may not be allowed.

There is no reason to suppose that any rigid restrictions of this type will be found in practice. After all it has been realised that development of Indian industries is in the interest of Great Britain. But for the sake of argument assuming that the old policy of checking India's industrial development is pursued, a policy might be adopted whereby sterling will not be released if it is likely to be conducive to the industrial development of India.

In such a case the calculations made with regard to withdrawal of currency according to the first method must be remembered. If the demand is just equal to Rs. 400 crores there is no problem. But if it begins to exceed that limit it is likely that the political power might be used and there would be danger to the existing industries.

To determine whether such a course would be seriously dangerous the way in which these repayments will be realised must be understood. The interest payments will be received by the Reserve Bank of India. It means that the profits of the Reserve Bank will increase, as all the profits, after due deductions (the dividend is only 4% or it might be increased to 5%) are taken over by the Government. In effect, therefore, payments on account of interest charges will go to increase the revenue of the Government and it will depend upon the government action whether they would create any trouble to Indian industries. If the government decide to give relief to the tax-payer by way of reducing indirect taxes, the income of the lower classes

will increase and since consumption will increase *Pari passu*, even if consumers' goods are given it will not affect the Indian industries. Again if the government decide not to give relief to the tax-payer but use such sums for public works programme the same result will follow.

As against this if the government decide to give relief by reducing taxes such as supertax or if a policy of reducing the public debt by the same amount is followed, the income of the richer classes only would be increased. It will only mean that there will be a greater propensity to save and it may create some trouble. Since it is assumed that only consumers' goods can be had from England there will be a tendency on the part of these classes to shift their demand from Indian industries to English industries. But, after all such a loss will not be of a serious nature because such demand shall be confined to articles of luxury only. England cannot supply foodstuffs and the other demands of these classes were never largely supplied by Indian industries.

More probably, however, it will lead to hoardings. With higher incomes consumption does not increase in the same proportion as the income and there will be a greater tendency to invest the increased savings. But since by the assumption import of capital goods is prohibited it will mean sterilisation of our savings or increased speculative activity on the stock exchange.

Similar effects would follow in case of additional payments of principal. Finding that nothing but consumers' goods can be had there will be a tendency not to import these goods beyond a certain limit. The magnitude of the balances will continue to be more or less the same and interest charges also will be the same. How long such blocking will be continued is not the point at issue. It has been partly discussed in Chapter Four. From whatever has been said it is clear that repayment of these balances does not mean a great harm to our existing industry. Therefore, there will be no need of raising the tariffs to protect our industries and from that source there will not be any difficulty of a serious nature.

Reviewing the whole discussion of the four factors we find that the first three are almost non-existent. So far the fourth is concerned there will be some difficulties but they cannot be regarded as rendering the whole transfer problem impossible of solution.

IV

Uptill now the argument with respect to the Budgetary Problem and Transfer Problem was developed with a view to pointing out how extremely difficult it is for England to effect repudiation of our sterling balances. It was necessary to develop argument in this fashion because of the common belief that England is sure to repudiate these sterling balances. As it has been already pointed out, the writings and utterances of officials and non-officials in England were largely responsible for such a belief. As a matter of fact English writers have always exaggerated difficulties of England and given rise to undue fears. Hence to complete the argument it is necessary to study the post-war position of Great Britain and find out whether the difficulties imagined by the British writers are really serious and whether it is in any real sense a hard task for Great Britain to repay these sterling balances.

First of all it is essential to have a correct idea about the Sacrifices which Great Britain will have to make in order to pay off these sterling balances. The national income of that country is estimated to be over £ 7000 million. The external debt of England amounts to £ 3000 million. Supposing that England is required to liquidate all her sterling balances within ten years, the sacrifice which the country shall have to make comes to 4 per cent and a little more. If the calculation is confined to India only, it may be said that Britain will be required to pay over £ 600 million. On the supposition that the payment is spread over a period of ten years, Britain will be required to sacrifice hardly 1 per cent of her national income. When the actual sacrifice involved in the repayment of sterling balances is so little, any argument attempting to give an impression that it is not possible for England to pay off these balances and hence they ought to be scaled down, must be regarded as almost meaningless.

To give further support to this conclusion it is necessary to point out the additions to her national income which Britain is sure to make in years to come. In working out the magnitude of Sacrifice which Britain shall have to undergo it was assumed that the external debt would be paid out of her own national income earned by internal production and external trade and investments. The enormous gain which England has secured by way of reparations from Germany in this war was not taken into consideration.

The actual amount in terms of pounds is not known. But from the principles of Potsdam Agreement it is clear that it is found to be in millions of pounds. Even if Britain decides to pay off sterling balances out of these reparations a large portion of her external debt would be paid off.

In all these considerations the real national income has not been taken account of. Before the war the national income of Great Britain was about £ 5000 million. It might be questioned whether there is any increase in the real national income of Britain or whether the rise is due only to higher prices. If it is due to higher price-level then the whole argument loses its force. For, ultimately England can pay off her external debt only by increasing her export trade and thus creating a wide margin between her exports and imports, and the capacity of England to create a surplus export trade finally depends upon the increase in the productive capacity of England. The true importance of having an idea of an increase in the productive capacity of England can be realised only when the peculiar position of England is taken into consideration. It is a well known fact that Britain has to import almost all the raw materials which she requires for her exports. If exports are to be increased it follows that imports must be increased. If, therefore, England decides to pay £ 300 million annually she will have to increase her export trade by a greater margin. The probable productive capacity of England is, therefore, the most important question which must be answered satisfactorily.

Unfortunately it is not possible to secure the necessary statistical data. However, from the information that has been made available it seems beyond any shadow of doubt that the productive capacity of England has greatly increased. Even agricultural production which could not be removed under ground was increased by 70%. With respect to industrial production World Economic Survey † for 1941-42 states, "In the United Kingdom the unemployment was down to under 150,000 persons in march 1942, having been about 1½ million in the same month of 1939.....The number of industrial women workers has been increased by 4,000,000..... As a result of all these measures, war production was doubled in the year from June 1941 to June 1942."

Recently the London Times has published, 'A Record of British War Production.' In this supplement Rt. Hon. Oliver Littleton writes, "Of all the munitions used by the armed forces of the British Commonwealth and Empire (8½ million men in all) since the beginning of war no less than 70% was produced in the United Kingdom itself."

To have a further idea as to how this increase in industrial production was achieved, use of the official division of industries might be made. The first group represented engineering and allied (munitions) industries. The second group included the basic essentials such as public utilities, transport, shipping and food. The third group comprised the civilian industries such as building, textiles, clothing, distribution and professional services.

The number of workers in the first group increased from 3,100,000 in 1939 to 5,200,000 in 1944, that in the second group remained same while in the third group it decreased from 9,300,000 to 6,000,000. It need not be supposed that increase in employment in the first group was secured at the cost of the third group. For, "the number of men and women employed in the forces, whole time Civil Defence and the women's auxiliary services rose from 550,000 in 1939 to 5,250,000 in 1944"

To sum up, taking into consideration increase in the agricultural production and gains from German reparations there is no room for any doubt concerning the productive capacity of England. It is absolutely easy for England to increase her exports so as to create a surplus export trade to the desired extent, and the policy advocated by the Labour party of increasing exports is in the right direction.

The conditions of international trade also seem to favour Great Britain in making it easier for her to pay off these sterling balances. During the Great Depression and the years that followed it the agricultural production increased more than proportionately in comparison with the industrial production of the world. This tendency is likely to be strengthened in the post-war years. Eventhough it is a fact that industrial production in U. K. and U. S. A. has increased it must also be remembered that agricultural production has increased almost by the same percentage in these countries. In addition to that while the agricultural production in Canada, South America and Australia has increased by a large percentage two important industrial countries

Germany and Japan have been defeated and plans are being prepared to turn Germany into an agricultural country and to kill Japanese industries. Generally speaking while the agricultural countries of the world have not been directly affected by war almost all the industrial countries were adversely affected by the war. The result is inevitable. The increase in agricultural production is bound to exceed the increase in industrial production and the terms of trade will go against the primary producer. In such circumstances it will be possible for England to secure greater amount of raw materials and food stuffs for the same quantity of exports. Thus it will be possible for England to create the necessary surplus export trade without increasing her exports to any great extent. When this fact is taken into consideration it becomes obvious that the difficulties of England are a product of the imagination of the British writers on the subject.

Lastly, one more factor which has some bearing on the problem might be mentioned. Any one who has read the famous reports of London Chamber of Commerce and Federation of British Industries will be convinced about the revolutionary change that is overcoming the British industrialists. They have not only realised the fact that industrialisation of the Eastern countries is essential and inevitable but they are prepared to help such a process by supplying capital goods. Two reasons are responsible for this changed out-look. Firstly it is realised by them that to ensure increased demand for their greater productivity the purchasing power of the Eastern countries must be increased. Secondly for technological reasons, it is easier to carry out a change from war production to the production of capital goods. It is only natural that British industrialists should now be prepared to supply capital goods when conditions are almost forcing them to do so.

Reviewing the whole discussion it appears that it is extremely easy for England to repay these sterling balances and any attempt to scale down these balances is without any basis. We should not allow ourselves to be carried away by the systematic propoganda of the financial press in England and America. On the other hand we must be on our guard to defend our position and turn down any demand on the part of England to reduce these sterling balances under one plea or the other.

V

The preface has been too long. But in view of the fact that the original essay was of a controversial nature, it would have been contrary to tradition to introduce changes in the body of the essay. Without, therefore, an apology for the monstrous length of the preface, it would be more appropriate to thank various gentlemen who have helped me in bringing out this second edition with the addition of this preface.

Dr. S. K. Muranjan of Sydenham College and Prof. N. A. Mawalankar of Fergusson College were kind enough to spare considerable time for discussion and I am grateful to them for their criticism and valuable suggestions. Mr. P. M. Shah, B. Com. of Indian Merchants' Chamber supplied information whenever I sought it and my indebtedness to him cannot be adequately expressed. Mr. G. V. Mahashabde, B. Com. has given considerable help in correcting proofs and getting the book ready in a short time. I record my thanks for his unsparing efforts.
