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Sterling Convertibility and the Sterling Balances By Randall Hinshaw	4 Pages
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STERLING CONVERTIBILITY AND THE STERLING BALANCES

Randall Hinshaw

The major financial obstacle to the resumption of sterling convertibility is the size--and more particularly the status--of the British external sterling liabilities. As a result of the disastrous experiment with convertibility in 1947, it is clear that convertibility of foreign-held sterling can be safely restored only if the inconvertibility (whether by funding, firm agreements, or otherwise) of a large fraction of the existing sterling balances is assured. The precise volume of balances which should be immobilized if convertibility is again undertaken is a difficult question to which a firm answer will not here be attempted. Instead, an effort will be made to provide a partial basis for such an answer by estimating two relevant magnitudes: (1) the present "real" value, or purchasing power, of the sterling balances in terms of dollar goods, as compared with the real value of the balances immediately before and immediately after World War II, and (2) the present ratio of British gold and dollar resources to British external liabilities, as compared with the corresponding ratio at other dates since the beginning of the war.

Purchasing power of the sterling balances

Between the outbreak of war in 1939 and the end of 1945, the external sterling liabilities of the United Kingdom rose from £476 million (\$2.2 billion) to £3.7 billion, or to \$14.8 billion at the former dollar-sterling rate. After continuing to rise slightly in 1946, these balances gradually fell to a level of £3.2 billion in June 1949. During the past year, sterling balances have again been rising, and in June 1950 stood at £3.5 billion, a figure only 5 per cent below the level reached at the end of 1945. ^{1/}

While the net decline in sterling balances since the end of the war has been almost negligible, there has been a sharp decline in their purchasing power. This decline has been particularly great in terms of dollar goods, and thus has served to reduce the dimensions of the sterling-balance problem--in part by increasing the incentive of such countries as India to hold on to the balances instead of seeking to convert them. The fall in the real value of the sterling balances, as expressed in dollar goods, is attributable to three factors: (1) the slight reduction in the over-all amount, as expressed in sterling, (2) the postwar rise in U. S. export prices, amounting to about 22 per cent since the end of 1945, and (3) the 1949 devaluation of sterling, which

^{1/} Sterling balances held by Sterling Area countries, which account for over two-thirds of the total, are actually higher than in 1945. This increase, however, is entirely attributable to a 30 per cent rise in the relatively modest balances held by dependent overseas territories. Balances of this group accounted for only one-sixth of the total in June 1950. In the case of other Sterling Area countries, total sterling balances are slightly lower than at the end of 1945. Source: Cmd. 8065, United Kingdom Balance of Payments, 1946 to 1950, p. 28.

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in itself accounted for a 30 per cent reduction in the purchasing power of sterling in terms of dollars. As a result of these developments, the real value of the sterling balances in terms of U. S. exports has dropped by almost half since the end of 1945. The course of this decline is shown in Table 1 below:

Table 1

Purchasing Power of Sterling Balances
in Terms of U. S. Exports

	A	B	C	D	E
	Sterling Balances in £ million	Sterling Balances in \$ million	U.S. Export Prices	Sterling Balances at Constant U.S. Export Prices (B/C)	Index of D
Aug. 1939	476	2,223	100.0	2,223	100.0
12-31-45	3,663	14,762	156.5	9,433	424.3
12-31-46	3,701	14,915	188.7	7,904	355.6
12-31-47	3,571	14,391	219.4	6,559	295.1
12-31-48	3,359	13,537	211.3	6,407	288.2
6-30-49	3,235	13,037	203.2	6,416	288.6
12-31-49	3,340	9,352	195.2	4,791	215.5
6-30-50	3,471	9,719	190.3	5,107	229.7

NOTE: The estimates in this table are obtained by deflating published official figures of British external sterling liabilities (expressed in dollars) by the U. S. export price index (Commerce unit-value series, converted to an August 1939 base). To express sterling balances in dollars, three exchange rates have been used: (1) a rate of \$4.67 (the average for the first eight months of 1939) for the one pre-war figure, (2) a rate of \$4.03 for the postwar figures up to September 1949, and (3) a rate of \$2.80 for the figures since September 1949.

It will be noted that while sterling balances increased by almost eight times during World War II, the relative increase in real terms, as measured in U. S. exports, was much less--i.e., on the order of somewhat more than four-fold. While the purchasing power of the balances has dropped by almost half since the end of 1945, it still remains more than twice as great as before the war, when the amount of sterling held abroad was determined voluntarily. This would suggest that at least half the existing sterling balances, or about \$5 billion, should be firmly immobilized before a second attempt is made to resume sterling convertibility.

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Ratio of British gold and dollar resources to sterling balances

Another, and perhaps better, criterion for estimating the amount of sterling which should be funded or firmly blocked is the ratio of British reserves of gold and dollars to external sterling liabilities. Before the war, the level of these liabilities seldom exceeded the level of British gold and dollar resources. Under such conditions, convertibility with the dollar was easy to maintain, since almost any conceivable increase in requests to convert sterling balances could be met out of existing reserves. This situation has changed drastically since 1939 and, despite recent improvement in the level of British reserves, remains far less favorable than before the war. The ratio of British gold and dollar resources to external sterling liabilities at various dates is shown in the table below:

Table 2

Ratio of British Gold and Dollar Balances
to External Sterling Liabilities

	A British Gold and Dollar Balances (\$ million) ^{1/}	B British External Sterling Liabilities (\$ million)	C A or a Percentage of B
Aug. 1939	2,632	2,181	120.7
12-31-45	2,813	14,762	19.1
12-31-46	2,979	14,915	20.0
12-31-47	2,376	14,391	16.5
12-31-48	2,172	13,537	14.0
6-30-49	1,965	13,037	15.1
12-31-49	1,950	9,352	20.9
9-30-50	3,004	9,719 ^{2/}	30.9

^{1/} Figures computed from British and U. S. sources. Includes private dollar balances, which are now much smaller than in 1939. Also includes Canadian dollars.

^{2/} Figure for June 30, 1950.

It will be noted that British gold and dollar balances, which in August 1939 was substantially in excess of British external sterling liabilities, amount at present to less than one-third of these liabilities. In the absence of adequate funding or blocking arrangements, this ratio would appear to be much too low to permit a safe return to convertibility under present conditions. In view of the likelihood of strong initial pressure to convert sterling balances into dollars in the event of a resumption of convertibility, a reserve ratio of not less than 100 per cent of gold and dollars against (unfunded or unblocked) sterling would seem even more justified than before the war.

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This would suggest that the amount of sterling balances which should be funded or blocked as a prerequisite for convertibility should be at least equal to the difference between British external sterling liabilities and British gold and dollar resources. Before making such a calculation, however, it would seem proper to add to British gold and dollar balances the unused portion of the British quota in the International Monetary Fund, since this is intended to function as a "second line of reserves." The unused portion of the British quota at present amounts to an even \$1 billion. If this is added to the \$3.0 billion of British gold and dollar balances, and if it is assumed that the volume of unfunded or unblocked sterling should not exceed the sum of the two amounts, we arrive at a figure of \$5.7 billion as the amount of sterling balances which should be firmly immobilized if convertibility were to be resumed with reserves at their present level. To the extent that British gold and dollar resources were to be supplemented by a stabilization loan, this figure of course could be correspondingly reduced.

It will be noted that the figure of \$5.7 billion derived by the present method agrees fairly well with the figure of \$5 billion suggested by the first approach. In either case, the figure is well in excess of the amount of sterling balances more or less firmly immobilized under existing arrangements. The latter amount was recently announced by Mr. Gaitskell to be "rather under" £1.3 billion (\$3.6 billion).^{1/}

^{1/} Weekly Hansard (Commons), No. 167, 20th Oct.-26th Oct. 1950, p. 326.

November 7, 1950

Notes on Pakistan Foreign Exchange Reserves
and Government Debt, 1949-50

Harrison Parker

Pakistan is one of the few countries whose currency has appreciated against currencies in which its foreign exchange reserves are held. Pakistan's reserves, in sterling and Indian rupees, have been relatively large: in September 1949 they amounted, at existing exchange rates, to about 90 per cent of the money supply or about 130 per cent of annual imports. Consequently, when the United Kingdom and India devalued their currencies, Pakistan's central bank suffered a considerable "loss." As the central bank had no reserves capable of absorbing the shortfall in its assets, the government undertook to compensate it. The increase in government debt on this account was equivalent to about \$200 million, far exceeding the residual increase of about \$36 million incurred during the twelve months July 1949-June 1950 in current fiscal operations.

Analysis of the changes in asset holdings of the State Bank of Pakistan during 1949-50 is complicated by the fact that the State Bank did not take all its revaluation losses at one time. This in turn was due mainly to India's refusal to recognize the new exchange rate between the Indian and Pakistan rupees following Pakistan's decision not to devalue.

The value of the foreign exchange assets of the State Bank of Pakistan, expressed either in Pakistan rupees or in U. S. dollars, fell 38 per cent during the year July 1, 1949 to June 30, 1950, or an equivalent of nearly \$300 million dollars. Two thirds of this drop was due to the revaluation of the State Bank's pound sterling and Indian rupee assets following the devaluations of those currencies, against which the State Bank received ad hoc treasury bills from the Government of Pakistan. There was little if any increase in the State Bank's other holdings of government debt during the year. The other principal changes in the central bank's assets and liabilities were a fall in government deposits by the equivalent of about \$70 million and a decline in bank reserves by about \$20 million, accompanying the adverse balance of payments which was responsible for the decline in foreign exchange reserves apart from revaluation. There was virtually no change in the note issue.

The government's total outstanding debt increased during 1949-50 by about the equivalent of \$236 million. The \$36 million part of this increase which resulted from current fiscal operations was absorbed chiefly by the commercial banks.

Foreign exchange assets

The foreign exchange assets of the State Bank of Pakistan are composed of pound sterling and Indian rupee securities and balances, together with a small amount of gold. These formed 59 per cent of the State Bank's total assets on June 30, 1950, while identifiable holdings of Pakistan government debt amounted to 30 per cent. On June 30, 1949,

foreign exchange assets and gold had amounted to 88 per cent of total assets. Appendix Table A shows the composition of these reserves at June 30 dates and at the time of devaluation of sterling and the Indian rupee.

Gold.--The gold holdings of the State Bank of Pakistan, which have not changed over the past year, amount to \$27.2 million dollars. In addition, Pakistan claims \$8.7 million in gold from India against India notes withdrawn from circulation in Pakistan before June 30, 1949.

Sterling.--On July 2, 1948, one day after the Bank opened for business, the State Bank's sterling holdings amounted to £100.8 million. An export surplus during the ensuing year raised these holdings to £115.7 million on June 30, 1949. About that time, a deterioration of Pakistan's balance of payments set in. Moreover, the provisions of the India-Pakistan Payments Agreement under which India would have met part of its deficit with Pakistan in sterling 1/ were not carried out. Consequently, Pakistan's sterling balances fell during the year by £27.4 million to £88.3 million on June 30, 1950. At the existing exchange rate these balances were worth \$247 million, as compared with \$466 million at the old rate a year before. Of the difference, 59 per cent or \$130 million, represented the loss on sterling devaluation.

Under agreements which have been in force since 1947, the larger part of Pakistan's official sterling balances has been blocked. From time to time agreed amounts are released from the blocked account (No. 2 Account) to an unblocked account (No. 1 Account). Pakistan's blocked sterling balances (the No. 2 Account) appear to have declined by about £22.5 million during the year July 1949-June 1950, while the unblocked (No. 1) account apparently fell by £4.9 million. The U. K.-Pakistan Sterling Balance Release Agreement of July 27, 1950, shows total releases of sterling from the No. 2 to the No. 1 Account of £31 million in this period. 2/ Total

1/ Under the Supplementary Agreement of September 10, 1949, which extended the payments arrangement that had been in operation in July 1949-June 1950, each country agreed to hold the currency of the other up to Rs. 150 million. Further current account balances were to be settled in free sterling up to Rs. 200 million over a 12-month period (as compared with Rs. 100 million in the first agreement), beyond which settlements would be made, if necessary, in blocked sterling. At the time of devaluation, Pakistan held Rs. 257.8 million in its account with the Reserve Bank of India and hence claimed that Rs. 107.8 million of this should have been transferred in free sterling (about £14.4 million). Since that time, further deposits were not made due to the refusal of India to recognize Pakistan's new exchange rate.

2/ £14 million of this amount was a temporary transfer which was made during the year because of the breakdown of the India-Pakistan payments agreement, and roughly approximates the amount which Pakistan would have earned under that agreement by September 18, 1949 (see footnote 1).

net drawings on the free account appear to have amounted to £35.9 million 1/. For the year ending June 30, 1951, releases of blocked sterling are to be allowed up to £17.5 million, with the possibility of additional releases depending on the length of time that the India-Pakistan exchange deadlock continues beyond September 30, 1950.

Pakistan has an additional claim against India for about £21.5 million for the transfer of India notes retired in Pakistan.

Indian rupees.--The State Bank of Pakistan's holdings of Indian rupee balances (at the Reserve Bank of India) totalled Rs. 127.5 million on June 30, 1949, as a consequence of Pakistan's favorable balance of payments with India and the settlement of the current account balance with that country under the first payments agreement. 2/ By September 18, 1949, this balance had reached Rs. 257.8 million. After the exchange rate deadlock developed between the two countries, no further credits were made to this account, but Pakistan drew on it for payments in India, so that on June 30, 1950 the account stood at Ind. Rs. 196.8 million. The State Bank carries this account at Pak. Rs. 196.8 million because it takes the position that the Reserve Bank of India is required by the terms of the India-Pakistan Payments Agreement to write up its Indian rupee liability to Pakistan 3/.

Holdings of Government of India rupee securities fell from Rs. 339.4 million on June 30, 1949, to Ind. Rs. 217.3 million (equivalent to Pak. Rs. 150.9 million) on June 30, 1950. This decline was in large part due to the transfer of Ind. Rs. 114 million worth of these securities to the Reserve Bank of India against the receipt by the State Bank of an equivalent amount of sterling securities in May, 1950 4/. The devaluation "loss" on Indian securities was equivalent to \$30 million.

1/ Sterling securities (blocked) amounting to Pakistan Rs. 75.6 million (£8.2 million) were received from the Reserve Bank of India in May 1950 in exchange for an equivalent amount of Government of India securities taken from the State Bank's holdings. There was a further shift of £0.3 million in assets "held with the RBI pending transfer." Since the net decrease in the State Bank's sterling holdings was £27.4 million, net total drawings of unblocked sterling during the year must have been about £35.9 million. The transfer of sterling from India to Pakistan in May fulfilled certain terms of agreements made between the U. K., India, and Pakistan in 1948 concerning the sharing by India and Pakistan of undivided India's sterling assets. (See State Bank of Pakistan Annual Report 1949-50, p. 15; and Reserve Bank of India Annual Report, 1949-50, p. 6, where the amount of sterling involved is given as £9.1 million.)

2/ During the first year of the payments arrangement, Pakistan also received a small amount of sterling when the Indian rupee balance temporarily reached the ceiling.

3/ See Appendix Table A, footnote 3.

4/ See footnote 1 above.

The State Bank also carries as an asset Ind. Rs. 431 million in India notes (equivalent to Pak. Rs. 300 million at the new exchange rate) which represents assets receivable from the Reserve Bank of India; the gold and sterling portions of these claims have been mentioned above 1/. The revaluation loss on these claims was equivalent to \$40 million.

Increase in Government Debt to State Bank of Pakistan

The increase in the government debt holdings of the State Bank of Pakistan during the year July 1, 1949 to June 30, 1950, which apparently amounted to Rs. 635-670 million, is almost totally attributable to measures taken by the government to cover the shortfall in the assets of the State Bank after the revaluation of its sterling and Indian rupees. This can be shown by the calculation in Table I, based on balance sheets of the State Bank for the given dates.

Most of the sterling assets were revalued in September 1949. Because of uncertainty within the State Bank and the Government as to the proper method of valuing Indian rupee assets, revaluation of these assets was delayed. Certain assets were revalued at the end of the Government's fiscal year and others not until the end of the State Bank's financial year. Publication of the June 30, 1950, statement was delayed for two months.

1/ India rupee notes in circulation in Pakistan on June 30, 1948, which were presented to the State Bank of Pakistan before June 30, 1949, were redeemable by the State Bank--under the terms of the "Pakistan (Monetary System and Reserve Bank) Order" of August 15, 1947, as amended--for assets of the Issue Department of the Reserve Bank of India in approximately the following proportions:

Gold	3.3%
Blocked Sterling	66.9%
Government of India Securities	26.5%
Indian coin, required to be resold to India for its bullion value and cost of minting	3.2%

Pakistan claims the same redemption right against Indian notes which crossed the border after June 30, 1948; India refused to accept any notes from the State Bank after March 31, 1949, in order to prevent this. Therefore the State Bank still holds these notes against which it expects the Reserve Bank to provide Pak. Rs. 300 million worth of the above mentioned assets at some future date. In addition, according to the State Bank, assets equivalent to Pak. Rs. 42.5 million which were set aside for Pakistan against notes already returned, are still physically held in India (State Bank of Pakistan Annual Report 1949-50, pp. 14, 42). In this paper the latter amount is treated as having been paid to Pakistan.

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Table I

<u>Date of Transaction</u>	<u>Increase in Gov't Debt to State Bank (millions of Pak. rupees)</u>
Between September 16 and 23, 1949:	
Issue Department "Gov't of Pak. Securities" rose by..... offsetting a decline in "Sterling Securities" by - exactly the same amount, or 30.5 per cent of their former value <u>1/</u>	257.1
Banking Department "Investment" rose by 157.2, presum- ably including an increase in ad hoc securities of about approximately offsetting a decline in "Balances held out- side Pakistan" of 163.6, of which 156-162 was presumably the writing down by 30.5 per cent of sterling balances on Sept. 18 estimated as 510-530. <u>2/</u>	156 - 162
Between March 24 and 31, 1950:	
Issue Department "Gov't of Pak. Securities" rose by offsetting a decline in "Government of India Securities" of exactly the same amount, or by 30.5 per cent of their former value <u>1/</u>	96.6
Between June 23 and 30, 1950:	
Issue Department "Gov't of Pak. Securities" rose by (transferred from Banking Department where it was replaced by 148.4 "due and since received from Government of Pakistan") offsetting (a) the writing down of "India notes representing assets receivable from the Reserve Bank of India" by 131.8 or 30.5 per cent of their former value, and (b) the writing down of "Assets held with the Reserve Bank of India pending trans- fer" ("Government of India Securities" down 3.0 (30.5 per cent) and "Sterling Securities" down 13.5 (30.5 per cent) <u>3/</u>	148.4
Total	658 - 664

1/ Exclusive of securities "...pending transfer," revalued June 30.

2/ This estimate, together with 257.8, the known amount of Indian rupee bal-
ances in Sept. 18, would make total balances on Sept. 18, 768-788 before
revaluation as compared with 767.7 on Sept. 16, and 612-626 after re-
valuation as compared with 604.1 on Sept. 23. A sharp rise in Indian
rupee balances had been occurring in the first half of September up to
the Friday balance sheet date of Sept. 16.

3/ The sterling securities "held with R.B.I. pending transfer" on June 30
amounted, before revaluation, to Rs. 44.1 million, as compared with
Rs. 38.8 million on Sept. 18, 1949. There had been a corresponding
decrease in Government of India securities "held pending transfer."

The calculation in Table I makes it clear that around 660 million rupees of the increase in government debt holdings of the State Bank of Pakistan from September 16, 1949 until June 30, 1950, was due to the revaluation of the Bank's sterling and Indian rupee assets. The resulting shortfall in assets was covered by the issue to the State Bank of an equivalent amount in ad hoc treasury bills by the Government 1/.

Known government debt holdings of the State Bank at the beginning and end of the period in question are shown in Table II.

Table II
Identifiable Government Debt Holdings
of the State Bank of Pakistan
in millions of rupees

<u>Balance Sheet Headings</u>	<u>June 30, 1949</u>	<u>June 30, 1950</u>
Issue Department		
Government of Pakistan Securities	0	509.8
Banking Department		
Amount due and since received from the Government of Pakistan on account of loss on revaluation of assets payable in sterling on Indian currency	<u>0</u>	<u>148.4</u>
Subtotal	0	658.2
Banking Department		
Treasury Bills	<u>124.8</u>	<u>101.6</u>
Total	124.8	759.8

1/ In the Budget Speech of March 13, 1950, paragraph 49, the Finance Minister stated: "The Government's capital budget (revised estimates for the fiscal year April 1949 to March 1950) includes a sum of Rs. 540 million under Capital Outlay on Currency which represents payments made by the Government to the State Bank of Pakistan to enable it to cover the shortfall in the currency and other reserves of the Bank arising from the depreciation of the pound sterling and the Indian rupee. The payment has been made in the shape of Government Securities." From analysis of the balance sheets, as shown in Table I, the use of Rs. 510-516 million for this purpose by the end of the fiscal year (March 31, 1950) is evident. No explanation is available for the difference between such an amount and the budget estimate of Rs. 540 million.

In the Report of the Central Board of Directors of the State Bank of Pakistan for the year ended June 30, 1950, p. 12, Governor Zahid Husain states: "The question of revaluation of these assets [the India notes representing assets receivable from the Reserve Bank of India--Rs. 431,054,000--and the assets held with the Reserve Bank of India pending transfer--Rs. 59,000,000] remained under the consideration of the Government till about the end of August 1950. The delay was caused by advice given to us by legal advisers that strictly in accordance with the provisions of the law, it was not necessary to revalue these assets. Ultimately in respect of [these] items...the view prevailed that they should be revalued...accordingly they sanctioned the issue of Government securities of the face value of 14.83 crores [148.3 million] to cover the difference due to the revaluation of the assets..."

In addition to the net increase of Rs. 635 million in identifiable holdings of government debt shown in Table II, it is possible that there may have been some addition to direct government security holdings carried as "Investments" in the Banking Department. This item, which is believed to include shares and obligations of government corporations as well as direct obligations of the government, rose from Rs. 144.9 on June 30, 1949 to Rs. 181.3 million on July 31, 1950. Certain of the week-to-week changes in this account can be identified as special transactions relating to direct government obligations: (1) in August 1949, Rs. 7.6 million was apparently shifted to Issue Department "Government of Pakistan Securities;" (2) in September 1949, approximately Rs. 159 million--see Table I--of ad hoc bills were received from the Government and placed in the "Investments" account to cover the shortfall in assets resulting from revaluation of the sterling balances in the Banking Department; and (3) in the June 30, 1950 balance sheet Rs. 148.4 million of these government securities were transferred to the Issue Department, being replaced by an equal item due from the Government, as shown in Table II. The net effect of these three changes was practically nil. Some part, however, of the Rs. 36 million net increase in "Investments" over the year may have represented open market purchases of direct government securities.

Thus it appears that the State Bank's holdings of Government debt may possibly have increased by an amount some tens of millions of rupees greater than the identifiable increase of Rs. 635 million shown in Table II. The latter figure, however, is smaller than the calculated amount of securities (about Rs. 660 million) delivered to the State Bank to cover its revaluation losses. It may therefore be concluded that apart from the securities covering the revaluations, the State Bank's holdings of government debt underwent little change in total in 1949-50. While there may have been some open-market purchases of long-term securities carried as "Investments," such acquisitions were offset at least in part by the decrease (shown in Table II) in holdings of treasury bills.

The State Bank's holdings of treasury bills are believed to consist at the present time entirely of ad hoc treasury bills created in August, 1948, to finance the scheme for funding sterling pensionary obligations, under which the Government purchased a sterling annuity from the United Kingdom. Apparently on June 30, 1949, the Bank held some bills acquired directly from the Government in addition to these ad hoc bills.

Increase in outstanding government debt

The total government debt of Pakistan increased by a little over three-fourths during the period June 30, 1949 to June 30, 1950, as shown in Appendix Table B 1/. However, if the securities turned over by the

1/ It is difficult to estimate the total government debt outstanding on June 30 because the Government's fiscal year is April through March.

Government to the State Bank of Pakistan to cover the shortfall of reserves due to revaluation of the Bank's foreign exchange assets are excluded from consideration, the increase due to current fiscal operations was only approximately Rs. 120 million, or 12 per cent.

The "permanent" (i.e. long-term) public debt outstanding rose from 735.4 million rupees on June 30, 1949 to 859.1 million rupees on June 30, 1950, showing a net increase of 123.7 million rupees. Special issues of government debt directly to the State Bank of Pakistan during the year totalled about Rs. 660 million, taking the form of ad hoc treasury bills. 1/ Other ad hoc bills, originally issued in August 1948 to finance the funding of sterling pensions, continued to be held by the State Bank with only a slight decrease in the amount. 2/ No three-month treasury bills sold to the market were outstanding either on June 30, 1949, or on June 30, 1950. 3/ On the earlier date, however, the State Bank apparently held Rs. 16-20 million of other treasury bills on which no information available. 4/ These bills were apparently paid off during the year. The net increase in unfunded debt was Rs. 21.9 million in the fiscal year ending March 31, 1950, 5/ and it may be assumed that the increase over the July-to-June year was of a comparable magnitude. The Central Government did not approach the State Bank of Pakistan for ways and means advances during the year 6/.

The analysis in this paper had indicated that probably the State Bank did not absorb a large part of the long-term government debt issued during the year, and that possibly it absorbed none. That the commercial banks may have taken as much as Rs. 100 million is suggested, though not demonstrated, by the scanty statistics available, which show a fall of about Rs. 60 million in the scheduled banks' cash reserves and a rise

1/ See text above.

2/ Appendix B, footnote 3.

3/ Report 1949-50, p. 27. The State Bank, on behalf of the government, had stopped offering new bills to the market after November 5, 1948. It again put out issues in the last two weeks of August and each week in September 1949. The total sold in this period was Rs. 32.5 million. See Statistical Summary, January 1950, p. 43. Since September 1949 there has been no issue to the market.

4/ Table B, footnote 3.

5/ Table B, footnote 5.

6/ Report 1949-50, p. 27.

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of about Rs. 80 million in their loans, making a net increase of about Rs. 20 million in these assets, while bank deposits and borrowings rose by about Rs. 120 million. 1/

1/ The available statistics are for the Scheduled Banks in Pakistan, taken from the State Bank of Pakistan Statistical Summary January and July, 1950:

Consolidated Position of Scheduled Banks
(millions of rupees)

<u>Item</u>	<u>June 1, 1949</u>	<u>June 30, 1950</u>	<u>Change</u>
Demand Liabilities	896.0	999.9	
Time Liabilities	<u>183.9</u>	<u>200.2</u>	
Total Demand and Time Liabilities	1,079.9	1,200.1	+ 120.2
Cash	34.1	47.1	
Balance at State Bank of Pakistan	202.5	132.2	
Advances in Pakistan	382.4	464.4	
Bills Discounted	<u>26.8</u>	<u>26.1</u>	
Total Listed Assets	645.8	669.8	+ 25.0
Difference			+ 95.2

APPENDIX

Table A

FOREIGN EXCHANGE ASSETS OF THE STATE BANK OF PAKISTAN
(in millions of Pakistan rupees
or, as noted, of pounds sterling or U. S. dollars)

<u>Type of Asset</u>	<u>July 2,</u> <u>1948</u>	<u>June 30,</u> <u>1949</u>	<u>Sept. 18,</u> <u>1949 1/-</u>	<u>June 30,</u> <u>1950</u>
<u>Gold</u> (Issue Department) <u>2/</u>	17.0 <u>(\$10.5)</u>	44.0 <u>(\$27.2)</u>	44.0 <u>(\$27.2)</u>	44.0 <u>(\$27.2)</u>
<u>Sterling:</u>				
Sterling Securities (Issue Department)	345.2	881.2	881.2	701.8
Sterling Balances Held Outside Pakistan (Banking Department)	<u>999.2</u>	<u>661.5</u>	<u>510-530</u>	<u>116.2</u>
Total Sterling Assets	1,344.2 (£110.8) <u>(\$406.3)</u>	1,542.7 (£115.7) <u>(\$466.3)</u>	about 1,400 (about £ 105) (about \$420)	818.0 (£88.3) <u>(\$247.2)</u>
<u>Indian Rupees:</u>				
Government of India Secur- ities (Issue Department)	136.9	339.4	331.7	150.9
India Notes Representing Assets Receivable from Reserve Bank of India (Issue Department)	5.3	428.6	431.9	299.9
Indian Rupee Balances Held Outside Pakistan (Banking Department)	<u>—</u>	<u>127.5</u>	<u>257.8</u>	<u>196.8 3/</u>
Total Indian Rupee assets	142.2 <u>(\$43.0)</u>	895.4 <u>(\$270.6)</u>	1,021.4 <u>(\$308.7)</u>	647.6 <u>(\$196.7)</u>
Total Gold and Foreign Ex- change Assets	1,503.4 <u>(\$459.8)</u>	2,482.1 <u>(\$764.1)</u>	about 2,465 (about \$759)	1,509.6 <u>(\$470.1)</u>

Source: State Bank of Pakistan Annual Report 1948-49 and 1949-50; also State Bank of Pakistan Statistical Summary January 1950.

Exchange Rates Used for Conversion: Pakistan rupee 1 = \$0.30225. Pre-devaluation £1 = \$4.03; post-devaluation £1 = \$2.80. Post-devaluation Pakistan rupee 1 = Indian rupees 1.44.

Notes will be found on following page.

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Notes to Table A - Appendix

- 1/ Based on Sept. 16 (Friday) balance sheet, except for Balances Held Outside Pakistan, the Indian rupee part of which on Sept. 18 is given in Report 1949-50, p. 12, and the sterling part of which is estimated. Other gold and foreign exchange assets did not change between Sept. 16 and Sept. 23 except for revaluations by 30.5 per cent as shown in Table II.
- 2/ Gold is valued in the State Bank of Pakistan balance sheet at .549191 grams of fine gold per rupee (equivalent to \$17.12 per ounce) instead of .268601 grams of fine gold per rupee (equivalent to \$35 per ounce) as provided under clause 23(4) of the State Bank of Pakistan Order 1948. (See Report 1949-50, p. 42.) Hence in calculating the dollar value of the gold holdings the factor of $(.549191) \times (.30225) \div (.268601) = .61798$ is used.
- 3/ The deposit balance at the Reserve Bank of India has not been re-valued downward in Pakistan rupees because of the provisions of Clause VI of the India-Pakistan Payments Agreement of June 30, 1948, unchanged by the Supplementary Agreement of September 10, 1949, which states: "In the event of either government taking action which results in a depreciation of its currency in terms of the currency of the other Dominion, Indian rupees held by the State Bank, or, as the case may be, Pakistan rupees held by the Reserve Bank, shall be revalued on the basis of the new parity, and the account of whichever Bank incurs a loss as a result of such revaluation shall be written up by the credit of additional India rupees or Pakistan rupees, as the case may be." However, the Reserve Bank has not yet revalued this account upward in Indian rupees. Therefore, its inclusion in the State Bank's balance sheet at the old parity overstates the Pakistan rupee equivalent of the value carried by the Reserve Bank of India by Pak. Rs. 59.5 million or 30.5 per cent of Rs. 196.8 million. In addition, the State Bank carries in the Suspense Account (Other Assets) an amount of Pak. Rs. 19.2 million rupees representing the claim of Pakistan on the Reserve Bank of India for a writing up in Indian rupees of that portion of Pakistan's balances in the Reserve Bank of India which was utilized between September 18, 1949, and June 30, 1950. These points are duly noted in the report of the Auditors of the State Bank (Report 1949-50, pp. 13, 44.) The sum of Pakistan Rs. 59.5 million and Pakistan Rs. 19.2 million is Pakistan Rs. 78.7 million. This is equivalent to about Indian Rs. 113 million, the amount of write-up to be made on Indian Rs. 258 million, which was approximately the balance on the date of devaluation.

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Table B
Changes in Total Government Debt Outstanding
June 30, 1949 to June 30, 1950
(millions of rupees)

<u>Classification of debt</u>	<u>June 30, 1949</u>	<u>June 30, 1950</u>	<u>Change</u>
Permanent Debt <u>1/</u>	735.4	859.1	+ 123.7
Treasury Bills <u>2/</u>	124.8 <u>3/</u>	763. <u>4/</u>	+ 638.
Unfunded Debt <u>5/</u>	about <u>140.</u>	about <u>160</u>	about + <u>20.</u>
 Total Debt	 about 1,000	 about 1,782	 about + 782
 of which:			
to cover shortfall in reserves after revaluation			about 661
for other purposes			about 121

1/ Report 1949-50, p. 27. Details of Pakistan's permanent debt statistics appear below:

<u>Loan</u>	<u>June 30, 1949</u>	<u>June 30, 1950</u>
2-1/2 per cent 1956-57	---	---
2-3/4 per cent 1953-54	318.94	318.93
2-3/4 per cent 1955-56	118.55	134.05
2-3/4 per cent 1958-59	67.55	103.05
3 per cent 1960	127.31	127.41
3 per cent 1963	30.01	30.23
3 per cent 1968	73.73	144.56
3 per cent 1969-70	---	---
1-1/2 per cent Income Tax Free Bearer Bonds 1958	0.86	0.86
	<u>736.95</u>	<u>859.09</u>

The 1949 figures, which show a slightly different total than that given above, come from Kothari & Sons Investor's Encyclopedia 1949-50, 14th ed., Madras, India, p. lxxxviii. The 2-1/2 per cent 1956-57 and the 3 per cent 1969-70 were placed on the market on July 20, 1950.

2/ Since no 3-month treasury bills issued to the market were outstanding on either date, it is assumed that the only items to be considered are treasury bills held by the State Bank.

Footnotes continued on next page.

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- 3/ Balance sheet in Report 1948-49, p. 41. Believed to consist of Rs. 105-109 million of ad hoc bills described below and Rs. 16-20 million of other bills on which no information is available. Rs. 108.9 million of ad hoc treasury bills "were created in August 1948 to finance the scheme for funding sterling pensionary obligations" under which Pakistan was to pay the United Kingdom £8,166,848 for a 50-year annuity; these bills are held by the State Bank. (See Statistical Summary, January 1950, pp. 14, 43; also Letters dated July 14, 1948, extending the U. K.-Pakistan Financial Agreement, H.M.S.O. 7479, pp. 7-8.) Examination of the balance sheets of the State Bank shows a temporary rise in bill holdings during the period May through July, 1949 over the original amount of bills related to sterling pensions. No information is available on these temporary additions to the Bank's bill holdings. From September 9 onwards the total amount of bill holdings was Rs. 4.1 million smaller than the original issue related to sterling pensions. In May 1950 there was a further reduction of Rs. 3.2 million. These decreases may be connected in some way with the annuity instalments to be received from the U. K. (totalling £832,500 from Sept. 1, 1949 to June 1, 1950) or with the payment of pensions from these sterling funds. There is also a connection, the nature of which is not clear, between this issue of ad hoc bills and the transfer of £8.2 million of sterling in May 1950 from the Reserve Bank of India to the State Bank of Pakistan (text page 3, footnote 1).
- 4/ Derived by adding to the Banking Department's "Treasury Bills" (Rs. 101.6 million, believed to be bills related to sterling pensions) the Rs. 661 million estimated total of ad hoc bills delivered or due to be delivered to cover the revaluation shortfalls, and held in various other accounts, as shown in Table I.
- 5/ Includes post office savings bank deposits, national and defense savings certificates, state provident funds, and other accounts (See Budget for 1950-51, pp. 11 and 12, revised estimates for 1949-50).

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