India’s Path to Monetary Independence

What is the issue?

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- Recently, the “Indian Rupee” depreciation to more than Rs. 70 a dollar.
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- In this context, it would be worthy to understand the context of how India achieved monetary independence, which was much later than 1947.
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What is the history of the Indian rupee’s travails?

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Pre-Independence

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- The association of Indian rupee with Britain was prolonged by factors beyond India’s control and continued even long after Independence.
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- From 1931 onwards, rupee was pegged to the “sterling standard” (Britain’s currency), which was a depreciating one at that time.
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- **War -** Because of this monetary dependence, when Britain (and France) declared war on Germany in 1939, it impacted the currency situation severely.
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- India’s economy was also geared up by the colonial government towards the war effort through imposition of production & money exchange restrictions.
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- Notably, the rupee, which was completely convertible into any currency before, was made inconvertible into any other currency from 1939.
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- Fund transfers outside British territory were severely restricted and dollar

securities held by private individuals were also compulsorily acquired.
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- This was done to enhance Britain's dollar reserves, and people were compensated in rupees at an arbitrary rate, resulting in losses to many.
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- **Implications -** Dollars for the war were also raised by selling silver bullion from India's reserves to governments outside the sterling area.
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- Importantly, dollars were spent on imports of essential consumables as dictated by the war requirements, and not others.
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- India had accumulated a sizeable sterling balance of £1,300 million in 1946, as almost all forms of consumer imports were curtailed due to war.
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- Subsequently, the corresponding increase in rupee circulation which was stocked up during the war, caused inflation in India.
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Partitioning the Pie

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- After the war ended, the transfer of the sterling balances was negotiated between India and Britain and later Pakistan also joined in.
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- Winston Churchill had been threatening to write off the sterling balances if not given a deal that is to his liking (which was an exorbitant ask).
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- But, with Churchill losing power in 1946, the new regime in Britain towed a more cordial tone towards India despite some tough negotiations.
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- India sought a commitment from Britain that "sterling (which was then over valued), won't be devalued in the near future, but that was refused.
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- Further, the chaos of partition violence and other unsettled political questions sidelined the more mundane economic discussions to the margins.
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The deal

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- Britain managed to secure restrictions on both India and Pakistan to judiciously use their Sterling reserves to secure its own “balance of payment”.
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- **Stress -** Britain had initially agreed to make the pound convertible under the terms of a loan from the U.S., which meant India could spend in dollars.
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- But Britain soon repudiated this convertibility clause, which in turn altering the character of the agreement entered into with India.
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- The pound convertibility pact was violated as Britain had to meet its massive imports from U.S. due enhanced consumer demand in the post war years.
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- A delegation was sent back to London to renegotiate the convertible portion of the sterling balances but that mission failed and the deal was never secured.
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- **Results -** The negotiations were finally concluded in the summer of 1949, after the completion of the bitter separation of Indian and Pakistani finances.
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- The Indian side agreed to deductions from the sterling balances for pensions of former British members of the ICS and for military equipment purchases.
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- The subtractions added to £100 million and limits were placed on how much could be drawn in a given period from the balances.
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How did the valuations vary since then?

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- While the British side gave credible warnings of an imminent sterling devaluation, the Indian side failed to decipher and capitalise on them.
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- The sterling was devalued steeply in September 1949, which took India by

surprise and literally wiped off a third of the value of India's sterling reserves.
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- Subsequently, India too had to devalue its rupee proportionally, which had considerable economic implications as imports become costly.
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- The two currencies were delinked in 1975 and have functioned independent of each other in monetary terms ever since.
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- The sterling was floated against the major international currencies in the early 1970s, but rupee was floated only in 1993-1994, after liberalisation policies.
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Source: The Hindu

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